BOQ Group Market Update 2021

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Speakers: George Frazis, Managing Director and Chief Executive Officer
Ewen Stafford, Chief Financial Officer Chief Operating Officer
Craig Ryman, Chief Information Officer
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Transcript:

Operator: Thank you for standing by and welcome to the BOQ Group Market Update 2021. All participants are in a listen only mode. There will be a presentation followed by a question and answer session. If you wish to ask a question, you will need to press the star key followed by the number one on your telephone keypad.

I would now like to hand the conference over to Cherie Bell. Please go ahead.

Cherie Bell: Thank you and good morning everyone. Welcome to this morning's market update. Before we begin, I would like to acknowledge the traditional custodians of the lands upon which we meet today and recognise elders past, present, and emerging.

Thank you for joining us for this morning's audio webcast. Joining me today is George Frazis, our Managing Director and CEO, Ewen Stafford, our Chief Financial Officer and Chief Operating Officer, Craig Ryman, our Chief Information Officer, and members of BOQ's executive team and senior management.

Due to legal restrictions, we are unable to discuss any details around the capital raising other than the basic terms referred to in the announcement and in this presentation. Please refrain from asking questions beyond the specific details of the capital raising as we are legally restricted from answering those questions on this call.

I will now hand over to George to provide an overview of the transactions and an update on our progress against our strategy.

George Frazis: Thanks Cherie and good morning all. Thank you for joining us on an exciting and extremely important day for BOQ as we finalise what will be a defining acquisition for the Company.

Today, we'll provide you with the details of not only a game changing acquisition of ME Bank and a capital raising, but also show you how our strategy is already paying off, as seen in our improved financial results for the half and improved outlook for the full year.

As many are aware, we are 18 months into our transformation strategy and our acquisition of ME Bank is a major step in making us a compelling alternative to the big banks. Together, we'll provide better customer experiences, greater opportunities for our people, and increased value for shareholders.

The transaction will be funded by a fully underwritten $1.35 billion equity raising consisting of a $350 million institutional placement and a $1 billion pro rata accelerated non-renounceable entitlement offer. We expect the acquisition to be completed before the end of BOQs 2021 financial year, of course subject to the treasurer's approval.

Turning to slide 11. Let me tell you why this transformational acquisition is strategically and financially compelling. Firstly, it delivers material scale, broadly doubling the size of the Retail Bank, increasing our customer numbers to almost 1.5 million, and increasing our retail net profit contribution to greater than 50%.

This gives us a platform for growth that is more capital efficient. ME Bank is also a highly complementary brand with strongly aligned values and today we're bringing together three brands that people love: BOQ, Virgin Money, and ME Bank.

Importantly, it will result in the diversification of our geographic footprint along the East Coast with each of our brands having differentiated customer targets that have minimal overlap.

From a financial perspective, in the first year the acquisition is expected to be low double digit to mid-teens cash EPS accretive and more than 100 basis points ROE accretive, including full run rate synergies. We expect to deliver annual pre-tax synergies of $70 million to $80 million by year three, driven by the alignment of our operating models and common core banking platforms.

The digital transformation is well underway and one of the key strategic benefits of this acquisition is that both organisations are on a Temenos platform. Next month we are launching Virgin Money on the latest cloud based Temenos core banking platform which will become the common platform for all our retail brands going forward.

Operating on a shared platform allows us to leverage the capital investment envelope across a broader base. And importantly, leverages Temenos' ongoing global innovation through continuous cloud upgrades to deliver best in class customer experiences. This improves our competitive position going forward.

Turning to our trading update on slide 12. As I mentioned earlier, we are beginning to see the strategy deliver meaningful results. We anticipate a strong financial result for the first half of FY21 with statutory net profit growth of 60% to 65% PCP to between $149 million and $154 million.

Cash earnings growth of between 8% and 10% PCP to between $163 million and $166 million. This is with the collective provision maintained at $270 million and driven by strong housing growth above system whilst also improving margin.

NIM is expected to be up three basis points on the second half FY20 NIM, delivering positive jaws for the first half of 1% PCP. Loan impairments are returning back to normal levels. The first half FY21 loan impairment expense to GLAs of 10 basis points.

