Question and Answer

Jill Craig
Former Group General Manager, Investor Relations

Thank you. Before we go to questions, as the usual procedure, if you can wait for a microphone, please. So the people on the Web and the phone can hear you. Craig, we'll start with you. So, microphone?

Craig Anthony Williams
Citigroup Inc, Research Division

Craig Williams from Citi here. You talked today about your aims for above-peer EPS growth. Part of the premise of your aim when you listen to your strategy seems to be the differentiation you have from peers in terms of your access to higher-growth-GDP countries. So what have you observed around the linkages between GDP growth in companies and foreign banks and the ability to achieve EPS growth which outperforms?

Michael Roger Pearson Smith
Former Non-Executive Advisor

Look, I mean, I think the important issue here is you have to get a critical mass in terms of your business volume in the various countries in which you operate, and if you are of critical mass, you will have a platform that will actually automatically grow with GDP growth. So if you're in a higher-GDP region -- or a higher-GDP-growth region, you would automatically expect your business to grow faster than one in the low one. So, of course, it is linked, but it doesn't mean you have to have the critical mass to be able to float, if you like, on that economy.

Shayne Cary Elliott
CEO & Executive Director

I think there is, clearly, a difference between a business here in Australia and New Zealand, which are highly correlated to GDP, because we're big. And the reality is in Asia, although we've got higher GDP growth, that's a good thing. Actually, our business has correlated to the trade flow within that GDP mix. And given that our relative size is still small, what I like about that is we can grow almost to respect of what GDP growth or trade growth does in that region. I mean, our total share of trade, if you will, would be very low single digits. So even if the total wallet doesn't grow, we can continue to pick up share in that market.

Jill Craig
Former Group General Manager, Investor Relations

Thanks. John?

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. I've got a question. It's -- we don't have the pack in front of us, but I think, Shayne, you might it there. On Page 77, what it talks about -- it talks about the APEA division in U.S. dollars which I think is simple to say is a fair way of looking at it. And a couple of numbers kind of jumped out. The first one is if you look at the average loans and advances just in the second half, you can see pretty impressive growth of that, 11%, but the spot growth was only 3%. So just want to get a feel there, were there assets moved off at the end of the period? And the reason why because risk-weighted assets APEA actually fell in the second half.

Shayne Cary Elliott
CEO & Executive Director

So just one point. That page is not the APEA division. That's the APEA geography. So that is everything that's booked in outside of Australia and New Zealand. So, for example, we're not talking about the balance sheet but if you look at, say, expenses on that, that will include all the cost of the hubs. So it's a geographic view rather than necessarily how we run our business, all right? So APEA, one of the issues around loans and advances is that also includes a lot of the liquidity book that sits in London, for example. So we trade lots of liquidity because they are rating, debt liquidity gets placed in London Central Banks, things like that. That's partly what that number is. So I don't know that that's necessarily a great way to think about APEA or our success in the Asia-Pacific region.

Jonathan Mott
UBS Investment Bank, Research Division

So I'll follow up on that. But if you look at it...

Shayne Cary Elliott
CEO & Executive Director

Yes, sure.

Jonathan Mott
UBS Investment Bank, Research Division

It's not actually a much of a different number if you look at the institutional Asia business as well, slightly different numbers, but again, a lot of assets moved off at the end of the period. Risk-weighted assets actually falling. Is that something to do where assets moved off balance sheet at the of the period or why would that come through?

Shayne Cary Elliott
CEO & Executive Director

No, I don't know. No, there was no kind of moving assets off the balance sheet within the Asia division or within the IIB division at the end of a year. Partly, it's to do with there's some seasonality obviously and in terms of trade. And the other thing is we do moderate our -- going back to what I was talking about in terms of the returns, pricing does move around in trade, and so we do moderate our appetite for that. We make sure we have a decent return. If pricing comes down, and there was some lower pricing at the end of the year, we don't participate, and so you'd end up seeing that volatility in our asset levels.

Jonathan Mott
UBS Investment Bank, Research Division

And also, that 23% growth that you did see coming through, how much -- obviously, a very large number. How much of that was trade versus other loans coming through?

Shayne Cary Elliott
CEO & Executive Director

A significant portion of it, most of it is trade.

Jill Craig
Former Group General Manager, Investor Relations

James?

