Question and Answer

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. I've got a question regarding the breakup campaign, which obviously has got a lot of attention and have lasted awhile and had a pretty good benefit in the retail bank but potentially has implications for other parts of business and I'm nagging in particular on the Business Banks. So one of the issues would be that competitors are seeing NAB Business Bank is a very strong part of the business. You attack them in mortgages, they retaliate by trying to get you in Business Banking, which in theory can be a faster growing part of the business. So I want to get a feel on how you are seeing that? Are we seeing increased competition now coming back as they were trying to get a piece of that pie, attack your franchise in Business Banking and how that is going to impact the profitability of that business as that grows? And whether the 30% cost of income, are you actually spending enough money to protect that business in this environment?

Cameron Anthony Clyne
Former Executive Director

I mean the breakup campaign was just a step in the process. So I said in March 2009, one of our battle fields would be reputation. So we just saw it as a step that's more to come. It's had a very positive impact in all that businesses. Obviously, it gets a lot of attention about what happens in the Personal Bank, but we were specific about saying what we were doing was trying to meet one of the key needs for customers in our all of their businesses by doing things differently. In Personal Bank, it manifests itself in fee reductions and interest rates that people see as competitive. In the Business Bank, it's had an extremely positive impact. And in fact, Joseph [Joseph Healy] and I, at the extensive number of customer functions we run, I mean it's a very positive source of competition. We lent $8 billion through the financial crisis, when others withdrew lending capacity $55 billion, that's what was important to the business, that we were there and supporting them. That's an element of being different and part of the breakup campaign. We led the charge in the Wealth business by saying you've got to have transparency and you got to have trust. Again, the reforms that are coming through are exactly what we said. That's what's important in our business. So what we've seen is a positive impact across the business. In terms of competition, that's normal. We've picked the fight. We hoped people would turn up and they did. That's fine, and we will continue to punch. The reality is this is a market we've had to dance that you actually see in file. So I think that tells everyone, this is a market organic share gain. So the breakup campaign, yes, it's high-profile but the reality is the way you're going to win in this market is go on and get other people as customers. We have share gains in every part of our business.

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Credit Suisse. A question on SGA. And if I talk quickly, you might not realize there's a couple parts to it. Looking forward for SGA, what the profitability outlook is and how we should look at that? In the absence of mark-to-market gains, is it a 0 profitability business unit or should we look at it being profitable going forward? And Mark, you mentioned under appropriate conditions, you would look at the other 3 SCDOs. What are those appropriate conditions and what should we look for in that regard?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, well, on the SCDOs, there's a secondary market for these things and so it's just a question of where they're trading at essentially. So that's quite straightforward, I think.

Jarrod Martin
Crédit Suisse AG, Research Division

But how much better does it have to get?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

I don't want to talk about active trades, if you don't mind. And then on the profit outlook, SGA is not a business unit we're trying to perpetuate, right? So we would like you to get to 0. So I don't want you to put it in perpetuity or something like that. Essentially, the bad debts are behaving themselves. But the U.K. and U.S. markets are fragile and things could get worse there. Also you tend to get your better credits repaying early because they can, they can refinance and the like. It's never been a bad bank, it's just been a set of assets that we didn't want to be in long run. But it will start to migrate to the things that either can't get right refinanced or a long term, some of which we won't able to reprice very effectively. So I wouldn't be looking for that to be a substantial profit generator. But at the moment, we're quite hopeful that the bad debts are not going to create a significant headwind for us in that. So on that basis, it wouldn't be a significant drag either.

Ben Koo
Goldman Sachs JBWere Pty Ltd, Research Division

It's Ben Koo from Goldman Sachs. Just a question on the business lending side. Can you just give a feel for where the growth in that business is coming from? Well, in terms, just give it to us, institutional or middle market. It's a little bit confusing because the growth looks a lot higher on that. And also just the pickup in the fee past dues, if is there's any particular where that is coming from as well?

Cameron Anthony Clyne
Former Executive Director

I might -- I'll get Joseph to talk about where he's seeing the pickup. I think, as I said, as Mark said, there's no worrying trend in pickup in past dues and we're not seeing significant new arrivals into the work out group or anything like that. We're just working through really a series of natural events. In some cases, we get to the end of a period where we've had customers being worked through, if you like. And the Christmas trading period, and other events have sort of tipped it in to that the final theme but nothing in terms of significant trends that we're concerned about. But Joseph, do you want to talk about the nature of the growth and where we're seeing the pipeline?