Our customer loan deferrals for both home loans and SME are now well below 1%. Our balance sheet is strong. Having generated organic capital with CET1 expected to be above 10%. The interim dividend is expected to be $0.17 per share, subject to the Board's final determination. Importantly, shareholders participating in the capital raising will be entitled to receive the first half dividend.

Moving now to slide 13. The Retail Bank turnaround has been driven by strong housing loan growth momentum across both BOQ and Virgin Money. Our Home Buying Transformation program and the improved time to conditional yes has driven a material increase in our housing loan portfolio, with net growth of approximately $650 million expected through the Retail Bank in the first half.

The new cloud-based Temenos core banking platform for Virgin Money had a successful soft launch in December, with a full launch for transactions, savings accounts and credit cards planned for the next month.

Pleasingly, as outlined on slide 14, the improved financial performance sets the scene for why the acquisition is so compelling, and is a defining moment in the delivery of our transformation. At the core of both businesses lies the purpose of helping all Australians get ahead, and creating prosperity for our customers, shareholders and people.

For those of you less familiar with ME Bank, it's a Retail Bank comprising of 99% home lending, with net balances of $26 billion. Made up of 75% owner-occupier, 87% P&I, with an average origination LVR of 59%, its products are distributed 70% to 75% via brokers, and the remainder through mobile mortgage lenders and contact centres. It also has $17 billion in deposits and a strong brand, in the top 5 NPS for the past three years.

This is a business we know how to run well and is very complementary to our business. We see the ME Bank acquisition as having a very close alignment to BOQ's strategic priorities. Our five pillars remain at the core of the strategic transformation, and ME's culture, brand proposition and digital roadmap all align.

Importantly, the ME customer segments complement those of BOQ and Virgin Money. Meaning we can drive continued customer growth with minimal to no overlap. Culturally our purpose and values both promote the growth and development of our people and this acquisition will realise greater opportunities for our team members.

Moving to slide 15. The really big news today is that this acquisition provides us with significant scale. Combined the Group will have a pro forma GLAs of more than $73 billion, total assets in excess of $88 billion, and total deposits of more than $56 billion. On a pro forma basis we expect to generate revenues in excess of $1.5 billion per annum, and cash net profit after tax of more than $400 million.

Our customer base will increase by more than 50% and be close to 1.5 million customers across the Group, presenting greater scale and opportunities for growth. The pro forma CTI is estimated at 56% pre-synergies, which we expect to reduce as the synergies begin to flow through. The combined business will maintain a strong capital position, with pro forma CET1 ratio of 9.8%. Further the cash return on equity is 7.6%.

Turning to slide 16. ME will remain headquartered in Melbourne. Its focus on Victoria and New South Wales complements BOQs traditional Queensland base footprint. We will be better geographically diversified with 31% in Queensland, 29% in New South Wales, and 21% in Victoria. It also increases our proportion of profit from retail, and rebalances the split between retail and business banking, enabling our growth to be more capital efficient.

As outlined on slide 17, the ME brand will enable us to target new customer segments with an attractive brand and customer value proposition to grow our housing portfolio. Each brand has a clearly differentiated geographic footprint and target customer segments, with minimal overlap. Working together will bring collective benefits to the Group, which is another reason why this acquisition makes good sense for BOQ.

I am truly excited about the opportunities ahead of us as we continue on our journey to transform BOQ. I look forward to the ME team joining the BOQ Group family. We also have the right leadership team in place to deliver on the transition on the strategy with significant experience in integration and transformation projects.

Thank you all for your time this morning on such an important day for BOQ. I will now pass to Ewen to take you through the financial benefits and integration program.

Ewen Stafford: Thank you George, and good morning everyone. Before I go into the financial aspects of the transaction and our approach to integration, I'd like to add a little more colour to the first half update that George provided. We will be back in front of you on 15 April with the full details of the first half FY21 results.

