Westpac Banking Corporation

2006 Interim Results
Analyst Briefing

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1:30pm

TRANSCRIPT

Andrew Bowden, Head of Investor Relations:

Good afternoon and welcome to Westpac's 2006 interim results announcement. My name is Andrew Bowden and I am head of Investor Relations.

Welcome to everyone here, and we have also got a number of people on line and a number of people on a conference call, so I would like to thank them for taking the time to tune in today.

Michael Coomer is hosting a session in Melbourne as well today and I would like to thank those who have attended in our Melbourne offices.

For the benefit of everyone here, for the technology in this room, I would like you to turn off your mobile phones please, that would certainly help us out. The format today will be very familiar to all of you. David will give an introduction and a summing up and Phil Coffey our new CFO will give the details of the result. So without further ado let me hand over to David Morgan, our Chief Executive Officer.

David Morgan, Chief Executive Officer:

Thanks Andrew. Good afternoon and welcome. I am delighted to present another record profit for Westpac. With this result we have again delivered on many fronts. In terms of reported earnings, cash earnings and cash EPS up 12%, cash ROE up, to 23%, a revenue growth of 10%, expense growth of 3% and accordingly a significant reduction in expense to income ratio at 300 basis points, to 47%.

We also increased the interim dividend 5 cents to 56 cents, an increase of 14%.

In terms of the composition of the result, the Australian Retail Bank was the key driver of our performance with cash earnings growth of 12% and BT was the star performer with cash earnings up 20%. The Institutional Bank was held back by our previously well-flagged run-off of the New Zealand structured finance portfolio. Excluding that drag, the Institutional Bank grew cash earnings at 26%.

New Zealand delivered a 4% lift in cash earnings, in New Zealand dollar terms, in what was a very competitive market.

For me there are five main features of this result.

Firstly revenue led; secondly our growth momentum was restored; thirdly a good quality result; fourthly a consistent result; and finally delivered real value back into the hands of shareholders.

Let me elaborate on each of those briefly. By far the greatest driver of this performance has been revenue up 10% in reported terms. This has been driven by improved growth momentum across the board assisted by very strong performances from BT and Financial Markets.

When I spoke to you this time last year loan growth in Australia was our biggest issue. I said to you we would fix that and we have fixed that. Momentum has been restored and we are back on track in Australian lending, ending the half at or slightly above system growth.

New Zealand growth has continued to be broadly in line with system. Meanwhile BT continues to gain significant market share, pretty much across the board. You can see particularly in platforms the market share of 12% gaining, share of new business at 16%; corporate super a market share of 7% and getting 10% of new business; marginal lending a 15% market share and achieved a 31% share of new business.

BT now contributes 11% of our total cash earnings, up from 8% just three years ago. This was also a high quality result. It was achieved without slashing margins, without going out on the risk curve and while maintaining a robust investment program.

In terms of price responsiveness, we have met the market, but we have not led the market. That is consistent with a margin decline, both within our expectations and within our medium term range, whichever way you choose to cut it.

We have maintained our risk disciplines and all of our risk indicators, both current and forward-looking, remain within comfortable and expected levels. Our investment program is placing better emphasis on the front line both in terms of our technology investments, but also across the bank over the last 12 months we put 500 additional front line jobs out there. Of course we have had a very substantial investment in Reach and in Pinnacle.

As with all results there are non-recurring elements in this one, they impact both positively and negatively. But either way you look at it, with or without non-recurring items, this is solid double digits bottom line growth.

Consistent returns over the long term are the benchmark, which isolates greater significance.

This result continues the strong trend of more than five years, with cash earnings per share growth of 11% compound average growth rate over the past five years and a cash ROE averaging 21%. This is the top of the major bank sector.

Finally an outstanding feature of this result is our ability to make a further step change in the dividend payment and lifting it to 14% while successfully completing the off-market buy-back last year. Combined that means we have in this half returned $2 billion to shareholders.

Dividends have grown at a compound rate of 13% over the past five years. Importantly we have retained the capacity to efficiently manage our capital base in future. Even after these payouts our capital ratios remain above target and our franking balance is in surplus.

This result demonstrates the strength and the health of the franchise.

Let me know hand over to Phil Coffey to take you through some of the detail.

Philip Coffey, Chief Financial Officer:

Good afternoon everyone and let me say that it is great to be here at my first results presentation and also to have the opportunity to give you the detail on what is such a healthy result.

As you would be aware we are reporting today under AIFRS for the first time and I thought I would just spend a few minutes explaining our approach. In making the transition from AGAAP to AIFRS we have looked to ground our approach on two principles.

Firstly, we have moved to AIFRS and that is the basis under which we should report because that is how you are going to see our numbers going forward and that in turn can allow us to simplify some of the analysis.

Secondly, we do need to provide transparency on key terms and so that has led us to focus on three items. Firstly, we will focus on cash earnings but our adjustments to NPAT will only be for significant items.

We are going to focus on growth in reported cash earnings because the adjustments for the prospective accounting standards, where quantifiable, were either small or offsetting and really we believe reported cash earnings best reflects our performance.

But we will show the adjustments to the components of earnings. For the prospective standards AASB 132 and 139 and certain insurance standards and accounting reconciliations because those items can be significant.

A quick summary of our performance shows good growth in both net interest, but especially in the non-interest income line with controlled expenses and little change from our impairment losses.

The most telling aspect of the result is the strength of the core earnings where the combination of adjusted 11% growth in income and 4% growth in expenses has delivered a 19% lift in core earnings.

You can see from the bottom of the chart that we have consistently managed a gap between our revenue growth and our expense growth and over recent halves that gap has averaged around 5 percentage points.

Core earnings didn't drop through into comparable increase in cash earnings because of the increased tax charge in the half. That increased tax was built around three issues. Firstly the effect of the run-off of the New Zealand Structured Finance transaction, secondly the end of tax concessions for Life Company earnings and thirdly a $61 million tax provision we took in the half in recognition of the estimated impact of our existing risks through a more onerous interpretation being taken by tax authorities around the globe.

This is a pretty important chart, so I will spend a little bit of time on it. If you back out the noise of the one-off factors in our revenue line over recent halves you can see that the impact of the prospective standards and the one-offs changes the mix of our operating income growth.