Joseph C. Healy
Australia and New Zealand Banking Group Limited

I'll be happy to do that. The growth is largely coming from the SME book. We've seen some growth in the institutional book, which has been event-driven such as the disposal of the energy assets in New South Wales. But the general trend and the top end of tone outside the events is for corporates to continue deleveraging. And that's being offset from our perspective by some strong pipelines and growth in the SME book, which obviously is our sweet spot. So that really is where the growth is coming from.

James Freeman
Deutsche Bank AG, Research Division

James Freeman from Deutsche Bank. I wanted to know of the business profit growth, how much of it actually relates to your mortgage book repricing that is actually in the business division. I mean you are a bit different to every other bank and you do include I think $50 billion, $60 billion, $70 billion of mortgages in that business. I just want to get an idea as to how much that's contributed to the actual business growth over that period? And also, Cameron, I just wanted to know, are you still happy to be in the longer term at a discount to every other major bank in terms of a standard variable rate on the $200 billion of back book that you have, not on the front book, but on your back book?

Cameron Anthony Clyne
Former Executive Director

We're happy with our interest rate position at the moment. Obviously we reflect what that is going at each competitive opportunity. But we're comfortable with that position at the moment. It's driving volume. Customers respond to that. We'll obviously see a safe interest rate sitting over time and what our competitors do. The good thing at NAB, of course, is that existing customers get the same deals as a new customer. And so obviously, there's a lot of heat around the mortgage market, but I think I wouldn't want to be in a situation where I'm offering my new customers better deals than my existing ones. That's how banks have poor reputations.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

And on the -- I'll have to check and come back to you on that. It's about a 6 basis point uplift on the mortgage portfolio but I haven't that the proportion in front of me. So it will have assisted, but the 7 basis point uplift in the Business Bank is not just attributable to the mortgage book.

Brian D. Johnson
CLSA Limited, Research Division

Brian Johnson, CLSA. A question for Mark and Cameron, I know you'll probably chime in on it as well. I mean, if you look at housing, there's no doubt about it that the November 2010 rate hikes we saw and basically environment, the banks as an industry are gouging housing boroughs if you have a look at the incremental ROE. But if you have a look at what basically happened since November, we've had the yield curve flatten quite considerably and you guys have narrowed the gap a little bit. West Lake [ph] didn't go up quite as much as you guys last time around. I was just wondering, Cameron and Mark, if we're to see the 90-day bank built, the short end of the yield curve statement a little bit again, and we would -- then that was to fly all the way up the yield curve, we have to see this rebound rate go up. Then the ROE I would imagine on some of the new housing lending could actually fall back to being, sub-cost of capital. Like at the moment, it's like a sweet spot for you guys, even the discounted pricing. Can you just give us a feeling on the sensitivity on the breakup campaign housing pricing? Should we actually get the yield curve -- sorry, there's a few missing pieces here, should we get the yield curve go back to the long-term basically cash 90-spread and we get the 3-year bond rate moving up accordingly, your ROE could actually fall on the broker origin, the housing could fall kind of back considerably tapping to low cost of capital? I just like to get a feel on...

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

I think it's unlikely to go below the cost of capital. We're writing mortgages today anywhere really between 19% and 25% ROE, depending on what's going on. And all of the banks, while they might have low, low appetite for off stock or rate rises and things like that, there's a lot of things going into the mix on average cost of funds. And if you get a situation like that and you've got a rising average cost of funds eventually, certainly on your front book, you'll accommodate them. And the question is an industry, what are they doing on the back book? And what I was describing on the transition to Basel III is going to put a lot into that mixer in terms of rising average cost of funds. It's going to have to find a home at some stage. So that is an industry issue. So I think it's very unlikely that enough would happen on the part of the curve you're describing to substantially impact those ROEs. And that even if it did, that we would do nothing about it.

Brian D. Johnson
CLSA Limited, Research Division

So that seem to be passed on. Okay.

Matthew Davison
BofA Merrill Lynch, Research Division

Matt Davison, Merrill Lynch. Just another question on the Personal Bank. Year-over-year, you've seen 12 bps of margin decay and you've had the SPR [ph] repricing during that time. Just interested if -- as you look out over the next 12 months whether the other factors you see improving enough to produce a margin decay over that time period that is better than the 12 bps because I guess just extrapolating the benefit out of this year's results from the SPR move would be going where?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

So the benefit in the first half was 6 basis points. Theoretically, the benefits, when you get to a steady run rate, should be 18 basis points or maybe a little below that because you have got some non-mortgage assets and some fixed rate mortgages and the like, but let's say it's 15 or 16 basis points. So other things remaining equal, we should see that in the second half. So we should see a strengthening in the NIM in the second half. Because in the first half, we not only had only 4 months of the 6 with the new prices but we hung back for I can't remember if it was 3 weeks or more. So we have the whole portfolio, not price where the RBA had gone. And so you see very little of it in the first half but you'll see a lot more of it in the second half.