But for now, and turning to slide 20, you will see we have built strong momentum in the business. Total housing growth will be approximately $800 million in the half, which includes a material turnaround in the Retail Bank and also includes a continuation of housing growth of $200 million in BOQ Specialist. This balance sheet growth, combined with capital margin management, which has seen NIM increase over the last three halves, will drive an uplift in our net interest income to more than $500 million.

Touching briefly on the Banking Relief Package deferrals. We are pleased that the vast majority of loans have returned to performing, with less than 1% of our housing and SME portfolios remaining on deferral.

Moving to the financial highlights of the acquisition on slide 21. The consideration price of $1.325 billion represents a 1.05 times book value, and 11.9 times underlying earnings when adjusted for the COVID-19 provisions. Once you overlay synergies this multiple drops to 8 times. The transaction is expected to be low-to-mid teens cash EPS accretive, and more than 100 basis points ROE accretive in the first year, FY22, when you include the full run rate benefits of synergies.

We have estimated expense synergies to be in the order of $70 million to $80 million on a pre-tax basis, delivered by the end of year three. Integration costs are expected to be in the order of $130 million to $140 million, to be treated outside cash earnings and funded from organic capital generation.

Our commitment to maintaining a strong balance sheet is clear in the anticipated first half FY21 CET1 ratio being above 10%. On a pro forma basis the CET1 ratio of the combined business is 9.8%. Deposits alone ratio will be approximately 70%, and the liquidity coverage ratio and net stable funding ratio are expected to remain well above target levels. This has the combined business very well placed to grow and organically fund the integration and the broader transformation.

On slide 22 we provide further detail on our thinking with regard to the approach to integration and synergies. Given the complementary nature of the businesses we see scale benefits through the alignment of operating models and technology platforms, consolidation of shared service functions, and supply chain benefits.

75% of the $70 million to $80 million of expected synergies are targeted to be delivered within the first two years. In addition we believe there will be further upside from wholesale funding costs benefits, reduced investment CapEx, and revenue benefits from combining the two businesses.

Turning to the integration process on slide 23. We have developed a phased approach across four clear time horizons in order to maximise benefits, while reducing the integration risk and maintaining optionality. During the pre-completion phase we will collaborate with a team at ME Bank to co-design a program that ensures we maintain the uniqueness of their brand and culture.

We have identified a set of integration hypotheses that will guide our approach to co-design. Including, the ME brand will remain as an additional complementary offering under our multi-brand strategy. Team members close to the brand and customer will remain brand-aligned. ME's digital investment program will be incorporated into the existing BOQ digital transformation roadmap, and shared service functions such as finance, people and culture, legal, property and procurement and their supporting technology platforms will be consolidated early in the integration.

So I will now pass to Craig to provide more detail on the digital integration strategy.

Craig Ryman: Thank you Ewen, and good morning to everyone. As you've heard, ME has strong business alignment. This strong alignment also extends to ME's technology strategy, where their current focus is simplifying to one core platform, being Temenos Version 18, automating processes to improve scale, and accelerating their build-out of the digital channel with a focus on origination.

I thought it was firstly important to call out the current BOQs technology transformation, as this informs the opportunities that ME presents. We are building a new cloud-based digital bank leveraging Temenos. This is a best of breed technology solution incorporating APIs and microservices, as well as the newer Azure data and analytics platform.

As you’ve heard, we have successfully launched an end-to-end solution for Virgin Money at the end of last year, with a market launch on track for Q1. The next phase of this BOQ transformation is to deliver lending and mortgages with a key focus on origination.

Importantly, we are building this solution to cater for multi-brands, where we will maintain the essence of the brands and the customer experience, but leverage the scale of one technology solution and one operating model. This strategy creates a very ambitious and simplified tech solution, reducing cost of run, cost of change, and accelerating innovation for both of BOQ brands.

So as you will have noted, the ME tech strategy has strong similarities, particularly with the core banking system and their acceleration of digital and origination strategies. As the BOQ transformation is being designed to accommodate multiple brands, we consider the ME acquisition as a great opportunity to extend our current transformation.