So if we start at the top line and look at reported operating income we grew by 10% but basically we are flat on the prior half. After adjusting for the accounting impact, that changes to an 11% and 5% and if you adjust the number of one-offs that we have disclosed to this group previously you will see that the core operating income pattern looks like a 12% growth over the full year with 5% over the prior half.

Our revenue line in the half also benefited with some very good trading results. If we exclude the better than normal, the better than trend trading results that we saw in our Financial Markets and Treasury areas, then you will see revenue growth is closer to 9% than the 12%. Having said that, 9% is still a very good outcome compared to the average 8% revenue growth that you have seen from us over the last five years.

Our half on half earnings feature is a similar one. It has been supported by solid revenue growth in both halves. Both the first half of '06 and the second half of '05. Our reported numbers show the larger impact of expense and provisions in the most recent half, but if you adjust for the nonrecurring items that I've just been talking to and that have been included in prior periods, you will find that our half on half pattern of growth is closer to a 7% and 5% pattern rather than a 9% and 3% pattern that you can see on the chart.

Now looking at individual components of our income and starting with net interest income. Our net interest income, if we adjust for AASB132 and 139 and the tax effective impact of the Structured Finance Transactions, increased by 6%. That was on the basis of a solid growth in average interest earning assets, which were up 8%, offset by an overall decline in margins of 5 basis points.

When you consider volume growth on both sides of the balance sheet have been good -overall loan growth of 11% when we take out the impact of New Zealand Structured Finance run-off has really showed that most of our portfolio is now getting back close to system and in some cases now running ahead of system growth.

The main drivers of our loan growth were housing growth in both Australia and New Zealand, the very strong card growth that we saw in Australia particularly in the second half, and the Institutional lending which is up 15% over the year.

Deposit growth has also been solid in both Australia and New Zealand, particularly in the high interest online savings accounts, which have seen very solid growth in both geographies.

Notwithstanding that growth, given the overall strength of loan growth we have gone back into the wholesale markets to top up our funding.

The margin movement needs a bit of explanation so I will just spend a couple of minutes on that. You can see that over the 12 months the reported decline in our margins was 4 basis points. After we take out the impact of the AIFRS adjustment it rises to a 5 basis point decline. That 5 basis points is a mixture of ons and offs – so in terms of the impact of the spread decline in our asset and liability mix we had a 9 basis point decline really on the basis of three factors. The additional wholesale funding that I mentioned to you, the switch between lower rate deposits to a higher rate online saving deposit, and the switch in New Zealand from floating rate mortgages to fixed rate mortgages.

We experienced another 1 basis point decline in our asset and liability spread, where the compression on margins on new lending were nearly offset by the better spread that we've got on a whole range of other deposit products. Those overall declines have been offset by the benefits that we have received from both compositional and high growth in financial markets and treasury earnings and where the two of those things contributed 7 basis points.

In Structured Finance, the run-off of that in our overall margin analysis deducted 3 basis points. So lots of ons and offs, so let me give you the summary.

The summary picture is that if you look at our underlying margin we see a 9 basis point decline in margins and that compares with the underlying 7 basis point decline that we talked about after the September half last year.

The adjusted non-interest income growth was really strong at nearly 14% and improvements in that area were dominated by three of our best performing areas. In Financial Markets, in BT and in cards. The 'other' category in this chart effectively represents the growth in our general banking and transaction fees, but a big contributor there was the Transactional Banking Revenue in Institutional Bank where we continue to do very well. Treasury income also contributed to this report.

Turning to expenses and the transition to AIFRS had very little impact on our expense line and so pretty much whichever way you look at it expenses grew by a little over 3%. I think the composition story is also a good one. Our personnel costs were up 6% on the back of higher remuneration and as a consequence of additional front line staff of nearly 500 people.

Offsetting that growth has been the fact that we have been able to hold the other major expense lines basically flat. We have done that because we are getting the benefits of the productivity savings that we would have hoped to have got from our system spend and because of our outsourcing agreements.

We have also shown the disciplines that we can bring to bear on our discretionary expenses. At this point I think I should mention that our expense management is much more around how we manage the relationship between revenue and expenses than it is around an absolute cost target.

In most circumstances we think that means you should expect to see from us expense growth around 4% and that is certainly what you've experienced over recent years. But there may be times when you see a higher expense growth and that will be because we basically see a revenue opportunity that we are not going to forego.

The outcome of our overall expense to income management over the half has been good and you have seen a steady improvement in the expense to income efficiency ratio and after A-IFRS adjustment we took another 340 basis over that ratio in the half.

The consequences of that heavy investment program has been an increase in software amortisation costs. In the most recent half we have moderated some of our project spend to around $160 million, but that reduction has really got more to do with the timing of the spend rather than the underlying activity.

Half of the expenditure that we make on these kinds of projects is expensed immediately and the residual tends to end up in our capitalised software balance. You will have recorded that the increase in both the balance and our amortisation charge over recent halves really reflects the uplift in spend that has taken place on major projects like Reach and like Pinnacle.

In the most recent half we have added to that project list a new program called Connect at Westpac, which has been a major enhancement to our systems infrastructure for people management.

The level of our capitalised software is approaching a peak and it is doing so for a couple of reasons – one is we are now starting to deliver the major projects that we have been building and secondly because we adopt an aggressive amortisation schedule, where most projects are amortised over three years.

Moving to our impairment losses line and let me start by saying our asset quality looks pretty good and I absolutely touch wood when I say that. But I am feeling good about that because we have seen few instances of new bad debts, certainly nothing systemic and we don't have industry or concentration concerns.

We have had lower impaired loans. Despite that and the continuing positive environment, we have seen a tick up in our credit charges and you will see from this chart that really that should have been expected because the increase is largely due to the increase in our collective provision. That in turn is as a consequence of the very healthy loan growth that we experienced in the half.

We created a capital deduction for credit on the transition to AIFRS of $80 million after tax and we have seen no need to vary that in this half.

Our forward indicators remain positive although we have seen an up tick in light of our delinquencies in mortgages and cards. In mortgages a big part of that is actually statistical because if we continued to grow mortgages at the same pace as we had two years ago, then effectively you would have seen little change in our delinquencies. But a slowing in mortgage growth has basically led to a flow through in terms of an up tick in delinquencies.

