Question and Answer

Andrew Bowden
Head of Investor Relations

Okay. You guys know the drill, so we'll just -- we'll keep it to 1 question each.

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. Question on business credit and probably a bit on the institutional side and also just on the comments you just were talking about then with the broadening out. A lot of the pickup in business credits so far has been institutional and predominantly within commercial property and in infrastructure. You also had some comments earlier that you're starting to see some margin pressure come in there. So can you just make a comment on the returns that you're now generating from that kind of lending? Are you getting adequate returns to risk? Because often, as competition comes in, some less good projects do get approved. And also just on the broadening, are you starting to see any kind of broadening outside those 2 areas, both in the institutional space and probably pass that over to the retail business banking St. George as well?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Well, it has been very strong in institutional and it's fantastic for us, actually, to be -- have the capability that we have in infrastructure. I'm going to get Rob to comment on it because he will talk a little bit about not only the lending that we do into the transaction, but the other sorts of support that we provide into the transaction. So if you look at the ROE, it's not just on the basis of the lending, it's on the basis of advise and other support that we provide. And Rob, while you're about it, you might want to talk about commercial property too, and then we'll pick up on the retail side.

Robert George Elstone
Former Director

Sure, truly. Thanks, Gail. Thanks, Jonathan. Note the first comment would be you're right in terms of where our growth has come from. It has been predominantly infrastructure and commercial property. In terms of the quality of that growth, it's the quality of growth you'd expect from most bank -- institutional bank. The infrastructure deals that are being done this year are very high quality and at the types of returns that certainly meet or exceed the Westpac line in the sand on ROE at 15%. Gail did refer to though, we do expect to see continuing margin pressure like we've seen in 2014 into '15 and more on the asset side rather than the '14 experience, which is more liability and asset side of the balance sheet. So that does mean eventually, you'll get to the point in the cycle where we need to determine whether those infrastructure deals are still going to meet our hurdle. But we're not at that point, Jonathan. In fact, I think we're someway off. In terms of the broader-based pieces, the other areas we've called out as opportunities for growth, we are seeing some really positive signs. So the superannuation sector, for us, has been a really important growth opportunity. Natural resources, whilst coming off a point in the cycle in terms of the investment spend, there are still some good quality projects that are being financed, and we've had some success there. Education and health are the other call out areas for us, before we go into the geographical sort of areas of Asia.

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Thanks, Rob. And look, on the retail side or the commercial side in AFS, what Rob said, certainly health, education, big sectors, SMEs, we've invested in that quite a bit, as you know, through both Westpac and St. George, so good pickup of new customers, Business Connect and Connect Now, the relative implementations in Westpac and St.George, really delivering more cross-sale per customer as well as new customers coming in the door. So SME, health, education and property. And look, our property at the moment, as you know, we worked down that level of exposure quite significantly over the last few years. It's at its lowest level it's been for about 7 years. So really happy with where we're placed and happy to take on board good quality commercial property transactions.

Andrew Bowden
Head of Investor Relations

Mark?

Mark Wilson
Macquarie Research

It's Mark Wilson from Macquarie. Just a question around macro-prudential changes and the potential for those moves in Australia, maybe a little bit on your experience in New Zealand as well and whether we can sort of extrapolate that here. But also really the possible impact on Westpac, more broadly, given you are a big lender in the investor space and this is the first time, I guess, we've seen the RBA, highlight the imbalances from that perspective.

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Well, we'd have to wait and see. I'm not -- I'm certainly convinced that whatever the RBA or APRA do will be quite sensible and moderate. I don't think that either of them are big fans of macro-prudential tools, extreme macro-prudential tools unless absolutely required. I mean, they're already using macro-prudential tools right now. Stress testing is a fabulous macro-prudential tool, deep reviews of sectors. For example, the housing review that's just being done, talking about the issues in order to make sure that banks remain across and on top of their lending standards, their underwriting standards, the quality of the book, the concentration of the book, and so on. So those are the sorts of tools they're using at the moment. And I think they'd like to stop at that suite of tools rather than start to intervene with additional policies that actually can be quite distorting, as soon as you move from the risk-weighted system to introducing other factors you can distort. So we'll have to wait and see. In New Zealand, there was quite a particular set of circumstances in New Zealand because of the heat in the Oakland market, in particular. And certainly, it's worked reasonably well, although again, some distorting factors made it a whole lot harder for new homeowners to actually get into the marketplace.

Andrew Bowden
Head of Investor Relations

Jarrod?

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Crédit Suisse. A question on financial markets' income, a fairly significant falloff this half. And if I was to compare the rates of drop-off versus the other banks, and the number's difficult to compare, but it looks as if Westpac's drop-off in financial markets' income is larger than the likes of ANZ and National Australia Bank. ANZ certainly highlighted the softness in their third quarter, but they got a bounce back in the fourth quarter. I just wanted to understand a bit more about the drivers and what happened there and were we coming off an unsustainably high first half and we should look more at the second half numbers as being a normalized level. So just some more color around the drivers there.