We will add ME as a third brand to our retail banking technology solution, thus further leveraging scale, optimising run and change costs, and enabling a third brand to leverage common innovation. This is a clear target state for the ME business, where the execution of the integration will be incremental to our current strategy, rather than a significant new build. Further, as both businesses use Temenos as the core it will make the migration of ME to the Temenos cloud platform considerably less complex as the data models will be the same.

Other key components of the technology approach include that there are technology assets in ME that will contribute to the combined entity, including the work they have done on digital lending and origination as well as their experience in agile ways of working. BOQ will also be able to leverage some of ME's corporate systems to uplift our capabilities. As ME is a standalone business, we'll have the flexibility and the sequencing of our technology roadmap as well. In summary, we've got strong technology alignment. We have a clear target state. We have a roadmap for a combined better business, one platform for our three brands. Now I'll hand back to George.

George Frazis: Thanks, Craig. Now to slide 26. Looking ahead, we expect our FY21 outlook to be ahead of where we were expecting when we announced our FY20 results. We expect jaws to be about 1% positive, above system growth in lending, NIM to improve slightly and for the cost growth to be 3% to support the business momentum. The Board has set a dividend payout ratio of 60% to 75% of cash earnings. We understand the importance of dividends to our shareholders.

I am really pleased at the progress we have made in executing against our strategy and in the financial results we are seeing. This momentum means we are now well placed to undertake this acquisition which will enable us to accelerate the transformation further.

Finally, turning to slide 27, as you've heard, this is a game-changing acquisition for the Group, both strategically and financially. It's about scale, diversifying our portfolio, leading-edge cloud technology and enabling us to deliver consistent profitable growth. It is an exciting day to see two strategically and culturally aligned businesses come together. We look forward to continuing to build all three of our brands, accelerate their profitable growth and create new opportunities for our people and the Group.

I'll now pass back to Cherie for Q&A.

Cherie Bell: Thank you, George. We'll now go to Q&A. Obviously today is a very big day for BOQ and our people and we're undertaking a significant capital raising, so if I could ask that questions be limited to one please. With that, I'll pass to the operator.

Operator: Thank you. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star two. If you're on a speakerphone, please pick up your handset to ask your question. Your first question comes from Brendan Sproules from Citi. Please go ahead.

Brendan Sproules: (Citi, Analyst) Good morning, George and team. I just had a single question just around how this business will be managed. We've seen in Australia that a number of banks that have undertaken running multi-brands within the single organisation has quite diverse product offerings across these brands, diverse IT and even diverse servicing offerings. I was just wondering how different ME Bank being managed within the Bank of Queensland umbrella will be.

George Frazis: Thanks, Brendan. You raise a really important point in terms of the reason why we're particularly excited about this opportunity is that if you think about what we're developing in terms of our Temenos core banking platform within VMA, this is the latest version of that platform. Its cloud based. There's no customisation. What it enables us to do is to make sure that we've got an ongoing upgrade pathway to leverage their global investment in innovation. What we've done is we've built that system in a multi-brand approach, so we know the end state. It doesn't change that strategy.

The beauty of the ME Bank acquisition is that because the data architecture is consistent and they're on version 18, we can easily schedule them into that transformation program. The end state is known. It hasn't changed. We'll have all three brands effectively on one core banking platform, which is really exciting and very distinct. Now, there's a number of synergies that Ewen has laid out. But what we haven't actually talked about is at the end of three years when we get to that point, we've got a banking platform that is really efficient and also able to add innovation for our customers that puts us in a really strong position, which we're excited by.

Ewen Stafford: Yes. Brendan, it's Ewen. I just might add a couple of things in terms of how we're thinking about it.

Given it is clearly a multi-brand strategy, where we have our people close to the customer, close to the brand, we'll continue that. That is entirely consistent with how BOQ operates as it is at the moment with the BOQ Blue brand and VMA on the retail side and similarly on the business side. I think from there then, the way the Temenos platform, multi-brand platform, is being built, it does allow for a simplified and consistent product offering. But then that can be configured and nuanced at a brand level.

From there, we certainly will be looking to, and as the technology integration continues then, to achieve more consolidation and consistency in the middle office, which I think was your point about servicing, and then certainly - and as I mentioned, within the shared service functions, as soon as we can and including the consolidation of those different technology platforms that support those areas.