There has also been some seasonality in this half. However our market data analysis does suggest these trends are grossly picking up and we would expect that these trends would likely continue towards the more normal historical levels.

Turning to business unit performance and starting with BCB. Well really the story has been around restoring volume growth momentum and we have had really good success in all segments with the exception of the SME segment where we have basically seen the brunt of the major introduction issues around Pinnacle.

We have been more aggressive on pricing but we have controlled that and we have done that where we want to meet the market and where we can still derive economic profit. In BCB margins are 11 basis points lower than over the prior corresponding period.

Fee income was strong due to the loan growth and to our Cards results. Housing in Australia has been one area where we have been very pleased. We have recovered momentum we are back growing to about 90% of system and we have done that through a couple of ways. Firstly, through increasing the productivity of our own sales teams.

For the rollout of our own sales program Westpac Way is bearing fruit and our own productivity was up 30%. We have also utilised a select number of brokers more effectively and so our broker proportion of new lending has averaged around 38% over the half and that is up from 35% in the prior six months. Importantly we achieved that growth without sacrificing price. Our mortgage spread is down just 4 basis points over the year.

Business lending has obviously been a very strong area in the overall economy and we have benefited from that as well. Our own institutional lending is at 15% and our other business lending, little markets and SME has grown 11%. As I mentioned we had that one soft spot of the SME segment but we really think that those implementation issues are behind us now and our most recent three month lending and the forward pipeline is very encouraging.

I think you can see the improvements we are getting in our business lending in terms of the growth over each of the last three quarters. In line with the increased competitive intensity that we are all experiencing in that segment our spread has declined 3 basis points over the year.

BCB deposits grew by 11% and on the surface you might think well that's a good result and there is not much change going on there and that would actually not be right. That overarching performance marks a significant change in the portfolio, both a structural change and a pricing change. The impetus to that change has been the attraction of our high yield online saving account and the unlimited transaction accounts – the 'all you can eat' accounts.

So in our case in Australia that is the Max-i-Direct account and the Westpac One account. Those two accounts have positioned us well and we are seeing good customer growth and retention, but the polarisation of our growth into those two accounts is having an impact on both our margins and our fees.

Our pricing strategies across the full range of accounts have helped to mitigate the impact of these two accounts.

Looking at WIB and you can see that the overall bottom line was lower as we exited our New Zealand Structured Finance transactions and as we ran down our Quadrant investments. When you get under those two impacts you can see the underlying performance has been solid. With strong performance from Financial Markets, and in our Transactional Banking area where we continue to successfully leverage our lead bank position.

We achieved very good volume growth in both our lending and in our debt capital market areas. That growth has been more than off-set by both margin compression and the fee discounting that is taking place in that market, which by all measures is a very competitive space.

A clear strength of WIB's results was in Financial Markets. The foreign exchange area in particular benefited from the increased volatility that we saw in the half in our core market, and those core markets are clearly the Australian dollar and the New Zealand dollar.

The higher market volatility that we saw in the market stimulated active customer hedging which was great, and it gave us more opportunities to extract value from the risk management that takes place in those books.

Importantly, that result was achieved without lifting our risk profile, and we operate comfortably within the Board approved limits.

Overall, cash earnings growth in New Zealand was 4% in what has been a tough environment for us. Actually the balance sheet growth has been really excellent. We've weathered the competitive intensity in the mortgage market, and we've held our share there, and we've recorded good growth in business lending.

On the deposit side, our online savings account in New Zealand has also been very successful both in attracting customers and in growing balances.

If you look behind the results you can see two sources of pressure for us in New Zealand. The first has been the ongoing migration of customers from floating rate mortgages to the substantially lower margin fixed rate mortgages. This shift has really gathered steam over the last 18 months as borrowers, I think quite logically, reacted to the rising and volatile interest rate environment by locking into fixed rate mortgages.

When we started this period we were significantly under weight in our fixed rate proportion compared to our peers. You can see that migration has pretty much run its course, and we're now back very close to being in line with the industry average. But we're still enduring the full year impact of that, and our housing spread declined 15 basis points over the prior corresponding period.

The second impact for us has been on fees. Our customers have actively adjusted their behaviour to minimise their fees. Our response has been threefold. To provide overall greater value to our customers, and additional flexibility in the way that we've been able to offer them packaged products; to increase sales, particularly through the branches, though a better lead identification and lead management system; and to increase overall volumes by providing incentives for lower cost channels. We reduced our fees on Eftpos transactions.

As David [Morgan] said, BT has continued to be a stand out performer, and I think you could arguably say they've had fantastic market conditions to support them. But when you look at our performance, it's really been built on growing shares in key wealth segments. In the categories like WRAP administration, or corporate super, we're continuing to grab share. In margin lending, we've had very strong growth, and in online broking, we've similarly have had strong growth.

At the same time, BT has actually breathed life back into our advice channel. Our planner productivity is now up 29%.

I think one of the other features of the BT performance is on expenses, where, despite the volume growth that we've seen, we've been able to hold cost growth, and we've done that largely by increasing the amount of straight through processing that we're able to achieve in that business area. So overall cost growth in BT was just 2%.

The Group Business Unit increased its contribution by $30 million over the prior corresponding period. As has been previously advised to this group, this business unit carries a lot of the noise, backing out some of the accounting anomalies. If we look behind that, the core performance is built on a number of components. Firstly, our treasury earnings, which were $63 million higher than a year earlier and $28 million higher than the prior period. Offsetting that performance were 1) lower earnings on surplus capital, and that followed the $1 billion buy-back that we conducted in December and 2) the increase in our tax charges, including the additional $61 million tax revision in the half.

So we've generated almost $600 million of surplus capital over the half, and I think that's an excellent result, and quite frankly, a testimony to our strong cash generating capability. That position gave us the confidence to lift our buy back by $300 million, and to lift our dividend by 14%.

When I look ahead in terms of capital management, I think there are a number of factors that we're going to work our way through. Firstly, there's the full and ongoing impact of AIFRS, including the transition arrangements that we agreed with APRA.