Matthew Davison
BofA Merrill Lynch, Research Division

And the other deposit drags that offset that?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, the deposit drags are really people shifting to iSaver-type accounts rather than low yielding accounts. So I think with the competition, the rates on offer, a lot of advertising, we're educating customers and customers are shifting their money around to a greater extent. And I think that's going to go on.

Richard E. Wiles
Morgan Stanley, Research Division

It's Richard Wiles from Morgan Stanley. Mark's talked a bit about the funding in terms of pressures and what that means for your requirements going forward. In light of those comments, how willing are you to continue to grow above system in mortgages?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, we've proven through this crisis that we've got a dynamic system where we reprice based on inputs. And there are headwinds coming. I think just because the banks start to pass through higher input costs doesn't mean the economy will end up with higher interest rates. The reserve bank can always cut rates to have the economic signals right in the economy and they have plenty of scope to do that. But what the nation is doing is investing in a stronger banking system, which will be a higher-cost banking system. And that will find its way eventually, it's a question of how quickly, into what customers pay for credit. It also means certain types of customers won't want to use the banking system. They will disintermediate. So there's a lot of change actually coming on this, but I do believe that water finds its level and this will work its way through. And it's more likely than not the Australian industry will continue to end up with decent ROEs.

Richard E. Wiles
Morgan Stanley, Research Division

What about the dollar funding requirement? You said that your requirement this year is $25 billion to $30 billion. You're growing above system in timelines. Do you expect business lines to pick up? And you've also got the headwind of making more in terms of funding with some liquidity. So how willing are you to continue to grow above system in mortgages? When does it put pressure on your funding requirement?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

So we have a good capacity at the moment because we're well-advanced. So it's not a short-term issue, it's a medium to long-term issue. One of the things we're going to have to do as an industry is significantly enhance our ability to distribute assets and not all assets are going to find their way to bank balance sheets. So we can continue to play a pivotal role in the Australian economy, but we probably can't afford to park all the credit on our balance sheets because that is the Achilles' heel of Australia, that we we're too dependent on foreign funding.

Cameron Anthony Clyne
Former Executive Director

If I can just come back from a strategic angle, one of the -- what was not sustainable in 2009 was to be growing mortgages at half time a system and business at 1.3x a system. We would not be able to participate in the rebound of business credit growth had we not actually grown mortgages aggressively because we would start to bump in to all sorts of concentration and it's another thing. So we had to, grow our mortgages. We wanted to get back some of the balance sheet moving. What's that actually done is actually given a substantial capacity in various ratios now that participate in the rebound and business credit growth. It's also forced us to make a significant uplift in our capability in the frontline sales and mortgage processing. You don't have a burning platform when you're not writing many mortgages. Now I'll leave out just to speculate as to what might be driving differentials and mortgage delinquencies. We were not around in 2008. We weren't writing mortgages. You got to have a real burning platform to fix the prices. We've got that and we've done a lot of work on the prices. So there's a number of strategic levels as well. It just all stems to be with us in growth, too, which goes to Mark's point.

Victor German
Nomura Securities Co. Ltd., Research Division

It's Victor German from Nomura. [Nomura Securities] A question on credit quality. I think a couple of days ago, ANZ highlighted that the outlook is remaining quite subdued, I think, if I'm reading your comments correctly. Today, Cameron you also talked about the 2-speed economy. In light of the fact that you're provisioning levels are arguably slightly lower than your peers, can you provide some outlook comments on the SME book and what those conditions actually are likely to translate to?