Brendan Sproules: (Citi, Analyst) Thank you. Can I just ask one clarifying question on that, just in terms of product offering, so we have seen Westpac and St. George really align their products over time.

Other banks have done it slightly different. What's your planning around the different product offerings across the brands?

George Frazis: Brendan, the way we will think about products is definitely simplifying our product set and also simplifying the end-to-end process and how we streamline those. As you know, what's really important with say, mortgages, is our 'time to yes'. That's something we've been able to do extremely well and we'll continue down that path. The way that these modern systems enable us to design is that effectively provides us the scope to have the different elements of differentiation by the different brands within the one product. This is a very simplified approach to product terms and conditions and also end-to-end process.

Brendan Sproules: (Citi, Analyst) Thank you.

Operator: Thank you. Your next question comes from Brian Johnson from Jefferies. Please go ahead.

Brian Johnson: (Jefferies, Analyst) Good morning. I was just wondering could you run through the differential in the NIM that we see between BOQ and ME Bank? The NIM looks a lot lower. Bank of Queensland historically has had a much higher benchmark rate than perhaps even the peers, so I'd just be interested if we could get some kind of walkthrough of the difference on the NIM between the two.

Ewen Stafford: Yes. Brian, it's Ewen. I'll take that one.

You're right. The numbers are different. Perhaps if I start at the BOQ 1.91%, the first thing we need to do is adjust out for business mix. We have an advantage there of about 30 basis points because of the business banking operations that we run. But then you just need to slightly net off about 10 basis points because of our branch network and particularly our Owner-Managers and payments to them. That then gets you to an apples for apples.

From there, Brian, the key difference is really about funding costs. As we look forward - and as I mentioned, we've obviously modelled those cost synergies and they're represented in those accretion statements, but we have not put through those models opportunity on the funding side. That's about circa 20 basis points. We would see that about - half of that being of the retail nature and then the other half, wholesale funding advantages that the BOQ business has. That's basically the walk. We do see an opportunity certainly to improve that 1.56% on the basis of those funding costs for the two reasons I outlined.

Brian Johnson: (Jefferies, Analyst) Fantastic. Ewen, if I could just push my luck with a second related question, if we were to break this down into the trading update versus the acquisition, on the trading update, you're talking that for the first half the margin is up, but you've delivered multiple assists on credit growth in the housing book. Housing's got a lower margin than the business book. Once again we're starting off with a higher reference rate. How do you have your margin expanding in the first half when, by its very nature, you must be embedding a bigger discount?

George Frazis: Brian, the thing to note is actually on the business banking side, we've done quite a bit of work. Although we haven't grown balances net-net given where the market's at, we have actually done a good job in terms of improving margin and return of the business that we've held, so that's the first point. I'll let Ewen cover off some of the other points.

Ewen Stafford: Yes. Brian, we'll provide the full detail and the usual walks on 15 April, but just to really summarise it, what we've experienced in the first half are some significant tailwinds on the funding cost side. When we spoke at the full year, we did signal that we had been late relative to the market to reduce term deposits particularly and so we benefited from the benefits of that as well as obviously the wholesale funding side of it in the first half. Then really, we've had the usual front to back book drag that we've been consistently calling out. Hedging costs and the benefit of that hedging costs has broadly been a wash with the capital and low-cost deposits.

That's the dynamics that have played out there and then a slight few basis points drag because of the high liquidity. But as I said, we'll provide that full detail in a month or so.

Brian Johnson: (Jefferies, Analyst) Thank you very much. Thank you.

Operator: Thank you. Your next question comes from Richard Wiles from Morgan Stanley. Please go ahead.

Richard Wiles: (Morgan Stanley, Analyst) Good morning. I'd just like to understand your thoughts around growth in a little more detail. ME Bank's been around for more than 20 years. It's got $27 billion of loans, so let's call it 1% share, that sort of level. It's hardly been a high-growth bank. Then you're talking a lot about the multi-brand strategy. George, that didn't work particularly well at Westpac when you were there, so what makes you think multi-brand will be a success at BOQ? Why do you think ME Bank will suddenly turn into a higher growth bank than it's been in the past?