James Freeman
Deutsche Bank AG, Research Division

It's James Freeman from Deutsche Bank. Just a question on capital, if I could, Mike. You've been building capital for a while despite actually good asset growth. And we reached a point now where we can actually start to see that coming back more -- over and above what we've seen in terms of high dividends and DRPs. I mean, when do our market buyback start or are you building a buffer for something else? And then just, Shayne, on trade. You mentioned the ROE, 10%. If we change APRA's ruling around the risk weighting on trade, what does the ROE go to or is that just a...

Shayne Cary Elliott

CEO & Executive Director

So I'll answer that very quickly. I'll answer that one quickly. So we haven't -- that hasn't changed. And if it did change, it's not hugely material. So this is the idea that APRA imposes kind of 1-year minimum tenor on it. Even if you reduced it to 90 days, it's better but it's, look, at the end of the day, I don't think it materially changes their appetite for that business.

Michael Roger Pearson Smith
Former Non-Executive Advisor

In terms of capital requirements, how long is a piece of string? I really don't know. All I can say is that the arguments and -- no, I should say discussions going on in the -- in Europe and in the U.S. would say that this issue has not gone away. Quite clearly, we are in a better position than most European and North American banks, and we believe that we have sufficient capital to cope with most likely increases. But I think it's too soon to call that one. And indeed, I think it's more confused now than it was this time last year.

Jill Craig
Former Group General Manager, Investor Relations

Jarrod?

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Crédit Suisse. A couple of questions. First of all, third quarter trading update, you expected Institutional margins to be down 20 basis points. They're only down 16 basis points in the second half. And considering a lot of that is sort of de-risking of the book, what sort of had change over the quarter for that to come in less than expected and your outlook for Institutional margins from here? You make the -- secondly, you make a comment about stable risk. Is -- do you mean that from a basis point perspective or dollar perspective? And then thirdly, your FY '16 ROE target of 16% plus, I note that you've got 20 -- nearly 20% of capital within the International business tied up in partnerships but it's only 11% ROE. What have you factored in, in terms of partnerships for that target of 16% plus?

Shayne Cary Elliott
CEO & Executive Director

All right. So...

Michael Roger Pearson Smith
Former Non-Executive Advisor

Let me answer that last piece, and then I'll let you pick up, Shayne. Look, the partnership issue is quite clearly something that we need to manage strategically. The efficiency of holding minority interest under the APRA-imposed Basel III guidelines is not efficient. And as we mentioned earlier, we will be looking at various ways of improving our capital efficiency in terms of getting a return. But that was really more about the existing business. If we can do additional things with things like a couple of the partnerships that aren't strategic anymore, then that would be an added benefit.

Shayne Cary Elliott
CEO & Executive Director

Okay. So in terms of our IIB margins, you're right. At the time of the update, we kind of indicated around 20% and then numbers came in at 16%. So what changed in that period? Actually, so just going through the 3 drivers. Interest rates, falling no material difference, that explains about half of the fall and that was kind of being on what we thought. Business mix was another big driver, and again, it was marginally better than we thought on business mix but there or thereabouts. Actually, the surprising piece is probably just the competitive pressure on pricing. So at the time, we felt -- I think we thought that margins on lines and trading things were going to be under more pressure than they were and also on deposits so that came in a little bit better than we thought. In terms of the outlook for margins, in terms of Institutional, you'd have to be -- you -- really, the driver there is going to be, and it's the same for the group actually, is just this continued outlook for low interest rates. And that just slowly works its way through the books. So if I just stand back a bit and think about the group for a second, you'd look and say group margins because of lower interest rates that have already taken place. Just working their way through the book is probably 3, 4 basis points pressure on margins, and it will be 1 point or 2 of other stuff in terms of business mix that would float through in the first half...

Michael Roger Pearson Smith
Former Non-Executive Advisor

It's probably worth talking about that 2 year.

Shayne Cary Elliott
CEO & Executive Director

Yes. That's interesting actually, and when -- obviously, we spend a lot of time analyzing the changes. And we've talked about those 3 things, the interest rates, business mix and then competitive stuff. Actually, if you look at the group over the last 2 years, just kind of looking at where -- that's the majority of the pressure has come. Actually, group margins x markets, 90% of that move is because of lower interest rates. All the other stuff comes out in the wash. You got margins are up a little bit in Australia Retail, which is a big chunk of the book, offsets the margins down and Institutional, which is big margin down but a smaller part of our book. That all kind of washes out and you're left with really 90% being driven by just the fact that interest rates are lower. So that's the outlook for margins. In terms of the risk comments. My comments were more around basis points, so saying we would expect provisions to remain in line with the size of our balance sheet, basically risk-weighted assets. So probably, if you're looking at a number, they're probably up 5-odd percent or something.

