Question and Answer

Jarrod Martin
Crédit Suisse AG, Research Division

Two questions. Firstly, on the lack of a special dividend this time around, note that your tier 1 ratio is actually higher than 12 months ago, when you did give a special dividend. D-SIBs doesn't come in until 2016, and you still have in excess of $300 million of franking credit. So just around your thinking there and what needs to be seen going forward for potentially that special dividend in -- to come back in? That's the first one. Second one, just on your point about increasing the investment expenditure. I note that your capitalized software has gone up 23% over the last 12 months. Amortization hasn't gone up as much. Are we expecting amortization to increase going forward, and to what extent? And how much more capitalization in that trajectory should we expect going forward?

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

Thanks, Jarrod. Let me start perhaps with the first one. Peter, and you can handle the second. On the first one, Jarrod, you're right. We are very happy with the strength of our capital position. It is a strong position, so -- but what we've done this time around, I think, is just a very sensible approach towards the dividend decision. So the normal pattern of ordinary dividend is $0.02 up and reflecting the strength of the position and not needing to raise more capital, immunizing the impact of that dividend through the DRP. We also flagged, though, we are into a new world where the D-SIB is going to come into play from 1st of January 2016. I think Pete outlined the factors and the framework that we use to think about that. And we haven't yet -- we've got time. That's a way away. We haven't yet set what the new preferred range will be. We'll do that in the second half of this year. So 6 months from now, there'll be another dividend, but for right now, I think it's just the sensible approach.

Peter Francis King
Acting CEO & Acting MD of Westpac Group

Then on the software cap, over time, we will see the amortization increase and particularly with the Westpac Life system now going live. In terms of the increase, I think over the full year of 2014, we'll see amortization at about 1%, maybe a little bit over 1%, to cost growth, so it will pick up in the second half. And that'll -- I think that'll see the size of increase in the balance to reduce a little bit or the speed of increase in the balance reduce a little bit.

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

It's often a function of when projects actually come on stream. And that's when you start to amortize them. So the new online system is just coming onto stream now.

Andrew Bowden
Head of Investor Relations

Brian?

Brian D. Johnson
CLSA Limited, Research Division

Brian Johnson, CLSA. Congratulations, Peter. Two questions. You kind of said that the nonrecourse debt -- well, can you spell out exactly what you wanted to say? You've said that you've received word from APRA. What word?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

So APRA have written to us and confirmed the treatment of the wealth holding companies. And what they've told us is that they should be consolidated into the level 2 banking groups. That will result in ratios changing, but not for us. They've also said that there will be some transition arrangements, but they're not clear, so...

Brian D. Johnson
CLSA Limited, Research Division

So the nonrecourse debt will not been netted against the equity investment in the life side?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

That is the result of consolidating the holding companies into the banking group. But for Westpac, there's no change. That's the important thing that I was saying today.

Brian D. Johnson
CLSA Limited, Research Division

I think it's more a question for CommBank, because I know they're listening in. Gail, if you have a look at the economic capital note, as we've gone through, and I apologize, I haven't had time to read it, but I'm assuming there's a big hunk of capital sitting in the middle as opposed to the operating divisions. When you recalibrate the new target, presumably some of that capital will end up floating back to the divisions. And the returns in those divisions will go down even though, at the group level, it wouldn't. Can you just explain to us what that means for pricing in the divisions?

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

We allocate the capital to the divisions.

Brian D. Johnson
CLSA Limited, Research Division

But there's a big hunk of unallocated capital sitting in the middle. There's certainly...

Peter Francis King
Acting CEO & Acting MD of Westpac Group

Look, I think, well, just there's 2 things. In terms of what -- the capital that we hold in the group at the moment, we basically hold -- so we allocate tangible equity, which means we hold the capital for the goodwill and intangibles in the group; we hold a bit of capital for the Treasury operation; and we hold capital for the next dividend. So they're the 3 big buckets that we hold in the group. The remaining piece is actually not that big this half. So we've got the majority of the capital actually allocated out to the divisions. The divisions always have line of sight both of what we allocate today, but changes in the future. So as you've indicated, should we move the preferred range, we may need to allocate some more capital, but the divisions will have line of sight of that and they will react to it. I'm not going to comment on how they react to it in terms of their strategies, but they have clear line of sight, and they will be thinking about what it looks like in 12 or 24 months' time.