George Frazis: Thanks, Richard. Just to correct you on the Westpac side, when I was running the St. George Banking Group with four brands, we actually grew it to more than 1.7x system and maintained margin, but we're not here to talk about them.

If I think about what we've achieved over - if you go back 18 months ago, BOQ was going backwards in mortgages. In 18 months, we've been able to turn that around. As you can see, for this current half, that's growing at 1.2x system. In fact, our exit rate is closer to 2x system. This has been fundamental improvements, which is the end-to-end process getting 'time to yes' down to below a day. We know how to do that. That capability can be applied across all three brands firstly.

The second thing to note is that we've also been able to achieve that turnaround (1) in our Owner-Manager branches, which is traditionally the hardest place to achieve growth, but now, we're also doing extremely well in our third-party broking channel. So again, we know how to drive growth - profitable growth that is with margin improvement in our third-party channel which is 75% of what ME Bank's channel is.

So we have the capability to grow all three brands and we really understand this business; it's a simple business which is core to ours. Then the final point I would state is all three businesses have yet to tap into the opportunities that digital distribution has and at the starting point of this is effectively the launch of VMAs new state-of-the-art mobile and banking app that will initially primarily be transactions, savings and credit cards, but the next phase of that is mortgages and that gives us a totally new channel to actually drive profitable growth.

Then the final point I should state is I do want to emphasise that what we are talking about is three brands on a common core banking platform that really simplifies everything beyond that's front-facing.

Operator: Thank you. Your next question comes from Andrew Lyons from Goldman Sachs. Please go ahead.

Andrew Lyons: (Goldman Sachs, Analyst) Thanks and good morning and thank you for the opportunity to ask a question. Just a question on CapEx; your integration costs of $170 million to $180 million when combined with the capital investment targets you provided last February would suggest you are certainly investing quite heavily in the combined Group over the course of the next few years.

I just was hoping that you could maybe talk to how your thinking about the return on investment in relation to that capital investment and also, has the capital investment requirements of the combined group contributed to the reduction in the targeted payout ratio for the combined group despite the fact that you did have ROE - you're getting ROE accretion from this deal?

Ewen Stafford: There was probably about three questions in that one, Andrew. So look, let me start with the investment program and then we'll come to ROE, how we're thinking about that and the interplay with the dividend payout ratio. I mean you're right, we do plan to invest in this business heavily over the next - and consistently over the next three years. I mean, at BOQ as you point out, we're in the midst of a major transformation and delivering positively against that, but the way we are thinking about the combined envelope is that it could well be up over half a billion dollars. So far it's

$100 million over the three years. But I think it's important just on those 170 - or just on those costs - integration costs, so we are thinking, as I mentioned $130 million to $140 million.

At the moment, our intent is not to capitalise those, so we will put those below the line in the years incurred and fund those out of organic capital, notwithstanding that would be part of the integrated funding envelope. But I think from how Craig and I are thinking about that funding envelope, there will definitely be CapEx synergies as we bring those together. We've already identified $15 million again, which is not on these numbers, but once we can get further under the covers and refine the planning, we are quietly confident that there will be further.

So that's really on the capital program and the interplay with that $130 million to $140 million. Just in terms of the payout ratio, the comment I'd make there is we really feel 60% to 75% is a sustainable payout ratio and it just allows us the flexibility depending on the different growth rates and where that growth comes from and bearing in mind, the business banking side of our operations as well. So, we think that's an appropriate rate of payout, just to manage that carefully.

Then just on the ROE comment, we have clearly stated it's greater than 100 basis points accretion. We are - I'm not going to be drawn on the target today, but we are targeting peer-level ROE outcomes. Peer-leading in the medium-term.

Andrew Lyons: (Goldman Sachs, Analyst) Thank you very much, that's helpful. Thank you.

Operator: Thank you. Your next question comes from Jarrod Martin from Credit Suisse. Please go ahead.