Definitely we need to consider what are the appropriate capital targets that we should operate under for that regime, and that will in part be affected by the first item.

Further, we've got to weigh up the impact of the new innovative, hybrid arrangement. And lastly we've got to look at the expected impact of Basel II in 2008 and beyond.

If we take the most conservative estimate of our capital ratios, and that is take the A-IFRS numbers and assume that there are no transition arrangements with APRA, then you would have seen our key ratios of ACE, at 4.7% and Tier one at 6.5%; both still very comfortably within the range of the existing targets. So by any measure we are well capitalised.

We lifted our dividend by 7c to 56c per share, and increased our payout ratio to 69%. Over the half we've also conducted a major review of our dividend policy, and we've looked to consider what are the real factors that drive our payout. Importantly the principles of the policy remain the same. We're looking to grow sustainably our levels of dividend, and we're looking to maintain 100% franking.

One of the changes from the review, however, is our position on new share issuance. Fundamentally we will continue to aim to absorb new share issuance by periodic buy backs. However we are prepared to tolerate some EPS dilution from time to time to ensure that we deliver a timely return of franking credits.

Before handing back to David, let me recap the highlights of these results. We continue to increase our cash EPS and our cash earnings at the upper end of major bank peers. We're achieving a leading ROE position and we continue to create a healthy franking surplus. Our result is built on a foundation of strong revenue growth and disciplined expenses. We've demonstrated our capacity to derive further efficiency improvements.

Finally, despite all the noise from A-IFRS, our capital generation is a standout. The $580 million in additional capital has enabled us to confidently increase the dividend, whilst maintaining our financial strength.

Thank you, and let me hand back to David for the wrap up.

David Morgan, Chief Executive Officer:

Thanks Phil. The outlook. Looking ahead as far as the world economy is concerned, it's facing some challenge of higher oil prices and some political instability, but notwithstanding that, growth is likely to remain above par for the course, for the consecutive year.

Back here in Australia, inflation is getting close to the top of target ranges, not surprising in the view of unemployment being at 30 year lows, and obviously was responsible for the tightening of monetary policy announced yesterday. Notwithstanding that, I'm still confident that we can look at growth around 3% in Australia, this calendar year, up from about 2.5% last year.

In New Zealand, a tougher situation, and we're expecting, following growth of more than 2% last year, to something below 1% in the current year.

Overall, that means that credit growth here in Australia over the 12 months through March 07, on a through the year basis, we're expecting overall credit growth to reduce from a rate of around 14% to around 12%, 12 months later in March 07. Compositionally, that might be made up with household credit growth remaining fairly constant at around 13%, however in terms of business credit growth, that looks poised to decline from 17% in the 12 months to March 06 to something closer to 11% by March 07.

Note that that is still a reasonably healthy overall credit growth rate at 12%. Given nominal GDP growth of around 6%, if that turns out, it means that notwithstanding the end of housing boom, we're still looking at a credit multiplier of the order of two.

In terms of the competitive environment, out there it remains intense. Competitors are expanding their footprints. There are more feet on the street than ever before. Price has been increasingly used to attract business, and there is competition for talent that is intense.

On the regulator front, compliance requirements remain heavy. As far as we're concerned, we are confident that the various international harmonisation challenges in the regulatory space are under good control. We have had some significant progress on other key regulatory issues, notably in New Zealand.

So overall on the regulatory front, still a heavy burden, but we're starting to see some light at the end of that tunnel.

We have a strong growth platform in place. In terms of wealth management, in my view we acquired well with BT, we integrated it well, and it's been very well managed post integration. We have superior platforms in place, and those and the increased cross sell into the Westpac customer base plus first quartile investment performance, means that those consistent market share gains that you've seen, should be able to be continued.

In terms of retail, we have a large high quality customer base with significant untapped potential. We are better positioned than we have been in the past to tap that potential. The majority of that additional of 500 front line personnel that we put in place last year has been in the Business & Consumer bank. Moreover, we have a well advanced program to release significant back office jobs for redeployment into the front line over the course of this coming year.

Finally, we've had major investment in Reach and Pinnacle. Reach is delivering well. Pinnacle we have worn the implementation pain, and that is now poised to deliver the full potential that it promises.

In terms of the corporate space, we have back our number one lead bank share position. We also have a superior transactional banking platform and capability, and a very strong infrastructure funds management capability in our specialised capital group, and Hastings which we now own 100% of.

So Westpac is in a strong position. Momentum has been restored, impaired assets are lower. We have strong provisioning for all known risks, and our capital ratios are strong.

I am very positive about the outlook for Westpac. We have the right team. We have the right management discipline. Our franchise health is strong: first quartile employee engagement; satisfactory progress on customer satisfaction; world leading position in sustainability; and sector leading EPS growth and ROE. Accordingly, I am confident that we will continue to deliver strong outcomes for our shareholders.

Thank you for your attention. Phil and I would now be very happy to take your questions.

Question & Answer

Andrew Bowden: We will take questions here but I will ask everyone to limit their question to one at a time first, and wait for the microphone first. I think Brian had his hand up first. Brian.

Brian Johnson, JP Morgan: A technical question for Phil. Phil, if we have a look at the collective provision, which I still kind of think as being a general provision, now sitting at the princely sum, if we take out the tax benefit, of about 39 basis points of risk related assets. While APRA haven't come out and formally made a ruling on this, the initial guidance was that they suggested that a minimum general reserve for credit losses should be established of 50 basis points over and above the collective provision. Can you confirm that the $78 million increment that you vaguely referred to is in fact a general reserve for credit losses?

The second question is that if I have a look during the period we had a $10 billion increase in risk weighted assets, and yet you're saying, I'm assuming that there was no increase in that $78 million over the period which would have reduced the cash distributable earnings figure. If in fact that is the case, why is it that the implied general reserve for credit loss coverage is actually falling? It does reduce cash distributable earnings.

Philip Coffey: Yes, but let me deal with a couple of the issues. Firstly, in terms of APRA, there's no doubt that they have indicated a benchmark of the general provisioning of around 50 basis points of risk weighted assets. They've indicated at every benchmark discussion, and so they should, because it's a pretty basic indicator to use risk weighted assets on the basis of 100% or 50% type risk weighting. And you should expect that organisations like Westpac have got a much more sophisticated credit assessment methodology, and that we discuss that with APRA, and even more so now, than in the recent times, as we move towards looking at the impact of the introduction of Basel II.