Cameron Anthony Clyne
Former Executive Director

I think there's a number of factors are playing. There are parts of the economy that are obviously performing more weakly than others. But the reality is there is still unemployment at a relatively low level and predicted to go lower. There is also a substantial infrastructure pipeline over the next decade, and we're very pleased in the business to have sort of been at above market participant in a lot of the recent activity. So there is a lot of positive signs that will drive activity. There are 2 factors at play here. One is how we stream from negative credit growth, which we have turned in 2010 to a positive credit growth. And the answer is yes. We're starting to see green shoes come through and demand come through and particularly in the last couple months where people business has tried to invest. The next question is where will business credit land from a system point of view. There are varying projections on that. When you take the midpoint of the averages, you're still talking 7%, 8%, 9% top business credit growth which is actually a much more sustainable long-run level anyways relative to GDP. That's -- yes it's a lower environment but that's still a positive environment. If you got business credit growth running at sort of 7%, 8% 9%, that's okay. And if you look at the funding pressures and the other things we're dealing with, that's actually probably not a bad outcome either. So we feel optimistic about the credit growth outlook, particularly the back end of this year and next year.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

And we feel it's highly comfortable with the provisioning as well. We haven't declared victory even though we're seeing a consistent decline in the bad debt expense. We've left all the overlays in place. We've got Basel II accredited models that tell us what we need to be providing, and we're observing all that. And in addition, we've got more capital ring fenced than we have purely in the provisions because we've got the GRCL [ph] still at top up in our capital calculations as well. So we feel fine on that. As they say, we haven't moved to relax any of that because the world is uncertain. But by far, the majority of the indicators are pointing to further improvement rather than a significant worsening.

Operator

We have a question from the line of Craig Williams from Citigroup.

Craig Anthony Williams
Citigroup Inc, Research Division

With respect to Slide 13 and sort of a bit of a follow on from Victor's question, it pointed out that your average on bad debt would take us 43 basis points over the past 30 years. And you sort of kind of being down with your current charges. This sort doesn't take much account about portfolio mix shifts in your portfolio. So with the past and those years, [ph] you're still seeing a shift towards mortgages over that time. So do you have a contemporary view on the cycle average loss assumptions in your book and I suppose the magnitude and direction of your decline in credit costs from here?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

I mean we haven't had a particularly large skew. I mean I think -- you go back to 1980, God knows, but if you go back to living memory, NAB was losing some mortgage share for a while and then it bottomed a couple of years ago and we pulled back 1%, 1.5% or something like that. So I don't think the mix we have today is substantially out of line with history. So I would imagine that the impact of that would be relatively immaterial. But I would hope and expect that, that 43 basis points continues to improve from here. As I said, we've had a bit of a bump in credit cards that will work its way out. We're not seeing anything on the mortgage side. The average credit scoring on business is rising. We've had some things shift into GIA in a few areas that are very well secured. And so the root shocks are really not coming through the way that there were. So I think we feel fairly optimistic on that front without being in a position to declare victory.

Operator

We have a question from the line of Andrew Lyons from RBS.

Andrew Lyons
RBS Strategy

I'll just note the risk rating on housing will continue to fall in the first half. And if you turn to Slide 35 of the presentation, I'll note that the LVR profile of approvals also continued to become more conservative. Can you perhaps just explain the extent of the link between the 2 and then whether this dramatic mark continues to reduce the capital intensity of the mortgage book going forward?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

We've got some graduated pricing particularly in the broker channels that favor low LVR mortgages. So we've had a significant swing in the mix of mortgages that we're writing to low LVR, which is on the front book, therefore, a very substantial risk weight difference to the back book. And it's significant enough given the flows to start shifting the average down. So we are growing primarily in low risk mortgages.

Andrew Lyons
RBS Strategy

So would it be fair to say that, that will continue going forward?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, we hope so. And we're certainly going to maintain the pricing differential.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Scott Manning from JPMorgan. I just wanted to focus of the cost side. The employee expenses were down period-on-period, and I know there's some FX impacts in there. So the uplift in constant currency terms were probably close to an average headcount. So I just want an outlook for where you think that costs of losing the incentivization of staff and in particular, the equity-based compensation was down $60 million this half, so I'd suspect with today's ROE and share process that when necessarily said that was little? [ph]

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

I'll say some numbers and then you chime in. So you're right on the FX effect. Our FTEs are up 3% and our average compensation grew 2.8% on an FX-adjusted basis. So it's pretty much in line. And then the incentive compensation is down about $60 million, but that's just a function of true ups that we do all the time based on which programs are going to vest or won't vest or whatever. So that just tends to fluctuate through time.

Cameron Anthony Clyne
Former Executive Director

We've got an extensive efficiency program as well about making sure that we're to be reinvested in the front line with the extensive of hiring we've done, I think 350 business bankers and just this business is hiring and that delays this business as well, that we're also taking some high costs in non-customer-facing positions out to redeploy. So that obviously changes the mix as well. I think like all shareholders, we would like to see when you base compensation vest. It hasn't been because we haven't delivered on to your sales basis. We have in more recent times but that's only a short period and we've got to do that on a sustained basis all the time be it that to vest.