Brian D. Johnson
CLSA Limited, Research Division

So Peter, without having read the table, can I just confirm there's been more capital in this result allocated to the operating divisions?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

You will see the growth in the allocated capital to the divisions going up because -- as we've recalibrated the model.

Andrew Bowden
Head of Investor Relations

Jon?

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. Just 2 quick questions on Page 25, if I could. The first one, I wouldn't have been saying this a while ago, but you can now set specific provisions to -- or individual, I should say, to impaired assets, up at 46%. Now I know the balance has come down a lot. And so is that -- 46% seems a large amount for the residual impaired assets. Is that because these are the worst of the assets, the hardest to get off the book? Why such a large provision given asset prices are rallying again, especially in commercial property? And a second one, which you talked on just to the right of that, you can see, you talk about the band-off [ph] for the charge wouldn't have been 12 basis points but would've been 16 if you include the interest-carrying adjustment. And you differ from your peers in your treatment. Can you elaborate on that and provide some more information? And is that a permanent adjustment? Or why -- shouldn't that be wearing off over time?

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

On your first one, you're spot on. It's just effectively that the ones that remain are a little bit more attractable. And so obviously, we -- the provision is directly associated with that particular exposure. And remember, it's the property ones that have -- we've been able to reduce so markedly over the last while. And property ones generally are a bit secured. So your first, you're simply right, it's just a little bit more attractable and so a higher provision for what's left in the portfolio.

Jonathan Mott
UBS Investment Bank, Research Division

And does that mean that the institutional charge, which was a recovery of $90 million, I think, in the half, will go back towards 0 over the next halves, 2 halves?

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

Well, difficult to know. We've -- Rob and I have these conversations frequently. If you asked me that in November, we probably would have said wouldn't get a result like this; so difficult to know. Obviously, there's still -- it's a very good-quality book. I mean that's the main thing I would say. There's nothing in the institutional book that's of any concern for us. On the second one?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

On the second matter, it's a very technical accounting answer which I probably won't bore the audience with today, but in simple terms, part of the impairment charge ends up in noninterest -- in net interest income. And you can actually see it in the provisioning notes. So if you look at the movements in the provisioning, you'll see the item increasing the provisioning balance, and the other side of it's in net interest income. So it's well disclosed in the provision note.

Jonathan Mott
UBS Investment Bank, Research Division

And you differ from the other banks.

Peter Francis King
Acting CEO & Acting MD of Westpac Group

We do. So we've probably implemented a more pure version of effective interest rate calculations. And it may be something that I have a look at in the future.

Jonathan Mott
UBS Investment Bank, Research Division

Does that swing round if rates start going up or...

Peter Francis King
Acting CEO & Acting MD of Westpac Group

It will change with rates but not markedly.

Andrew Bowden
Head of Investor Relations

Scott?

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Scott Manning from JPMorgan. You've been very focused in the last couple of years to maintain that discipline around the customer margin. And indeed, it's been trading a reasonably tight range. 2.01's the lowest that we've seen it pretty much since 2009, so down 5 basis points for the period. How confident are you that you can maintain that line in the single -- on margins? Or are we entering a more competitive environment where you'll have to let that drift a bit lower to remain in the market?

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

Scott, it's worthwhile looking at the individual divisions there because AFS has actually gone up slightly. So the impact on margins for this period has been, as we've previously flagged, in the Institutional Bank, so the customer margin there. And largely, I mean there are a number of factors, but the main one is this working capital balance, which has become more valuable under the LCR rules and so been more fiercely competed for. So that's where the margin declines occurred, and then obviously, in New Zealand as well, a more competitive environment. So that's worthwhile just looking at that. Going forward, as I think Pete indicated, we -- I mean AFS is well placed. We expect to continue to perform in the same fashion as we have in the first half. There'll be some further decline in WIB. If you want more detail on that, perhaps Rob could give you some. And New Zealand, it's some of the shift's already occurred; two, they're fixed rate, it's a rising interest rate environment, so that margin pressure should ease somewhat.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

And secondly, just on the Treasury, reasonably flat. Yield curve not a lot going on domestically, so where did those gains get generated? And are they sustainable going forward?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

Oh I think they're -- while it was fairly flat, there were some movements during the period and the Treasury was well positioned for those moves. And there was -- so the majority of it was interest rate risk in the balance sheet and also a bit of a pickup in returns from the liquidity portfolio. So we're pretty happy with the Treasury performance this half.