Jill Craig
Former Group General Manager, Investor Relations

Victor?

Victor German
Nomura Securities Co. Ltd., Research Division

Victor German from Nomura. A couple of questions if I may. Firstly, in terms of credit quality in the Commercial book, it looks like BBDs there have increased from 251 in the last half to 471. Just wondering if you can give us a little bit of color as to what's driving that and more broadly on appetite that you've got in that business given there are some suggestion from your peers that you are taking more risk in that book, and I'll follow up with another question.

Michael Roger Pearson Smith
Former Non-Executive Advisor

Well, I'll answer that last part. No, we're not. But we did anticipate that question. So Phil is all prepared for -- to give you an answer.

Philip Wayne Chronican
Former Chief Executive Officer of Australia

Thanks for that. Yes, the bad debt cost is roughly $150 million up year-on-year. There's really 3 major drivers to that. The first of them is that we released some on the previous Queensland flood provisions during 2012, so that's nonrepeating. That's $54 million, so that knocks a big hole in it. The second big component is we had some write-backs in the corporate portfolio of around $37 million in the previous year. Again, a non-replication of that knocks a hole in that delta. Most of the risk is pretty finely spread. The only one that's probably worthy drawing some attention to and you'll get to it is that there is an increase in Esanda of around $32 million in provisions. And that's a combination of both book growth but also a change in the mix of the book. So there has been a bit more of used cars versus new cars in that book, obviously, carries a higher expected loss. And there's also been a valuation issue in some of the used cars. So it's not thing that would threaten the profitability of the Esanda business, but it is one where there is some real underlying movement in the provision. But really, that's the only one of any materiality. Everything else across the book is in single-digit millions and commensurate with growth in the book. And as Mike's pointed out, we've looked pretty closely at the quality of the new business acquisition and we're comfortable that it, as well with an underwriting standards and in parts of the portfolio, it'd be fair to say that our new acquisition is actually a better quality than the back book.

Michael Roger Pearson Smith
Former Non-Executive Advisor

Thanks. Thanks, Phil. I'd like Nigel just to give a little -- a view on how he sees it as the Chief Risk Officer as well.

Nigel Henry Murray Williams
Former Chief Risk Officer

Of course, I'll be exactly the same as Phil. We've actually done quite a review because I think those comment about what our competitors would be saying, that we're taking business off them that is worse. So we've got quite a major of view of all the new business that's actually come on and we've actually done that review by bank, by state, by business sector. And we haven't -- the new business that's come on in that Commercial and Corporate business is the same or better quality than our existing book. And so the emergent period losses are the same or better. So we've seen no sign that, that new business is of worse quality than our existing loss behavior. And if you actually look at that individual loss experience, what we've seen this year is actually very similar to what our long-term average is. So a lot of that is the reverse of last year.

Michael Roger Pearson Smith
Former Non-Executive Advisor

We have, of course, lost some business through other banks that we didn't want. I would say that.

Victor German
Nomura Securities Co. Ltd., Research Division

If I can just follow up, with one more question. Looking at capitalized software balances, they're up about $400 million. Can you maybe give us sort of directional trend where you expect that to go? And also, how do you expect the amortization charge to play out over next few years?

Shayne Cary Elliott
CEO & Executive Director

Yes. So I mean, the nature of the business is changing, right? So the nature of the business is we're much more about technology than we are about labor. And so you'd see as a mix of your expenses, you would expect to see technology and that's characterized in many cases by amortization -- software amortization of the balance on our balance sheet increase. In the sense there's no right -- well, there's no right number for that, I'm obviously worried about trends in the amortization pressure. What I'm worried about is making sure that we get value from that investment, all right? So that to me is the critical thing that we've got to show that we get valued-added better products, better productivity outcomes, et cetera, and that's where the focus is. In terms of the trends, it's been increasing. You'd expect that it will continue to increase a little bit. It will moderate in terms of the rate of that increase, partly because we still have some reasonably major pieces of work that have to come online, banking on Australia includes a little bit, completing Transactive, the foundation system in Asia, et cetera. Some of those pieces have yet to finish and they'll increase in the amortization balances. What is the amount? It does put pressure on our OpEx, obviously, so you get an increase in your OpEx as a result. And our approach is at a simplistic level, and again, we worked really hard to get this, it says, when we're investing in new projects, we should make sure we get the balance right within the year between things that drive new revenue and things that drive productivity, that the productivity projects are sufficient to cover the full uplift and amortization, if that makes sense, right, so that we can kind of self fund those amortization increases through productivity projects. And if we can get that balance right, then we're okay. And that's -- if you look at this year, that's what happened. Amortization actually increased pretty materially in the year, but on a constant dollar basis, our expenses were flat because we drove enough productivity to pay for that. And that's our approach going forward.