Jarrod Martin: (Credit Suisse, Analyst) Morning, George, morning, Ewen. Thanks for your time. Question on distribution and how you see that going forward. You said 25% mortgage managers and 75% mortgage brokers; so on the mortgage managers, will they continue just to be ME Bank focused or will they be able to offer a broader suite of products? Also, part of the attraction that those mortgage managers pushed was that not only are you getting a cheap mortgage, but it's benefiting your super fund because of the ownership of ME Bank previously. So does that proposition change now with BOQ ownership?

Then on the 75% that are through brokers, I note that AFG flows over the last 12 months had particularly halved now that there was an issue at the start of the pandemic, so how that's going to be managed and how the differentiation between the brands is going to be able to still offer you some form of growth?

George Frazis: Thanks Jarrod and all good questions. I mean the starting point in terms of distribution is that at the actual BDM level or mortgage manager level, we will be definitely leaving differentiation by brand. I think it's important that those bankers and BDMs really focus on growing their particular brand.

Now above that in terms of management, particularly when it comes to leadership in third party, we would look at how that operating model works. The thing I would say about the third-party distribution channel is that what makes success in terms of growth there is: One is certainty that you're going to approve a loan that you've approved previously. The second thing is that you actually do that quickly and the third thing is that you've got a distinctive segment that the brand is attracted to.

So, all those three things we do really well and the three brands that we're offering have a different customer segment target, so there is very little overlap of that. What we end up having is quite a compelling offering providing choice to the aggregators and the brokers.

Just on the link to the members, and obviously we will want to ensure we are providing a compelling offering to the industry members, but it only represents around about 10% of the flow today. It's not a critical part of the growth going forward. We definitely know how to run mortgage lenders and we definitely know how to grow in the third-party channel.

Jarrod Martin: (Credit Suisse, Analyst) Thank you.

Operator: Thank you. Your next question comes from Ed Henning from CLSA. Please go ahead.

Ed Henning: (CLSA, Analyst) Thank you. I've got a couple of questions, but I'll stick to my one. If you look at ME Bank, can you just run us through the front book/back book pricing difference there and will that be less of a drag going forward than BOQ on your NIM?

George Frazis: Maybe I'll start off and then handover to Ewen. Ed, thanks for the question. I mean, dealing with the front book/back book issues is part of life in terms of running a retail bank. As you can see, we've been able to increase margin and deal to that within BOQ, so we'll be applying those disciplines across the combined business. I'm really pleased that we've got very good capability in our product to make those trade-offs in terms of the price volume trade-offs. I will hand over to Ewen to give you a bit more colour about that.

Ewen Stafford: Ed, the front to back book differential is quite consistent with BOQ on our average portfolio numbers, so it's in that order of the early 40s. It won't have any impact from that perspective. The pricing has not been overly aggressive on that side either. I think perhaps where the bigger differentials from market averages is more on the deposit side as I referenced earlier in terms of those funding costs drag. We're very comfortable and I think we are very aligned on that front to back book impact.

Ed Henning: (CLSA, Analyst) That's great, thank you very much.

Operator: Thank you. Your next question comes from Azib Khan from Morgans Financial. Please go ahead.

Azib Khan: (Morgans Financial, Analyst) Thank you very much. George, you mentioned earlier that you're bringing together three strong brands. The ME brand attracted quite a bit of negative publicity around last July when ME announced a freeze on withdrawals -home loan redraws for certain customers. Has that resulted in more than usual customer attrition for ME over the last six months and what level of customer attrition if any are you assuming as part of the combined financial targets that you've laid out today?

George Frazis: Thanks for your question. You're right in the sense that the redraw issue did create an issue for ME Bank and its branding. In fact, if you look at the behaviour in terms of NPS, ME Bank roughly was in third position, fairly similar to where BOQ and Virgin Money was at. They then dropped from that position given the issue. They did quite a bit of work to recover and contacted all customers and I think although slightly slow to the party you might argue that they did a very good job to recover and then it's gone back up. I'll hand over to Ewen just to give you a bit more colour around that.