TS Lim
Southern Cross Equities

It's TS Lim from Southern Cross. If it's under Page 148 of the pack and if you look at agri, fishing, forestry and mining -- if you look agri, forestry, et cetera, right across, it seems they've gone backwards for all the countries. Is that just due to natural disasters or is this a deliberate strategy?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, outside Australia, it's going to be FX-assisted, I would say. Foreign exchange assisted. To my knowledge, there's no significant shift in any of the foreign franchises to move away from agri. As to the -- you've got a $1 billion decline in Australia, did we re-classify anything there or did we just...

Joseph C. Healy
Australia and New Zealand Banking Group Limited

I'd say, it's naturally adjacent.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Of people paying down debt. It's a bit more just commodity prices. So no change in strategy, just probably a combination of FX and customers paying down.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

There has been -- I know through the natural disasters, customers withdrawing down their time management deposits and gain tax relief. We ought to do that. And I think one of the strongest areas of growth has actually been agriculture as well.

Brian D. Johnson
CLSA Limited, Research Division

Brian Johnson, CLSA. Could I refer to Slide 91 in the pack? And I realize a lot of this is basically inherited. When you have a look at kind of like asset concentrations, at the very long cycle commercial real estate is the time bomb for most things over time. And when you have a look at it, I would have thought a sensible concentration would be that no one business should never exceed 7% or 8%. Can I just ask, are you comfortable with those concentrations that we see in commercial property? And does that really open up the headwind to basically grow the mortgage book to offset that? Could we just get an outlook for what you're going to do? Are these commercial property concentrations too high? And if they are, what are you going to do to reduce them, if you they are -- if they can, in fact, be reduced?

Cameron Anthony Clyne
Former Executive Director

I'll get -- we'll get Bruce Munro, our Chief Risk Officer, to answer that.

Bruce F. Munro
Former Group Chief Risk Officer

Well, let's ask the risk guardian. [ph] So we have been on a deliberate strategy for reducing our exposure to commercial real estate in 2 ways: the first is to grow our asset classes; and the second is to actually reduce the absolute exposure to commercial real estate. Our view was that it was getting a little bit high and we have got targeted reduction over the next couple of years. There's got to be a balance with looking after your customers as well. And so we're doing it in that way basically. So we have a target, we're heading towards that target, we'll achieve that target in the next year or so. It's that comfortable.

Brian D. Johnson
CLSA Limited, Research Division

It's just that -- I mean NAB is basically a business growth story, and this is such a big proportion of the book that if you got a strategy to reduce it, it's got some pretty profound implications for growth overall.

Cameron Anthony Clyne
Former Executive Director

I think -- I was just going to say, you got to look at weather as being actively reduced towards actually, in fact, we're growing other asset classes. We are growing other assets classes that will occur as well. So we're not -- that draws some of the reduction.

Brian D. Johnson
CLSA Limited, Research Division

Could we get a feeling as to what you think a prudent level is that?

Cameron Anthony Clyne
Former Executive Director

Well, it's going to depend, it's about 6 or 7%. We're a business bank and were not uncomfortable. Obviously, you look at some of the exposures in the U.K., that's obviously higher than what we like and that we have a more active reduction program in the U.K. Australia's our core market. We've been here for 153 years, and we've been doing at property and we'll continue to do it. Joseph, yes?

Joseph C. Healy
Australia and New Zealand Banking Group Limited

Well, I think the commercial real estate exposure in Australia needs to be understood in terms of its makeup. So about half of the $42 billion is SME based where the average loan size is about $1.5 million. So it's a broadly diversified portfolio where we've got small businesses of acquired the premises that they're working in or by making investment-related -- sorry, diversification-related investments. But the average loan sides are half that book is in line with an average residential mortgage in some parts of the country. So it's not commercial real estate as you would traditionally think of in terms of large, big tickets commercial real estate. It's actually commercial real estate very much in line with a large SME Bank. So from a risk perspective, it's a very different asset in my view.

Brian D. Johnson

CLSA Limited, Research Division

[indiscernible]

Joseph C. Healy
Australia and New Zealand Banking Group Limited

No, no. I said it's not concentrated. What I'm -- I mean, if you look at the risk to that kind of book, it's much more of a systemic macroeconomic risk than it was a commercial real estate in the CBD [ph] or in large sectors of such to correct.

Hany Messieh
Former Investor Relations
Okay, we have come to a close. So thanks, everyone, for joining us this morning.