Michael Roger Pearson Smith
Former Non-Executive Advisor

I think that's the way to look, is to have the ratio of IT expense to both income and expenses and see how that moves. But I think we have to expect that banking as an industry is going to get more and more tech dependent. I mean, that's just the way the world is going. The good part is that, that technology should be getting cheaper all the time. You just need more of it, but it's not going to drive the cost up too much.

Jill Craig
Former Group General Manager, Investor Relations

Andrew.

Andrew Lyons
Goldman Sachs Group Inc., Research Division

It's Andrew Lyons from Goldman Sachs. Just 2 questions. Firstly, a further one just on the Commercial business. One for Phil, perhaps. Can you just maybe give us a bit of a view around the status of the revenue environment at the moment? I know your balance sheet was up about 7% admittedly from a period, in your point view.

Michael Roger Pearson Smith
Former Non-Executive Advisor

Do you want to go to Mark or do you want handle that?

Andrew Lyons
Goldman Sachs Group Inc., Research Division

With income up about 4%, so just wondering can you just give us a view just on the volume and also the competitive environment at the moment. And then just a second question, just on your economic profit, up strongly year-on-year, but then the second half it actually appeared to fall. The growth in your capital requirements appeared greater than the growth in your cash earnings. Just what was the -- any drivers around that?

Michael Roger Pearson Smith
Former Non-Executive Advisor

Why don't I -- well, in fact, I'll get Mark Whelan who runs the business. But Mark can talk to the difference between the revenue and lending growth which has got a lot more to do with the deposits from lending, from recollection. But Mark, why don't you take that?

Mark Whelan
Group Executive of Institutional

Yes, just with regards to the lending growth. Well, as you say, the numbers are up around about 7% year-on-year on the lending growth. And the revenue that we're getting off the back of that, the NIM actually was just slightly improved in the lending side. Where we've seen drag probably for the last 2 to 3 years has been on the deposit side. As you would expect with the low-interest rate environment, we have that as a big effect particularly in our transactional banking accounts. That's been a significant drag on the revenue over the last 2 to 3 years. This year was no different. We're expecting to see that maybe bottom out. So looking forward, we think that there's good potential for that to actually be a tailwind rather than a headwind as we've had. And the other point I'd note with regards to the revenue growth, the numbers that you see there in the division are really based on our lending and deposits. What it doesn't take into consideration is the cross-sell that we generate, and a lot of the other banks actually put that into the corporate and commercial space. If you look at that, that cross-sell revenue was up about 8% whereas our deposit and lending growth was at -- revenue growth was at 4%. Combined total effort revenue, which is what you'd do in comparison to our competitors, was up around 6%, 6% to 7%. So -- and we expect that we can continue to do even better on that particularly on the cross-sell growth because there's more upside to come in the markets business, we believe, and also in the mortgage side particularly, and trade.

Shayne Cary Elliott
CEO & Executive Director

So in terms of the economic profit. I mean, very -- a simplistic way of thinking about it, but the economic profit is basically our ROE minus our cost of capital. So, call it 15.5 minus 11, it's about times our capital plus the value of the franking credits. And the difference is in the second half, obviously, our capital levels increased. ROE was a little bit lower in the second half than the first half, so that's A. But more importantly, it was actually to do with franking credits, which was in the second half. Actually, it was our offshore businesses -- were a bigger driver of profit growth, that come, obviously, without those franking credits on a proportional basis and that's why you end up with that half-on-half difference in economic profit.

Jill Craig
Former Group General Manager, Investor Relations

Michael?

Michael Wiblin
Macquarie Research

Michael Wiblin from Macquarie. 4% to 5% revenue growth, I mean, that's reasonable getting the crystal ball out. Can you give us some idea of where that's going to be coming from, particularly given you've got some margin decline still coming through next year? And then just a double-barrel question just on the margin, I mean, if we do see more rate cuts here, I know it's not consensus now, but if we do see more rate cuts, I mean, when do we start to get worried that the earnings on free funds start to get crimped even more than you're forecasting?

Shayne Cary Elliott
CEO & Executive Director

So I think clearly, if there were further rate cuts, it does crimp your earnings on capital and low interest rate balances. So that would be the case, it's really a question of your ability to reprice the other side of your book. And there's lots of your variables in that equation. The first question in terms of where...