Ewen Stafford: Yeah, just a couple of other factors. On slide 33 in the top right-hand corner there's a section where we lay out an overview of ME Bank and where we have included the home loan growth. You can see they've had some outstanding years where they've put in FY17 $2 billion on the balance sheet, $1 billion in FY18 and $2 billion between FY18 and FY19. So, we are – and then it plateaued a little into FY20 and that's sort of how we're seeing FY21 as well.

I think importantly though with that strong growth and also the margin management from the ME Team, it hasn't had a big impact on profitability. It's more an asset growth and then a step-off into 22 consideration. Obviously through the due diligence that we have done and through the management discussions we've had, we've had extensive opportunity to form our own view on those forward looking forecasts and make whatever adjustments we felt was appropriate to those. That's what's replicated in the models that have driven those accretion statements.

Azib Khan: (Morgans Financial, Analyst) Just on that growth outlook Ewen and George, George you did mention earlier that the combination of the two businesses allows you to generate more capital efficient growth. Can I take that to mean that you'll be targeting stronger home loan growth than business loan growth over coming period?

George Frazis: What it does for us is obviously we're going to focus growth on both, but our weighting on business banking was higher than retail banking. What this acquisition enables us to do is have a weighting of about 50/50. In that sense growing both sides just means we're going to be able to generate better returns in terms of ROE and not chew up as much risk weighted assets and capital.

Ewen Stafford: That's right and just to put some numbers against that, the ME risk weight intensity is at 39%, BOQ at 67% pre this combination, so that just illustrates George's point.

Azib Khan: (Morgans Financial, Analyst) Thank you.

Operator: Thank you. Your next question comes from Josh Freiman from Macquarie. Please go ahead.

Joshua Freiman: (Macquarie, Analyst) Hey guys, thanks for the opportunity. I'll just ask the one question. Excluding the transaction you guys guided to a slightly positive NIM over FY21, while peers' resulting quarterly updates have shown material margin benefits come through for deposit margins, just when we do our channel checks, it highlights your retail deposit costs are typically higher than peers. I just wanted to check and see how you see the trajectory of deposit margin benefits impacting your margins in FY21 and beyond. Thanks.

George Frazis: Thanks Josh. Maybe I'll start off and then hand over to Ewen. I mean the starting point is that as we announced today, basically our half-on-half NIM improve by three basis points and what we're saying is our expectation for the full year is a flattish to slightly positive NIM with, I have to stress, a positive 1% in terms of jaws. But I'll let Ewen give you a bit more colour around that.

Ewen Stafford: A few comments on that one from me, Josh. Firstly and I think when I was unpacking that a little bit earlier, firstly we were later than the market on average to cut into our TD pricing, but Chris and the team have now been working through a reset of that and we've experienced considerable benefit, in the order of about seven basis points of positive NIM in the first half. We will see some flow-through on that into the second half, so we are getting that benefit, albeit perhaps a little later than some other parts of the market.

Secondly and we've mentioned this I think consistently for the last couple of halves, we have historically had a higher cost deposit base and we are structurally working to reduce that and making really good progress on that, in bringing that down to lower cost deposits. The Virgin Money go life of phase one of the digital bank will really enhance that, when that goes in in March as well, which is going to be led out by transaction and savings accounts as well.

I guess in summary, there was a structural issue which we are dealing to and will continue to build out those lower cost deposits. Then secondly, we have now started to or have cut those rates and are seeing the benefits come through into NIM. That will continue that tailwind into the second half.

Joshua Freiman: (Macquarie, Analyst) Thank you.

Cherie Bell: Ladies and gentlemen, that concludes the Q&A session this morning, so I'll hand back to George for a closing comment.

George Frazis: Thanks Cherie and thank you all for your participation. A game-changing day for BOQ, an acquisition which is compelling strategically and financially. This significantly improves our competitive position today, but importantly creates a pathway to an innovative, leading digital bank with a personal touch for tomorrow. We are very much appreciative of your support and your time today, so hopefully everyone thank you and have a great day.

Operator: Thank you. That does conclude our conference for today. Thank you for participating, you may now disconnect.

END OF TRANSCRIPT