Andrew Bowden
Head of Investor Relations

Brett?

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

Brett Le Mesurier from BBY. Peter, another question on margins. On the loan margins, you said that there was a 7.7 basis point decrease, and you said that was largely in mortgages. Presumably, that means there was roughly a 7 point decrease in the mortgage book. So that would imply that the margin on new business was a lot less than the margin on the existing business, given that about 10% of the book comes on in 6 months, the new business was about $30 billion against current outstandings of about $300 billion. Can you comment on the gap between the new business margin and the one you've currently got in force? Because it looks like it's of the order of 50 basis points given the comments that you've made, which seems a large change in 6 months.

Peter Francis King
Acting CEO & Acting MD of Westpac Group

Yes. I haven't got the exact numbers, Brett, but I think that's way too big, yes...

Brian Charles Hartzer

Yes, I can...

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

Yes, why don't you speak to it, Brian?

Brian Charles Hartzer

Thanks, Brett. So we have seen some decline in front-book margins on mortgages. But actually, if you look year-to-year and you take into account all the different factors that affect margins, which are the customer rate, the discounting, the product mix, the channel mix and the like, actually, year-on-year, I think our front-book margins are up. So we've seen a decline in the first half, which reflects some competition, but the overall net interest margin, which is really what we've been managing to, is up. So we feel pretty comfortable with where we're at. There is some competitive tension. We are responding to that, but we also have offsets and we manage the book very carefully according to that. So it's not nothing like the 50 basis points.

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

And can I ask a second question, probably for Rob, on trade finance margins? There's a comment in WIB about the decline in margins associated with the large increase in trade finance. Can you comment on what's happening with the trade finance margins and the absolute level that you're seeing on those at the moment?

Robert Whitfield
Former Chief Executive

Yes. Thanks very much. In terms of trade finance margins, they do remain very competitively competed for by all the international banks, so there has been margin pressure. We've seen really strong volume growth that has largely offset that margin pressure to give us a pretty flat result overall. In terms of where that's going, we expect that pressure to continue because these are high-quality assets, short-term duration, very effective under the new Basel rules, and so it's a very important part of our customer proposition as we expand into Asia. What's important to remember for our trade finance book is it's a very small book, though. So it has had a modest impact over the institutional margin overall.

Andrew Bowden
Head of Investor Relations

Thanks, Rob. Andrew?

Andrew Hill
BofA Merrill Lynch, Research Division

Andrew Hill, Merrill Lynch. Two questions. Firstly, on expenses. The productivity gains seem to have been slowing down in pace from FY '11. And the $102 million this half was about $20 million below the same level of the previous period. I'm just wondering should we expect that number to start going up again given the investment process? And how much of an impact Lloyds is likely to have on that? And the second question was just around risk-weighted assets. I'm just wondering if you can talk about the opportunities to optimize risk-weighted assets and, in particular, how we should we think about credit risk-weighted assets relative to exposure at default going forward.

Peter Francis King
Acting CEO & Acting MD of Westpac Group

Sure. Well, on the risk-weighted asset question, I think we've done a good job over a long time of optimizing, if you use that word, the RWA calculations, so we feel like the heavy lifting's done in terms of optimization. So that won't be a large feature in terms of the result moving forward. What was the first question?

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

The first one was on expenses. Yes and look, I wouldn't read too much into whether 1 half's got slightly more than the other half. Our pattern is to seek to offset the ordinary increase of expenses that come through salaries and rents and those sorts of things with productivity dividend, and we've achieved that. So the -- each line division know they've got to run their expenses, their ordinary expenses, at flat. And then you add the investment on top of that. And then we manage, as you know, to core earnings growth. So that's the normal pattern. There remain plenty of opportunities for us around productivity. It's a huge area of focus for us. We're definitely driving our digital agenda to improve productivity, make it a lot easier for customers, a lot more self-serve that's actually happening, customers doing things themselves that previously went to branches or went into contact centers. Our Bank Now and FreshStart, for example, are very strong uplifts for us from a productivity point of view: less rental, less in the way of transaction management processes. So very, very strong focus for us across-the-board, but I wouldn't read too much into 1 half to another.

Andrew Bowden
Head of Investor Relations

We'll take some questions on the phone. From Craig Williams, please.