Michael Roger Pearson Smith
Former Non-Executive Advisor

All of which are possible.

Shayne Cary Elliott
CEO & Executive Director

All of which are possible, sure. In terms of the revenue growth, I think 4% to 5%, I think it's a good outcome. And because it's about the quality of the revenue growth, right? So to when -- to some extent, we could grow revenue faster by taking more risk, by pushing out our global alliance business. That's not our strategy and that's not what we're going to do. And I made that point about maintaining our risk appetite. So I think 4% to 5% good quality revenue growth is a good thing. Where is it going to come? It's going to come -- and so the kind of higher than average will come out of Australia again in terms of Retail Commercial. It would be at or about the average. Institutional Asia will continue to be faster than average. New Zealand actually has been s laggard for some time. Although, recently it's is actually picking up a little bit. It's only 15% of the bank so it doesn't have a big impact on the group. But that's more of a positive than a negative. And Institutional Australia, I would say, will be -- continue to be below average. So you kind of -- you balance all those things out, you come somewhere around the 4% to 5%. But that's all on a constant dollar basis and who knows what the effect of foreign exchange might be. So growth where it should be. Growth in the businesses we're investing at in. Growth in the businesses where we have a competitive advantage and the ability to growth.

Jill Craig
Former Group General Manager, Investor Relations

Brian?

Brian D. Johnson
CLSA Limited, Research Division

Brian Johnson, CLSA. I had 3 questions, if I may. In the smallest fund imaginable under the capital management bit, it says that you've released some the capital in the LMI in the second half. Can you just run us through exactly what you've done there? And then I had 2 other ones.

Shayne Cary Elliott
CEO & Executive Director

Rick can answer that one.

Richard Marc Moscati
Former Group Treasurer

Yes. So LMI is now partly financed with -- so LMI, we refinanced with some hybrid capital. And from a regulatory perspective, that's a deduction at a hybrid capital level rather than Core Equity Tier 1.

Brian D. Johnson
CLSA Limited, Research Division

Can you give us a dollar figure on that?

Richard Marc Moscati
Former Group Treasurer

I think off the top of my head it was $150 million. Not massive, small.

Brian D. Johnson
CLSA Limited, Research Division

The second one is that if you have a look at your expected loss, and I apologize I haven't got the pack in front of me, but the expected loss, I think, from memory, declined from 38 basis points to 37. The actual loss is running at 25. We had a much bigger kind of capital release in the expected loss in the capital adequacy note. I think from memory, it was about $200 million. We saw the dollar value of new impaired assets increase by about -- so there's the new emerging impaired assets increased by about $250 million. Can you just give us a feel about the vulnerability of the dividend at some point in time when the expected loss becomes the real loss? And I would have thought every year you run under it, there's a year when it's probably going to run above it. Because this looks optimal.

Shayne Cary Elliott
CEO & Executive Director

Do you want to talk about the trends and expected loss, Nigel or no?

Brian D. Johnson
CLSA Limited, Research Division

Can we come back to that dollar figure of new bad loans coming through?

Nigel Henry Murray Williams
Former Chief Risk Officer

Okay. So the new bad loans that are coming through, if you look where they are, they're actually in -- and I think we've got a slide, I think it's Slide 71 that actually shows the size of the impaired loans. And you'll see -- as we said last year, we saw us going down market to the small business banking market, et cetera. And so you're seeing the recoveries from that much higher, much better. So our actual losses will be lower.

Brian D. Johnson
CLSA Limited, Research Division

But the new impaireds are down?

Michael Roger Pearson Smith
Former Non-Executive Advisor

Yes, new impaireds are down.

Nigel Henry Murray Williams
Former Chief Risk Officer

New impaireds are down 22% year-on-year.

Brian D. Johnson
CLSA Limited, Research Division

So that explains why it's going from 38 to 37.

Michael Roger Pearson Smith
Former Non-Executive Advisor

Yes.

Brian D. Johnson
CLSA Limited, Research Division

But the 25 basis points versus the 37 basis points is still a pretty big GAAP?

Nigel Henry Murray Williams
Former Chief Risk Officer

Yes, and we -- I think we would expect to see some improvement in the 37 as well. So I think there's still a little bit of room there in various areas to come down. But, I mean, you're quite right, as you know, that the 25 is lower than the expected loss number and it might be 3 years. It might be 5 years. It might be 7 years, but we'll -- at some point, we'll see a higher number.