Peter Francis King
Acting CEO & Acting MD of Westpac Group

Thanks, Jarrod. In the -- if I think about the businesses, it's -- the major drop-off was in the Treasury business. And when we looked at the 4 areas where Treasury makes money, it's interest rates here in the U.S., it's the liquids portfolio and it's the basis books. All of those delivered lower income in the half, so it wasn't -- and when we looked at the risk-taking positions for the opportunities, we're very comfortable with the fact that we weren't taking risk for opportunities that weren't there. And so the other point I'll make is even at that lower return, the return on equity, the Treasury deliberative is very good, so it's still a very good business from a returned perspective. In terms of potential, as I said, it's probably best to look at that over the year rather than the 6-months period. So we've seen volatility last year half-on-half, we've seen it this year half-on-half. And it really depend on the conditions or the opportunities that we see in any particular year, but we think the risk we're taking for the return equation is right for the half.

Jarrod Martin
Crédit Suisse AG, Research Division

And you didn't see any opportunities in the late part of the fourth quarter?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

In terms of the months, we did have a better fourth quarter and we did have a better September, but earlier on was a bit softer.

Andrew Bowden
Head of Investor Relations

Just pass it to your left there, Jarrod. Brian? Pass it to Brian.

Brian D. Johnson
CLSA Limited, Research Division

Congratulations Gail on yet another result, where we see the dividend grow at exactly $0.02 per half year. Gail, today, you're lifting the capital target and we also don't know what the FSA might require. Could you give us a feeling on the capacity? And in the result, we also saw cash EPS running at the reported EPS. Could you give us a feeling on the ability to actually maintain that nice, steady, reliable $0.02 growth if the capital requirement was actually to go up?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Well, Brian, that's hypothetical, so we don't know what the capital might do. But certainly and in terms of the range that we've got at the moment, we're very comfortable that we'll be able to maintain that. Now it's really going to depend on what happens and then how we deal with it. That's my discussion about the connection between stability and growth. So what we deal with it -- if we have to hold more capital, that's a cost to the bank, it's a cost to the system, how do we deal with that. Like many businesses, you'd actually think about whether you pass that cost on or whether you price for that cost, either you do that or it results in a lower return. So one way or another, we need to think about that cost and how we'll actually deal with it. But at the moment, very comfortable if we'll be able to maintain that dividend trajectory on what we know.

Andrew Bowden
Head of Investor Relations

I might take a call, I can say I got a call here from Victor German.

Victor German
Commonwealth Bank of Australia, Research Division

My question, just if I could follow up on Jarrod's earlier question on market's income, and in particular, Treasury income. So there's obviously a reasonable decline there. Peter, if you could perhaps break it down for us a little bit further in terms of the impact of lower interest rates and also impact -- I've noticed you've build up your liquidity portfolio, particularly you re-weighted it towards higher cost liquids. Just wondering if you could give us some sense for what impact those had on Treasury performance.

Peter Francis King
Acting CEO & Acting MD of Westpac Group

Victor, I don't think it's worthwhile going down into the portfolios themselves. It's the -- the thematics are the important things. Probably the only other thing I'd highlight is we have moved some of the liquids portfolios into available for sale accounting treatment and that has seen some revenue reflected in the reserves rather than in the P&L, but apart from that thematic, not really any value in going down deeper because we managed these portfolios based on what we see in the market.

Victor German
Commonwealth Bank of Australia, Research Division

I appreciate that. But you're sort of saying that we should look at full year numbers as a guide for what this business can achieve going forward, but environment is changing, and your, presumably, your hedges are rolling off and liquids are more expensive, so I'm just wondering to what extent the FY '14 is a good guide for FY '15? Or there should be actually some sort of step down due to those forces?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

It will depend on the market movements in credit spreads, interest rates and basis costs, more than it will -- the balances themselves is the way to think about it.

Andrew Bowden
Head of Investor Relations

We'll take a question from Craig Williams as well on the phone.