So in those discussions, we've landed on an approach, which basically led to the collective provisioning levels that you saw. Then when we looked at that, we then said, well what about losses that we would like to provide for but the accounting treatment does not allow us to account for; that we expect to see, but where the incurred accounting treatment doesn't let us do that. So we took a capital deduction of after tax $80 million on transition [in October 2005], to provide for that risk.

When we did the assessment at the end of March, we decided that it would still be an appropriate deduction to take. If we vary that, then I could understand why you would argue that that might come out of your earnings calculations. We didn't vary it over the half, and so we didn't make an adjustment to that.

Did I answer all of your questions?

Brian Johnson: So it will be from cash earnings going forward?

Philip Coffey: If we adjust that deduction, yes. I can see why that would be the argument.

Brian Johnson: And that would come out of disclosed distributable earnings?

Philip Coffey: Yes.

Nick Selveratnam, Credit Suisse: When you look at your numbers, March 06 versus March 05, the year on year increases seem strong, and that's prevalent in most lines. However, when you look at it sequentially at March 06 versus September 05, the line by line items and the total is significantly less impressive. I wonder if you could, and in some cases flat. I wonder if you could talk us through whether there are some concerning trends, and perhaps could answer, I seem to recall last year there was some dialogue on seasonality of your results, and some difficulty with us perhaps fully comprehending why; is that part of the reason.

David Morgan: Nick, can we take that in two parts? Let me make a couple of general points first, and then there are a couple of very, very important points that Phil [Coffey] will want to make on both what is appropriate like for like comparison.

There are no concerning trends Nick, since over the last three halves, we have had an improving trend in terms of our underlying core business over those three halves, abstracting from seasonality. So structurally, we have had good momentum over the last three halves.

In fact, and even within the last half, Nick, which is obviously not evident from the numbers, we had a much better second quarter than we had a first quarter. So in terms of the structural momentum of the business over the last 18 months, there are no concerning trends; on the contrary the trends were encouraging, including the intra half year trend in the latest [half].

Secondly, you're quite right. There is seasonality as between our two halves traditionally. We have, in previous investor discussion packs, shown that seasonality half and half, and we're happy to include that again. However, I think there are some additional corrections that need to be made this time around to give a proper immediate prior period comparison. I think when we do that proper immediate prior comparison, the revenue growth on immediate prior period is much closer to 5%, and the cash earnings growth with a properly based comparison is again 5%. In other words, both annualised would be 10%.

Let me ask Phil [Coffey] just to explain why those are the best numbers for a comparison over immediate prior period with both revenue and cash earnings. It's very important, so I want us to take some time with this, because you're quite right, prima facie on comparison it looks like revenue is completely flat on the immediate prior period, and similarly not much better with cash earnings.

If we can take some time with this, because it really matters.

Philip Coffey: I tried to emphasise in that revenue chart how the reported picture for the growth over the prior period starts at zero and ends up at five, it's on my slide five. You can see that clearly the biggest impact is in fact the AASB132 and 139 impacts on the revenue line, which when you take that impact out, changes the picture from a 10% growth over the full year with flat on the half, to 11% growth over the full year, and 5% on the half.

Then there are a lot of other one off factors, that at the end of the day, whilst they are significant for individual halves, you can see that we end up dropping to the bottom line, where once again, the growth in operating income over the prior period is around the 5% mark.

When we look at that in a cash earning sense, that's the major driver of the change. A couple of other factors that actually drive the change when you look at the half are the tax on the Life Company earnings, which obviously have changed to half on half. Also if you look at the WIB result, you'll see that one of the big impacts in the comparison of the prior period, is the swing around in the impairment losses line, where the impairment loss line for WIB the second half last year was very low. And we would have said uncharacteristically low. It's not the kind of loss picture you'd expect from an institutional bank and moving back to I think in the last half the charge of $40 million odd is about what you would expect, but that has had quite a big impact on the cash earnings picture.

When you walk through those changes and you look at what the half on half picture is, we would say the picture where it's a seven and five picture. So 7% in the half, and 5% in the most recent half, in terms of growth and cash earnings, giving us a total of 12%.

Hamish Carlisle Merrill Lynch: Look, I have a question around financial markets income. The reported number is up massively on last year and last half, and reading through your commentary, you're attributing part of that to the change in accounting, which looks to me to be a number of around $70 million benefit. I just wonder whether you could comment on what that $70 million was, and more importantly, whether you viewed it as a sustainable step up, as we move forward.

The other question I have was just in relation to the difference between the product income you're pointing to and the residual, which I assume is the head office trading or treasury type function. I wonder whether you could just comment on what you viewed as a mid-cycle sort of level of group centre balance sheet management revenue.

David Morgan: No doubt we've had a good trading result, and we tried to give as much of the detail behind it to help you in understanding that. The financial market's picture, which we gave basically, showed the total financial markets product income was up by just on $84 million and a large part of that was due to the foreign exchange earnings. We've had trading gains as well in our treasury operation; they flowed through in the trading income line, and in that specific banking. All those have contributed, as has the transition arrangements in the accounts.

In terms of what's a more reasonable level of treasury earnings, that's a tough one for us, because in the transitioning to AIFRS we achieved two things. First of all, we achieved a very good level of hedge effectiveness. So one of the things we set out to do when we looked at our treasury books was to try to reduce the amount of noise that comes through from hedge ineffectiveness. In the half, the impact of hedge ineffectiveness for us was only two million dollars, which is a lot less than what other banks have had to experience. So we've set our books up I think very well, and we would hope to see that that would be controlled going forward.

One of the flipside consequences of that is that we have more books and more instruments that are fair valued, and therefore we will get more volatility coming through the treasury line as a consequence of that.

Now we're comfortable with that, because we actually set out to manage the risks that come through that movement in market, and so we're absolutely focussed on doing that, rather than just saying, well the fair valuation winds will blow us whichever which way.