Craig Anthony Williams
Citigroup Inc, Research Division

Perhaps, along the similar lines to a couple of the other questions. But you've called out a desire to tilt to growth as an organization. That's probably easier to manage to positive jaws when you don't pursue growth at system levels in its focus to fashion. Your expense growth is running at 6%. And your capitalized expenses, as opposed to software particularly, balance I think was up 55% in your capital adequacy reconciliation. Can you talk about the expected interplay between revenue and expense growth as you get back to system growth rates? And can you explain the capitalized expenses growth of 55% in the half, as is apparent in your cap add statement?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

Yes. Thanks, Craig. In the cap add statement, that balance was particularly impacted by the Lloyds acquisition, so quite a lot of deferred expenses came across on those loan balances. We also had some small movements between line items, and that explains the majority of the movement. There were also some increases in mortgage broker costs, but the first 2 factors were the big factors.

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

I mean I would say, Craig, on your overall expense comment of up 6%, I think Pete did a very good job of breaking that down so that you can see, if you separate out the impact of acquiring Lloyds and the foreign exchange translation, the actual expense growth was 1.6%. So -- and that includes the investment over the half. So I think you need to understand the various components of that.

Craig Anthony Williams
Citigroup Inc, Research Division

But basically, the message is positive jaws to be expected, for the most part.

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

Well, we don't sort of -- we don't put out a target or a comment about positive jaws. We certainly are aiming at core earnings growth. And as we are tilting to growth and managing our margin really tightly, there's good revenue uplift that we're actually achieving. And then you've already heard me talk about the productivity initiatives that we have in place.

Andrew Bowden
Head of Investor Relations

Let's take a question from John Buonaccorsi, please.

John Buonaccorsi
CIMB Research

I'd just like to ask 2 questions. Firstly, just on home loan growth. As you've increased the fees and the incentives in phase 2 brokers, to direct business too, are you looking to really lift that broker market share? And, if so, what's the target? And second question is just, what's the split in your trade finance book between financial counterparties and corporate?

Andrew Bowden
Head of Investor Relations

John, we might take that first question first, on mortgages, but I might ask you to ask that question again because we didn't quite -- I didn't quite pick it up. So...

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

Brokers.

Brian Charles Hartzer

It was to do with the brokers and what's our target around brokers. I think I'll just take you back to the update we gave in March where we talked about the fact that the tilt in the growth in mortgages, we've really been looking at all the aspects that drive the pipeline of growth in mortgages. We've been looking at channels. We've been looking at consideration. We've been looking at process. As we did that, one of the things we found was that, in broker, we were out of the market on commissions in some areas and we had some processing issues in other areas. So we've worked to address that. And as a result, broker being broker, it's bounced back quite quickly, but our view would be that we really want all the channels to perform well. And we would expect, with some of the other changes we've made in processing and in advertising and in sales capacity, that we would see a further increase in our first-party origination as well. So we don't really have a target per se for broker, but what we do want to see is that all of our channels are performing well and delivering good returns.

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

I mean it's not a material uplift this half. It's gone to -- I think 45% of our new lending was done through brokers, whereas in the past half, it was 43%. The system as a whole, I think, has increased in terms of the percentage that's being done through brokers. So it's not material, but it's what you would expect as you refocus in the way that Brian's just discussed.

Peter Francis King
Acting CEO & Acting MD of Westpac Group

And John, on your trade finance question, most of it's corporate.

Andrew Bowden
Head of Investor Relations

Okay. Can I take a phone from Victor German, please?

Victor German
Nomura Securities Co. Ltd., Research Division

Just actually a couple of clarifications from me. I'm not sure if I missed [indiscernible], but I suspect I would. But would you be able to provide us an indication of what Lloyds contributed on the revenue side? I saw the expenses line but just contribution for the revenue for the half.

Peter Francis King
Acting CEO & Acting MD of Westpac Group

It's around double, Victor.

Victor German
Nomura Securities Co. Ltd., Research Division

Double that of expenses?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

Yes, yes.

Victor German
Nomura Securities Co. Ltd., Research Division

Okay. And secondly, just wanted to pick up on that margin comment. So 7 basis points, on underlying basis, from assets. I noticed you provided divisional split in terms of margins, but obviously, margins is impacted by deposits as well. Just focusing on the asset side, are you able to give us an indication of where most of this pressure is coming from?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

Yes. In terms of the asset side, we indicated that was around 5 basis points in the mortgage portfolio, of that 7. And the remainder was really due to the business books, both in institutional and in AFS and in Australia and New Zealand. So I think that gives you a thumbnail sketch of what's happening there. And...