Shayne Cary Elliott
CEO & Executive Director

But it is to double. Even if we had seen it jump from the 25 to 37, that's 50% jump. Let's say, so provisions will grow from 1.2 to 1.8, would you be able to sustain your dividend of 1.8 provision loss years? I mean, would you be able to it forever? No. It wouldn't be a good thing, but if you ended up in a cyclical thing, I think $600 million is not a good thing, obviously, but it's within the realm of affordability for the dividend.

Michael Roger Pearson Smith
Former Non-Executive Advisor

And it a 10-year cycle, 8 years, you'll be below the expected loss rate. I'd say it's only the 2 years where you shoot above it. So I think we're okay.

Brian D. Johnson
CLSA Limited, Research Division

I'm pretty confident you won't be around to see it, Mike.

Michael Roger Pearson Smith
Former Non-Executive Advisor

You know something I don't. Why is that?

Brian D. Johnson

CLSA Limited, Research Division

Just the final one, when you -- you have a lot of stuff on productivity today which is great. But when you have a look at ANZ, you are running 3 disparate core systems. Can you just run us through the thoughts on that going forward?

Michael Roger Pearson Smith
Former Non-Executive Advisor

Yes, I can. Our business mix is not like our competitors. It's different and the -- we have a couple of what I would call legacy core systems and one new one. One of the core systems in New Zealand is actually potentially can be upgraded because it's still being serviced effectively and grown. So it's really the core system in Australia, which is the issue going forward. Is there a need to replace it right now? No, there isn't. And the reason for that is that we are putting our investment in the customer front-end systems and we are basically hollowing out the core banking system, so that it's -- the need for a core banking system like you used to have to have will no longer be relevant as the technology changes. And what we will be faced with some time down the line, maybe in 10 years, is a need to actually replace our accounting system, but it will not touch, effectively, the front end, and that's where we're moving to. So that's a decision that we will have to take at some stage, but it won't be like replacing a core banking system as it is today. The technology has moved along and continues to.

Jill Craig
Former Group General Manager, Investor Relations

Richard?

Richard E. Wiles
Morgan Stanley, Research Division

It's Richard Wiles from Morgan Stanley. Your ROE target of 16% isn't a long way above current ROE...

Michael Roger Pearson Smith
Former Non-Executive Advisor

You think it's so simple to achieve, but this has basically got to be a continuing trend and at 15.3%, there's still a fair way to grow. Sorry, but I didn't let you answer -- ask the question.

Richard E. Wiles
Morgan Stanley, Research Division

I had 2 specific questions. Firstly, how much of that is just driven by mortgages growing above system over that 3-year period? I assume that's an ambition to maintain your recent track record. And secondly, what broad assumptions are you making about IIB within that 16% target?

Shayne Cary Elliott
CEO & Executive Director

Yes, that's a good question. Look, growing mortgages helps. By the end of day, mortgage is tiny little piece of our capital base, right? So it can grow as fast as it likes and responsibly. It'll help but that in itself doesn't really drive our -- in terms of the group average because it consumes 10% of the group's capital.

Richard E. Wiles
Morgan Stanley, Research Division

Generates lot of profit.

Shayne Cary Elliott
CEO & Executive Director

I don't...

Richard E. Wiles

Morgan Stanley, Research Division

I mean, retail was -- retail had a great year and a great half so if it's not using a lot of capital...

Shayne Cary Elliott
CEO & Executive Director

No, no. I agree...

Michael Roger Pearson Smith
Former Non-Executive Advisor

But, I mean, you can give it all the capital you like. But it's the fact you can't build the business much more than system growth, right? And how do you fund it? And we could give Phil another $3 billion of capital. He'd have to go and -- what would he need?

Shayne Cary Elliott
CEO & Executive Director

$200 billion of mortgages.

Michael Roger Pearson Smith
Former Non-Executive Advisor

$200 billion of mortgages. Now how is he going to do that, and fund it?

Richard E. Wiles
Morgan Stanley, Research Division

Isn't the point that he can grow his earnings very strongly without much capital? That allows you to continue to neutralize a day...

Michael Roger Pearson Smith
Former Non-Executive Advisor

Sure, but we...

Richard E. Wiles
Morgan Stanley, Research Division

Maybe do a buyback that James wants?