In terms of the result, clearly it was a big one for us in the half. Our earnings in treasury were up $28 million over the prior period, and that's a good result for us. It is a consequence, as I said, of both additional instruments that we are managing, and the overall success that we had with doing that.

I'm not going to try to estimate today what I think that that absolute number will be. You will have a better idea as we work our way through that.

Hamish Carlisle: Phil, can you just be clear on the $70 million lift related to the transition under 132 and 139. It appears to have come out of the incomes. Could you comment explicitly on what that is?

Philip Coffey: That $70 million is the difference between reported trading income and the underlying trading income.

Hamish Carlisle: No, it's the difference between your reported trading income including 132 and 139, and excluding 132 and 139?

Philip Coffey: There are a whole range of individual items that flowed through. Some of them fair valuation and securities, and some of them other pieces of accounting transitions. I'd be really happy to go through that in detail offline, but I don't have all the facts here.

Ross Brown from Deutsche Bank: A question on New Zealand, but it's just in two parts. The first, the currency hedge, was at 1.09 I think for the first half in New Zealand? I presume you've got a similar hedge for the second half, and if you could indicate what rate that's at. And, am I right in assuming that into 2007, there's zero earning hedge because of AIFRS?

Then, a follow on question in terms of the operational environment in New Zealand. I note the outlook statement about expecting some modest improvement in the earnings growth. Given we haven't seen the flow through yet of economic slowdown in terms of credit growth and bad debt, how confident can you be about that pick up in New Zealand earnings?

Philip Coffey: You're right. We have got our second half for New Zealand earnings hedged, and it's probably around 1.09, but I don't have the exact number on me. I'm just getting a nod. You're right, because of A-IFRS, we're not able to get hedge accounting treatment going forward. I think that's a good example where we have to deal with the economic risk versus the accounting implications. The economic risk clearly is that there'll be, from time to time periods, when the New Zealand dollar is clearly overvalued and we would look to take foreign exchange hedge cover in that. We won't get the hedge effectiveness, but economically that's what we'll be looking to do. We'll be advising the market at the end of the period how much foreign exchange transactions we've done in that regard. But that will be a time for time exercise, rather than having a fixed proportion of future earnings being hedged.

Ross, on the second part of your question, about New Zealand operations. It's a tough market and we've done a good job on volumes. We've done a good job on expenses, and we think that catch up on the margin crunch from the fixed to floating, which has hurt us disproportionately, has just about run its course. However, that said, as I tried to say in my outlook about the New Zealand economy, I think there are some serious risks on the downside there with the economy. They have had a much more aggressive tightening in monetary policy than we've had here, in a more narrowly based and less resilient economy.

Unless they ease off with the same alacrity that they've increased, then we could have a worse outcome a bit under 1% that's implicit in the forecast. So yes, as you're saying, are the risks downside there, I would absolutely agree.

James Freeman, Goldman Sachs JB Were: Phil, I just wanted to get a little bit more clarity around the tax provision. Last half we had $48 million coming from an onerous tax environment. Now we've got another $61 million. Is there any more coming next period? I guess what are the actual future use of these tax provisions and how will you be releasing them?

Philip Coffey: As I mentioned, we've got three impacts of tax: structured finance, the large company earnings, and then the provision. In terms of the provision, on a quarterly basis we look at all the tax risks that are incumbent in our book, and we probability weight the likely outcomes of those risks, and we then adjust the provision for the probability weighted impact that would give us.

You're right, the last two halves have affected our interpretation and therefore through the probability weighting of where certain outcomes might land. Should we get used to it? I would hope not, but it will really depend on the outcomes of how we move. There are a large number of issues that we're in discussion and multiple geographies and so we are trying to get the composite picture there for that.

James Freeman: Is any of this relating to the tax liability in New Zealand?

Philip Coffey: Not specifically.

William Ammentorp, Macquarie Equities: Just a quick question for Mike Pratt. Obviously the mortgage business has gone through a lot of up and downs in the last two years. About three years ago you highlighted in a strategy presentation, that if you looked at the profit pool analysis, there was a significant gap between the market share of Westpac's mortgages and the profit pool that existed in that marketplace. Given the increased use of brokers, Westpac's not playing in the higher margin low-doc space to a great extent, and other factors rolling through, including some market share losses.

Can you update us three years on, how you think you sit? Have you closed that gap in the mortgage profitability pool versus the mortgage market share?

Mike Pratt, Group Executive Business & Consumer Banking: Thanks William. Of course in three years time the markets moved as well significantly and we've seen quite a significant decline in mortgage margins, as anticipated over that period.

In terms of our current structure though, I think at the moment our positioning is where I'd like it to be. We are doing around system [growth]. In this market now, I think around system is a good position to be in. The reason I say that is that if you are looking to grow overly aggressively in the mortgage market, you are giving away, in terms of what I'm seeing, far too much margin.

So I think we've got the mix right pretty much. I would like to see our own productivity improve further in our first party channel. You've seen in the notes today significant improvement, which we committed to in first party. There is still more room to move there, and that's very much around the technology pieces. So there's further upside on the sales productivity.

On third party, I think one of the things to remember there is that we have somewhat of a different model to a number of other players in the market. We're doing over 60% now of third party flow online. Of the top ten aggregators in the industry, we are the largest player online into those top ten aggregators. The industry average for interest in that is about 35% of flow online.

Now the benefit of that is clearly costs down in our office, and also costs down in the broker's office, which is an advantage to them. The other aspect of that, is we have really focussed in on those top ten aggregators, and that of itself is an advantage, rather than dealing through what is still a couple of thousand odd brokers in the industry. We still deal with others, of course, but 80% of our flow is coming from the top ten in the industry.

The third aspect of the broker piece is that we actually fulfil through our branch. So when the mortgages originated and it's time then to draw down and have those arrangements completed, that happens through our branch. That is an opportunity for another needs conversation, and a further wallet check. If you look at the product share on the back of a third party mortgage, it's actually improved quite significantly by this concomitant action that we've taken.

William Ammentorp: Sorry, maybe I am being an American or I am being obtuse; so have you increased your share of the profit pool?

M Pratt: Yes we have. Yes, definitely.

William Ammentorp: Is it still a significant gap?