Craig Anthony Williams
Citigroup Inc, Research Division

Look, your operating leverage is very good with CTI in the low 40s, now, and you've now engineered an outcome of at or above system, growth in credit across the business, too. But you've delivered negative draws for the past 2 years. So now that credit costs are perhaps providing less of an earnings tailwind for the business, do you now prioritize driving those positive draws in an effort to grow earnings and dividend?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Craig, we remain focused first and foremost on core earnings, as we have done over the past few years. And frankly, it's that softness in market risk revenues that actually resulted in negative draws. We know without that, we'd be able to repeat the first half performance for market risk into the second half, we actually would have had positive draws. And so we're not about to invest our cost programs or investment programs based on that type of one half situation in trading revenues. So core earnings is the first element. However, clearly as you heard me say in my presentation, we're very focused on productivity, and I think, through the service revolution, you're going to see a further step-up in our productivity agenda. And that's driven by the simplification initiatives. It's driven by the transformation of our distribution. It's driven by this new way of working, faster, quicker way of working. So I think you will see a step-up in productivity. We've largely offset ordinary expenses with productivity benefits. I think you can expect to see a bigger productivity benefit into the 2015 year. And as you heard me say, the sort of 41%, 42% range, I want and expect to see that come down too as a consequence of these initiatives.

Andrew Bowden
Head of Investor Relations

We'll take one from the phones, one more. Scott Manning, please.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Just your thoughts on the outlook for the margin given we've got a quite substantial tailwind across the fund coming through over the next couple of years, if you look at your average cost across your long-term wholesale portfolio and also with what rates are and also given the heavy-lifting is done on the LCR. The deposit pricing is also helping out. Low interest rate environments largely worked through the free floated well. So is it a little bit too much to ask for, maybe because the margin actually starting to trend up next year, to provide that underlying growth that you're looking for and profitability?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Why don't you have a go for it?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

You can always ask, Scott. We don't provide line-by-line guidance, obviously. But if I talk about the dynamics, I think, you've hit it right. On the lending side, we are seeing robust competitions, so both in mortgages and housing. And as Rob said, the institutional book, that's probably where the pressure is going to be and a bit more QE announced recently or probably see more money looking to work, got to work. So the trend there is probably still heading down. In terms of wholesale and retail, deposit pricing is by far the biggest impact on cost of funds drivers. We will have a headwind -- sorry, we will have a tailwind from wholesale funding if market rates stay where they are but not quite as big as this year. So it's very important what happens in the retail deposit piece. And then, on free funds, I felt we're at the bottom. But the swap rates dropped again below -- well below 3%, so we have to wait and see. You would've thought that 3-year rate would be edging up by now, but we might -- it might delay it a little bit into the later part of '15 or next year depending on where we see it. So it sort of put all those together and it will depend on each piece what we deliver next year.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

I guess another way to ask the question is given you've restored rates of growth back to system this year given the slight margin, do you feel more confident that being able to sustain at system or above system the rates of growth as well as managing the margin next year?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

I'd say yes.

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

We expect we'll be able to do both. I mean that's the key. I think we've shown that this year, we expect to be able to do both.

Andrew Bowden
Head of Investor Relations

We'll take a final question from Richard Wiles.

Richard E. Wiles
Morgan Stanley, Research Division

Richard Wiles, Morgan Stanley. I wanted to ask about system growth in mortgages as well. You were very clear last year that you wanted to reinvigorate the home loan business. In the media release, you've referred to an increase in customer numbers. You've also talked about some of the things you're doing to improve product service. As you just said, you're targeting above system growth for 2014, do you specifically want to achieve that in a Westpac franchise as well as a St. George franchise? And do you think you can do that?

Gail Patricia Kelly
Former Chief Executive Officer, Managing Director and Executive Director

Absolutely. In fact, Westpac had a really strong trajectory. Jason, you may want to say a word or two about it. It's on a very strong trajectory over the course of the past, like, 3 halves, if you think -- you were about .6 of system some period ago, and it's steadily grown to the September data point, which is 1.1x system. So a really steady pickup in the Westpac brand as well. Jason, do you want to say something?

Jason Yetton
Former Group Executive of Westpac Retail & Business Banking

Yes. Thanks, Richard, for the question. Yes, look, I think we're very pleased. At the start of the year, we explained how we wanted to go about growing our mortgage portfolio across AFS. If you think back to the second half of last year's results, we're at 0.7 of system across AFS. First half, 0.9, and across all brands in the second half or one-time system. We spoke about the drivers of that, including increased brand consideration in both St. George and Westpac. We spoke about increasing sales force effectiveness. We talked about improving the operational efficiency and speeding up time TS and service elements. And I think, across the whole group, we've done that very, very well. We're seeing strong growth in the St. George brand over the course of the year, and if I look at the Westpac brand, we've gone from 0.9x system in the first half to 0.9x system in the second half and in the month of September 1.1. If I look at the work we've done, I feel pretty confident that actually we are in a sustainable position to grow. We've done that without compromising margins too much. We've done that without compromising credit quality. I guess, the key issue is what happens with competitors in the overall market, but we see that as being pretty favorable. So still see a positive environment for home lending and strong momentum in both brands. That said, there are still opportunities for us to improve on all the 5 dimensions, and that's what the organization is focused on.

Andrew Bowden
Head of Investor Relations
Thanks, Jason. And look, with that, thank you very much, and good morning.