Shayne Cary Elliott
CEO & Executive Director

Look, I don't think -- hang on. I don't think we're disagreeing here. You're right. It's an important part of -- what I'm saying is in terms of business mix is not the driver of it. In fact, the way that you get to 16% is exactly what we see it, that's growing. It's growing Australia fast and continuing to do that responsibly. Driving productivity in New Zealand in terms of driving the P&L, we think there's a big upside -- continues to be a big upside on that. And then in terms of institutional Asia in particular, we've got growth and there's a little bit more productivity in terms of IIB in general. So it's all of these little bits and pieces all gets you to that point. Going back to the question about partnerships earlier on. That current goal kind of assumes status quo in terms of what we have, right? So we're not dependent on a change and strategy around partnerships in order to get to the 16%. And I think the other point, Richard, it did say 16% plus.

Jill Craig
Former Group General Manager, Investor Relations

Do you have a follow-up, Richard?

Michael Roger Pearson Smith
Former Non-Executive Advisor

My job there -- that was the threshold, yes.

Jill Craig
Former Group General Manager, Investor Relations

At the risk of starting that again, did you have a follow-up, Richard? No. Brett, and then Scott, please.

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

Brett Le Mesurier, BBY. The tax rate in the APEA geography seemed to be 19% in the first half and 14% in the second half. Also, the Wealth Management business in the segment earnings part didn't seemed to pay any tax of any consequence. What were the factors that created that? And I don't recall, in the third quarter update, any reference to that.

Shayne Cary Elliott
CEO & Executive Director

No.

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

So also when did that become obvious that, that was going to be the case?

Shayne Cary Elliott
CEO & Executive Director

Sure. I'm actually going ask -- I'm not tax whiz. I'm going to actually ask Shane Buggle, my deputy, to talk through the tax numbers. Shane?

Shane M. Buggle
Group General Manager of Internal Audit

Okay. Thanks, Brett, obviously, it's a function of where -- which countries you earn this. Which tax jurisdictions, so it's just a mix of where we earned through the -- to the half and through the quarter.

Shayne Cary Elliott
CEO & Executive Director

Yes, in terms of the Wealth piece, though.

Shane M. Buggle
Group General Manager of Internal Audit

What was the question on Wealth?

Shayne Cary Elliott
CEO & Executive Director

The Wealth taxes were -- there was a $50 one-off in there.

Shane M. Buggle
Group General Manager of Internal Audit

Yes. That was resetting of the tax base on the acquisition of the OnePath. And so we were in dispute with the Australian Tax Office. We settled our dispute, and we released a $50 million deferred tax liability.

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

Can I go back to the ROE question? The ROE that you're targeting in the APEA region. Are you expecting that in your forecast period to hit the company average?

Shayne Cary Elliott
CEO & Executive Director

No. No, I don't -- no, and I don't think it will hit the company average. It won't be 16%. It's unlikely, and, again, it goes back to that point about how we create value. We have some businesses that are high return that tend to be lower growth. And we have some businesses that are lower return, still above our cost to capital, that are high growth. And as long as you get that balance right, and that's why I tried to give you that example of kind of a 13 -- and I'm making -- these -- I don't want people to run away and say [indiscernible] is 13%. But I said, as an example, a 13% ROE growing at 10% is about the same value as a -- actually it's a bit more than a 20% ROE growing at 5%. And so, no I don't think that's a necessary outcome. What I will say, I think that the Institutional business in Asia absolutely has the opportunity to be midteen ROE. We know that because of some of the business that we do today and as the weighting of that business grows within IIB, it'll push the -- that APEA business higher. We also know that from other -- from some of our competitors and it's about getting the balance right between what you do in that business and that's why I spent a bit of time today talking about that trade example. The more you do that, obviously, it's pulls up the average.

Michael Roger Pearson Smith
Former Non-Executive Advisor

But it's also an integrated strategy. You can't just dissect it in pieces. There is a flow of income going both ways. And the customer base requires the presence of your regional presence in -- to get that custom. So you might be making more money out of an account in Hong Kong or you might be making it in Australia, but you've got to have both to connect to it. It's an integrated strategy.

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

So what do you currently estimate the ROE of that business to be?

Shayne Cary Elliott
CEO & Executive Director

Well, we don't estimate it. We know.

Michael Roger Pearson Smith
Former Non-Executive Advisor

You should be interested in group. You should be interested in the group ROE. That's the number you should be watching. And you should be watching the trend of it.

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

Okay. So where your incremental capital goes is important in defining what that trend is?

Michael Roger Pearson Smith
Former Non-Executive Advisor

Of course, and as Shayne has said, the incremental capsule goes where there is a potential shareholder value to create shareholder value.