M Pratt: Look, in terms of where I see the opportunity growth, if we can do around mortgage system growth as I've said, then we are comfortable with that. The opportunity remains for us still in that SME sector that Phil and David were talking about, to grow there, because that is a bigger profit pool in terms of where our opportunity is. We are growing, for example, in SME still at around 0.6 of the market system. We are growing above system in our middle market area. If you look at the total debt market profit pool in SME, it's about 60% of the total debt profit pool. So if we can improve that now in the second half and beyond, through the Pinnacle capability, that is the big opportunity for us, rather than the mortgage space. Does that answer your question?

William Ammentorp: Sure.

Mike Macrow, INVESCO; Firstly David, thank you for the increase in the dividend pay out ratio. Secondly, given that you've got 18 months more in the chair, I wonder if you could give a bit more detail around your goals on recovery of the SME market share performance - what will happen in your remaining tenure?

Finally, just on the cost side, I think the composition disappoints me a little that it's the low cost growth figure is the line upon non-personnel costs, how confident are you that that sort of trend is continuable or sustainable?

D Morgan: Thanks Mike. I think I had foreshadowed at the full year, Mike, that while I expected us to be on system for the full year, in SME that we would be below system in the first half, but certainly at system in the second, since we're still working through the Pinnacle issues in SME. I will still be expecting that to occur, that us to get at least system growth in the SME now that we have definitively resolved the issues with implementation of pinnacle in that segment. Phil, do you want to take the costs?

Philip Coffey: So, on the cost, Mike, the amortisation expense is probably going to pick up a bit in the next half or two, and so we have to deal with that. But there are a lot of other factors that are helping us in dealing with those underlying expense pressures. As I mentioned in the presentation, the outsourcing arrangements that we've had, have allowed us to be the customer and allowed us to achieve expense savings. We are quite a long way through this investment cycle, so that's one of the things that gives us confidence around how that expense picture is going to look over upcoming halves.

Will we see a potential pick up in those other lines? That's possible. I mean, it's very hard to hold them flat half on half on half, but it still feels to us like we are in good shape, as I said, to deliver expense growth around that kind of 4% per annum level, other things being equal.

Jeff Emmanuel, UBS: David, a question on non-performing loans. I saw the slide and the reversion back to a more normal level, but the 90 days overdue has ticked up. I think it's almost doubled over the half and full year, up to $500 million, and a lot of it's in the other products, the non-housing. I'm just keen to get an update broadly on credit quality. And, is this specific to the institutional business and Australia, or is it a bunch of items?

Philip Coffey: Why don't I take the specifics and then you would talk on credit quality, David. In terms of specifics, in the investor discussion page, there's a slide on overall credit quality, and we look at stress loans in total. So we look at the three components of that. So, impaired, the 90 days plus overdue but well secured, and then the other watch list and substandard loans. You will see in that that the half finish, basically, in terms of the total of our stress loans, as a percentage of our total commitment, is basically flat with where we finished at the end of September. So there's been some shift in the composition, so we've grown in terms of 90 days past due but well secured, and we've actually shrunk in terms of watch list and substandard, and our impaireds are actually slightly lower as well. So the total picture of our stress loans actually still feels very healthy for us.

In terms of the individual components in that 90 days past due but well secured, there was one width exposure that added to that and a number of other smaller business bank exposures, but really that's a reclassification that's gone on as opposed to an overarching uplift in our stress loans position.

Jeff Emmanuel: When you actually look at the chart on page 88, even if you add the NPL, the growth NPLs in the 90 days over, you don't get flattening, you get a pretty sharp increase. But the numbers against September are $489 million and then $471 million for this half, on growth impaireds, and $281 million up to $500 million on the 90 days – halfway down page 88. So just that $162 up to $355 million.

Philip Coffey: Yes, so that's absolutely on the 90 days past due well secured. That's the items I mentioned in terms of the one width exposure and some other reclassifications in BCB.

Jeff Emmanuel: Is that the cross-city tunnel?

Philip Coffey: Well, you know we don't talk about individual exposures.

What was the other point? The impaireds are slightly lower, and then as you can see in that chart, the watch list and substandard is really where there has been an absolute decline as well.

Jeff Emmanuel: I guess I'm just trying to isolate whether it's one item or whether it's a broader set of loans drifting up into 90 days?

Philip Coffey: No, it's one item in width and some other items in BCB.

David Morgan: So just overall, is there anything that we're seeing either in actual bad debts or, more importantly, the forward indicators of those in either the transaction managed book or in delinquencies? There is nothing that we are seeing that is other than what we'd expect with terms of a normal cyclical pick-up plus some seasonality in those delinquencies plus the statistical effect of the number of delinquencies over some slower home loan growth for the system as a whole, nothing that wouldn't be predicted by our modelling, nothing that wouldn't be expected from all of our analysis.

Now, obviously, eternally vigilant but there's nothing sitting in there that's out of line with our expectations at this point in the cycle.

Craig Williams, Citigroup: Perhaps a question for Rob Coombe, if I could, just around the BT business. Could you perhaps make some comments around seasonality and revenues in this business? Growth rates year on year have been terrific; that hasn't been as apparent looking at the half on half comparison.

Secondly, what progress is being made in terms of converting the better investment performance into retail managed fund sales? Also any sort of comments you make around bringing private bank into this division; is it actually in these results, and what sort of impact has it made to the divisional contribution?

Rob Coombe, Group Executive BT Financial Group: Okay. The business is seasonal, but performance shouldn't be massively impacted by seasonal impacts. So if I look at the seasons, the second half is normally a little bit stronger than the first half, and that's by virtue of the fact that you've got the silly season around super, which is the 30 June period and also the big spike up in margin lending and also managed funds volume. So you also have much more working days in the second half as well. So there's a greater focus, so there is some slight seasonality.

In the figures that have come out, I can understand why it looks a little bit more seasonal than what it is in reality. If you look at your packs on page 50, where you're comparing the first half with the second half, it says, for the JDV sale and the termination of the Life Company benefits, the cash earnings grew by 4% in the second half; in fact, that adjustment was just for the JDV sale, and if you did include the termination of the Life Company benefits, the cash earnings would have grown by closer to 8%. If you also reflected the impact of Cyclone Larry, which hit in the second half on the general insurance business, it would be closer to 12% growth half on half. So I think that that's just given you a misleading impression of seasonality. There's not that much seasonality in the managed funds industry.