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

In the mortgages, some of it's because of the switch from variable to fixed. Interest rates being what they are at the moment and people expecting interest rate increases, there's been a -- you can see it in the disclosure, there's been quite a shift, from a customer point of view, to fixed. So that's obviously comes at a lower margin. So that's some of the difference in mortgage margins.

Victor German
Nomura Securities Co. Ltd., Research Division

Right. And that's all predominantly in Australia. Or is it New Zealand as well?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

No, there's a little bit in New Zealand as well.

Victor German
Nomura Securities Co. Ltd., Research Division

The 5 basis points includes both Australia and New Zealand?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

It does...

Victor German
Nomura Securities Co. Ltd., Research Division

Right. Are you able to give us an idea for what the split's between 5 between New Zealand and Australia?

Peter Francis King
Acting CEO & Acting MD of Westpac Group

1 in New Zealand, 4 in Australia, broadly.

Andrew Bowden
Head of Investor Relations

Richard?

Richard E. Wiles
Morgan Stanley, Research Division

Richard Wiles, Morgan Stanley. You've been pretty good at predicting some of the challenges in the Institutional Bank. At the last result, you included it in your considerations for 2014. I notice, in this result, it's not in there as a consideration for the second half. I don't expect you to predict the loan loss charge, but could you make some comment on what sort of revenue growth and pre-provision, profit growth expectations you might have?

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

I think that's one for you, Rob. Sort of feel like maybe we should have put it on the slide, Richard.

Robert Whitfield
Former Chief Executive

Thanks, Richard. Look, I think you've got to look at the -- some of the drivers of the current performance. So the customer growth is up 2%. And we've been very clear to say that our cash earnings growth would have been up 7% if you took out those infrequent items. And if you back out the impairment comment that you made, that added $90 million, its core earnings would have been up 5%. So if you back those infrequent items, take out the impairment charge and make your own assessment of what that will look like in the future, then you can get a trajectory of what we're looking like. We're really comfortable with our position and the growth opportunities. In terms of where we are in the cycle, I think you've got to go, in terms of the margin, back to what your view is in terms of the excess liquidity. Clearly, the U.S. are tapering, which is starting to reduce it, but there's still lots of cash around the globe, which means great-quality assets are still going to be highly competed for. So I guess the bottom line is still pressure on the margins, good underlying business growth momentum and impairments probably provide less of a supporting tailwind.

Andrew Bowden
Head of Investor Relations

I've got one more question. I'll take from James, at the front here. Regis [ph], just bring it down to James here. Thanks.

James Freeman
Deutsche Bank AG, Research Division

It's James Freeman from Deutsche Bank. I just was after a bit of an update on Asia. It was something that you mentioned a few periods ago that was a big investment; just an idea as to how that investment's gone, where we're up to, any changes?

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

Thanks. I've touched on it briefly in my remarks, but again, I think, Rob, why don't we hear it from you directly? I'm personally, as the CEO, really pleased and indeed think that we're ahead of where we expected to be from a point of view of this organic growth strategy in Asia. Remember, it's a strategy that's predicated on supporting our customers' institutional, corporate, commercial, retail customers as they're increasingly trading and investing in Asia; and the reverse, as individuals trade and invest back in Australia. But Rob, why don't you give some more detail?

Robert Whitfield
Former Chief Executive

Yes, fantastic. Thank you. Look, some of the things we've achieved in 2013 Gail made reference to in her presentation. So the first, of course, is our success in the Aussie-renminbi. And with 11 banks trading that now, we've got about a 25% market share there, so very successful. Lots of capability build in 2014 leading into 2015. So our trade finance capability, new platform in place. A lot of new hires of staff: we're coming off a modest based -- a modest base, but about 100 new FTE in Asia, and so there that includes risk and governance employees, but also people in the frontline, so more bankers on the street. We've got a new Chief Risk Officer up in Asia, so building that capability as well. We've established in Asia an advisory board, and that's had a couple of meetings. And you will have noticed the very recent appointment of the Chairman of SingTel, Simon Israel, which we are really pleased about Simon joining that board and able to give us some advice as we continue to grow and continue to invest in Asia. But it's a very focused strategy coming off a relatively modest base.

Andrew Bowden
Head of Investor Relations
Okay. Well, with that, thank you, everyone, and good morning. And please, if you've got any further questions, you know where we are.