Shayne Cary Elliott
CEO & Executive Director

I think, though, you can say, Brett, today, if you look at Asia, which is obviously where the strategy is, the Asia business today, the ROE is above our cost of capital, and it's improving, okay? And the reason it's improving is because we do get -- you do get a scale benefit. There is obviously a fixed cost element both in terms of actual kind of expense and there's almost like a kind of a fixed capital cost, i.e., there's a capital minimum that starts that you grow your way out of. So it's growing. It's low double digit. It'll grow into that kind of low middle digit over time. Is it likely to be above 15% in the long term? Probably not. But a good 13%, 14%, 15% ROE business in Asia growing, with the growth characteristics that it has, that's a great business such a great way to create value. And to Mike's point, that's just looking at it stand-alone, not taking credit for the fact there's no debt. Look, obviously, I used to run the Institutional side, so I'm passionate about it. But obviously, there's no doubt in my mind today that we are in business in Australia today because we have a relevant network in Asia. There's no doubt about that. Now can you perfectly count it and figure on it? No. But we know that that's the case, and that, that is reinforcing to our leading position here in Australia and New Zealand Institutional.

Jill Craig
Former Group General Manager, Investor Relations

Scott.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Scott Manning from JPMorgan. The guidance -- the outlook commentaries around the group, the integrated approach, the cost-to-income ratios for the group, the ROE for the group. The prior targets in years gone by have been 25% to 30% of earnings coming from Asia, so it was more aligned understanding around -- getting people to believe in the Asian growth component of the group. So 2 questions. Firstly, within that original target of getting to that 25% to 30%, what was the equivalent capital number that was penciled in to achieve that? And secondly, within the group ROE outlook, is that 25% to 30% coming from Asia still applicable or is that now off the table?

Shayne Cary Elliott
CEO & Executive Director

So first of all, the 25% to 30% was talking about the earnings from APEA, so it was really a point about being outside Australia and New Zealand. And the principle behind that was to say we're serious. This is about an important business. It wasn't about whether it was 25.2% or 30.5% or whatever would say this is meaningful. We haven't walked away from that goal. So that's -- these new goals are in addition to that. So that goal is still there, right? And in terms of -- is that kind of part and parcel of the mass that says we can get to the 16% and the 43% CTI and do the 25%? Yes. But it also says, hey, over time, the world changes in terms of capital rules, how we think about partnerships and all those other bits and pieces. What we don't want to get is lock in to do something silly just to meet a 25% goal. For example, just hypothetically, holding on to a partnership, because, obviously, that helps us achieve the 25% earnings goal. It might not be necessary in the best interest of shareholders, however. I don't know. I don't remember what the capital assumption was at the time that, that goal was given.

Jill Craig
Former Group General Manager, Investor Relations

Any more questions? T.S.

T.S. Lim
Bell Potter Securities Limited, Research Division

This is T.S. from Bell Potter. All the discussion about Asian banks. You never talk about India or north Asia. This market is still difficult for ANZ. I mean, what is the x factor needed for you guys to succeed in those markets?

Michael Roger Pearson Smith
Former Non-Executive Advisor

Well, India, we have opened a branch and now we are considering to grow. Acquisition opportunities are limited in India because of the regulation. And quite clearly, in the last couple of years, nothing has been happening in India because of the state of the government at the moment. No decisions are being made. In terms of north Asia, Japan and Korea, they're difficult markets. We have looked at opportunities there before. We still are growing our organic business. But Korea, for example, I mean, most banks in Korea are earning an ROE of about 3%, which is not really where we would like to be. So I think that looking forward, we will continue to build our organic business in Korea, in Japan, and in India. And I think that's the best way to go at the moment.

Jill Craig
Former Group General Manager, Investor Relations

And I think with that, Mike, we might hand back to you for any closing remarks.

Michael Roger Pearson Smith
Former Non-Executive Advisor
Okay. Many thanks. So let me just wrap up by saying that we presented a clean and the high-quality results today, one which demonstrates that we're creating a better bank for our shareholders and for our customers. It's also clear that the super regional strategy provides us with so much more long-term potential, but it is a long game, but it has enormous opportunity. As I said earlier, we have set additional targets, which are reducing the cost-to-income ratio to below 43% by the end of 2016 and achieving an ROE of above 16% over the same period. And I think it also demonstrates that we're continuing to make progress in unlocking the potential of our franchises here in Australia, in New Zealand and Asia-Pacific. And as I said earlier, there's a promise of more to come. So, many thanks indeed for being here today. Thank you.