As far as converting good performance into flows, for our go-forward products, which is basically [unclear] institutional market, and also through platforms, as we all know, 80% of flows are going that way at the moment. We were net inflow in the half of $800 million. However, we still have a very large retail book; we're just running off one of the largest retail books in the country. That's in secular outflow, so that was outflow of the $800 million and the net flow situation was flat through managed funds. We're expecting that to significantly improve. There are a couple of reasons for that. One is, we were selling into the market with one arm tied behind our back with let's say a poorly rated international alliance, which we've replaced, as I'm sure you're all aware of, and we think that will trigger some significant inflows into that category. We also have had a number of positive re-ratings on our Australian equity capability and movements in the model portfolios on platforms as well, which we think will trigger into improved flows in the second half of this year as well.

In relation to the private bank, it hasn't moved into BT yet; won't do so until 1 July, and the P&L won't move until the end of the financial year. The intention there is not to lose the focus that it has at the moment on servicing banking needs to high net worth individuals, but just accommodating or putting much greater wealth focus on the needs of those clients. So, just lifting up the products that we can offer to those clients and also the advice that we can provide to those clients particularly given a lot of their needs are: how do I invest as opposed to how do I borrow.

Brett Le Mesurier, Wilson HTM: Over the past year the cost of your retail deposits has been increasing but the cost of your wholesale funding has been decreasing by about 30 basis points as the retail deposits have been increasing. Can you tell us the reasons why you've been able to effect that substantial fall in your wholesale funding costs, and whether or not you can continue to have that falling as your retail deposits increase – in other words, substantially offsetting the impact of the higher cost of retail deposits?

D Morgan: I think you'll find that the reduction in wholesale funding is a consequence of the fact that we actually didn't go back into the market last year. So there's probably some impact of the size of the balance. But in general, we would have expected that our cost of wholesale funding would have dropped over the last year or two. I mean credit spreads on everything else have come down, and so our capacity to go into the global capital markets and cheap funding has improved as well.

Our view on credit spreads is that we're getting pretty close to the bottom of that cycle. And so over time, you would actually expect that we might bump along here for a bit longer. We might get even lucky enough to get another year of very finely priced wholesale funding. But over time you would expect that to pick up.

I'm not sure globally we'll ever go back to the kind of levels that we saw three, four, five years ago. I think there's so much global capital that exists in the system today, I just can't see the spreads going back to you know borrow, those bad old days. But I would as I said, I would expect that that will over time probably widen out in offshore too, Brett.

Jarrod Martin, ABN AMRO: David, could I get your comments on whether it's been a tweaking or a changing to your pricing strategy? I note on slide nine that you are looking to be price responsive. Previously you've wanted to really have a focus on holding margins. What's the risk that you have a more significant margin decline, and also that you pick up I suppose greater bad debts at this time in the cycle?

D Morgan: That's a very fair question, Jarrod. It's absolutely a pretty, fine tuning, Jarrod. We haven't abandoned our risk disciplines or anything like it. We haven't abandoned our focus on profitable growth. What we found was there was a lift in competitive intensity. And we had to be more agile if you like, and more responsive in making sure that we were meeting the market.

So it is really unambiguously a fine tuning, and I'm very confident that once you get – you've probably got enough results in now to see what our margin performance, these would be our findings, but the evidence is absolutely consistent with that.

Jarrod Martin: And on picking up bad debts at this time in the cycle, you don't think there's any risk of picking up further bad debts with increasing to more system asset growth?

D Morgan: I mean this is the point in the cycle where a lot of bad debts get written down. If there's any bank in the country that's aware, we're acutely sensitised to that, it is us. I mean we have absolutely stayed true to our determination, Jarrod. When that downturn comes, we will be second to none in terms of the major bank sector as we go into that, in terms of risk positioning and positioning.

We've worked too hard and too long to squander that for a few points of market share late in the cycle, and we won't do so.

Matt Davison, Merrill Lynch: My question was on New Zealand. You've flagged the migration of the mortgage book, and you've flagged some migration of customers from higher fee products. If we look at your ROE in that business, it looks to be the highest it appears, and it looks to be above 40 per cent. I just wanted to get a sense for whether there are any other vulnerabilities in terms of the product set, and migration issues in that market, or whether you've seen the worst.

D Morgan: Matt, I think we've seen the worst. We have absolutely been quite aggressively, both pricing down where we've been at the high end in terms of certain fee categories or shifting our customers to lower fee products. And that's taken a hit in the short run, but we're expecting we will get that back through customer satisfaction, customer retention and cross sell. We are largely through that, Matt, not wholly, but we are the majority of the way through it.

Andrew Bowden:

Well thank you very much for attending.

D Morgan:

Andrew, can I just say in conclusion, just picking up the questioning, and thank you for the questioning. Firstly on that immediate price area, I just want everybody to be clear on that, because absolutely it's easy to have that reaction going first through about how flat it looks on both revenue and cash earnings and of all the potentially misleading things from all the noise around IFRS, that was the greatest probability and certainly on my first view of the draft, I exactly had that reaction. But rest assured when we go through, the like to like comparison is a ten per cent annualised growth in revenue and cash earnings.

To both James [Freeman] and to Brian [Johnson], it's my certain knowledge and I hope you too, James, know that we would never, whatever we would do we would not go under provision for known risks. So in terms of this provisionally for credit, including exhaustive discussions with APRA, we have satisfied ourselves, and we have satisfied APRA that we are fully provisioned for known risks.

And James, to your point about is there more of the same coming down on the tax, again when we provision, we provision very fully. As fully as our auditors allow, and we really want to do this once and do it right. We can't say never, but I have to tell you, I would be extraordinarily, extraordinarily surprised if we have to do any topping up of what are now very, very ample provisioning. The last thing is I'd like to thank you all; this has been my fifteenth result. It's been number one for Phil and I did bring this hat along but he didn't need it so you are a very, very nice group so thanks for the session.

Andrew Bowden:

Well thank you very much and good afternoon.

[END OF TRANSCRIPT]