Operator: Thank you for standing by and welcome to the Bank of Queensland 1H24 results. 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 Ms Jessica Smith, General Manager of Investor Relations and Corporate Affairs. Please go ahead.

Jessica Smith: Good morning, everyone. Welcome to BOQ's results presentation for the half year ended 29 February 2024. Thank you for taking the time to join us today. My name is Jessica Smith and I am the General Manager of Investor Relations and Corporate Affairs at BOQ.

I would like to acknowledge the Traditional Custodians of the land on which we meet today, the Gadigal people of the Eora Nation. I pay my respects to Elders past and present.

With me today is Patrick Allaway, our Managing Director and Chief Executive Officer, and Racheal Kellaway, Chief Financial Officer, who will present the results.

We are also joined in the room by BOQ's executive team and senior management. Following the briefing, there will be an opportunity for questions and answers. I will now hand over to Patrick.

Patrick Allaway: Thank you, Jess.

Just before starting, I'd like to convey our condolences to those impacted by the tragic events in Sydney over the past week. Our thoughts and support are with everyone who may have been impacted, including BOQ Group team members.

I'd like to take the opportunity to welcome everyone on the call. I'd also like to welcome our Chairman and the executive team who are in the room with me today.

This is a very special year for BOQ as we celebrate our 150 year anniversary, a significant achievement. This milestone has given us moment to reflect on the evolution of the Group over that time and what makes BOQ unique. We provide an important banking alternative to the major banks, that is centred on our deep customer and community relationships, our strong Queensland heritage and our niche specialty businesses operating nationally.

We have recognised that our future success - we need to address our legacy complexity, structural challenges and changes in the way we do business, in the midst of accelerating industry headwinds and an increasingly commoditised market. This requires differentiation through consistently exceeding our customer expectations, lowering our cost to serve, deepening our position in niche specialist segments, diversifying our revenue mix into higher returning sectors and turning our size into an advantage, making simplicity and agility our strength.

Turning to slide 8 and for the key messages I'd like to leave you with today, we said at the full year that earnings would be lower in FY24 with the impacts of heightened competition on both sides of the balance sheet, more exacerbated for BOQ due to our higher relative cost of funding. We also said that our simplification program would partially offset cost inflation and increasingly regulatory impost. With low single-digit growth in our underlying cost base, amortisation combined with investment in our transformation would be incremental to this underlying position.

The results we're announcing today reflect this outlook. I want to emphasise that we're delivering against what we said we would, maintaining transparency regarding our challenges and the outlook and that we have a clear strategy in place to respond to market shifts.

This half, we delivered $172 million in after-tax cash earnings and $151 million in statutory profit after tax. We're delivering on our commitments and what we can control.

We've agreed our Remedial Action Plans, addressing our Court Enforceable Undertakings with our regulators. We've received the first phase independent assurance sign-off for the programs.

We've commenced steps to simplify the business, centralising our operations and contact centres, exiting our non-core New Zealand asset portfolio and reducing our property footprint, making a good start to locking in our $200 million productivity target for FY26.

Our digital transformation is progressing on plan with continued growth and uplift in the performance of our retail banking apps. We're pleased to have reached the milestone of four-star ratings on both MyBOQ and ME Go apps. We're in the last testing stages for digital mortgages and ME legacy migration with phase 1 launch for both of these programs commencing in the second half.

I'd like to acknowledge that this is a difficult period for many Australians, adjusting to high cost of living, higher interest rates and difficulty with the rental market. We're continuing to support our customers and communities with a particular focus on those converting from lower fixed rates to higher variable rates, customers in hardship and more vulnerable Australians.

We've held firm on our discipline on how we grow and allocate our capital, while home lending is not providing an adequate return. BOQ's financial resilience remains strong, with a CET1 above our target range, prudent liquidity management through the repayment of the TFF and a well-secured, high-quality lending portfolio.

We continue to have high conviction that our transformation plan will address legacy challenges and deliver a stronger and simpler bank. That said, we do recognise the market dynamics have materially shifted since we set our FY26 ROE and CTI targets.

Margin expansion and the prevailing environment is challenged. Should the current margin shifts become structural rather than cyclical, we recognise we will need to think differently to elevate additional ways to achieve these targets. I will talk to this in more detail shortly.

Moving to slide 9 for our financial overview, our statutory net profit after tax for the half was $151 million with cash earnings after tax for the half of $172 million. As I said, this result reflects not only the highly competitive landscape, but decisions we've made supporting the delivery of long-term benefits to our shareholders.

Recognising the importance of dividends for our shareholders and balancing the need to continue to invest in the business, the Board has determined to pay a $0.17 dividend, a payout ratio for the half of 65.2%. Racheal will provide more detail on the financial results shortly.

Moving to slide 10 for a review of the retail bank, income was down 19% on the same period last year, reflecting continued margin pressure in the home lending portfolio and customers switching to higher-yielding deposits.

The home lending portfolio contracted $400 million in the half, as we continued to hold our position on the careful deployment of capital. We deliberately grew ME brand mortgages broadly in line with system, where we have a lower relative cost of acquisition. We will deliver ME as our first major scalable, low cost-to-serve, end-to-end digital brand in FY25.

We again saw growth in deposits in the retail bank of $663 million against the prior comparative period, driven by both term deposits and through our digital assets. Pleasingly we saw an increase of 17% in active deposit customers on the digital platforms. Our improved app ratings and NPS scores, as compared to legacy, speaks to the enhanced customer experience of the new banking platform. We continue to grow the number of retail customers that choose to bank with us, up 7% in the past 12 months to 1.2 million retail customers.

Finally, in the retail bank, we've been able to service a broader range of customers' needs with strong growth in insurance, superannuation and card payments, growing capital-light earnings and further strengthening our relationship offering. We are focused on uplifting our ROE, one avenue is through growing these third-party revenues, while also addressing commoditised mortgages and deposit markets through our low cost-to-serve digital offering.

Moving now to slide 11, a review of the business bank. Competition intensified in the business banking sector in the half, combined with an easing of credit settings across the industry. We have retained a disciplined approach to both credit settings and margin management, with lending growth in healthcare and agriculture offset by a cautious approach to larger commercial real estate and slowing specialist home lending. This resulted in stable lending assets and a 4% decline in total income.

We are increasingly focused on growing our higher-returning niche SME segments where we have an existing competitive advantage, particularly in our specialist sectors of equipment finance, insurance premium funding and novated leasing. Initiatives completed in the first half, to enable quality growth in the second half, include investment in business-enabling technology, structural changes to streamline and simplify our business bank operations and recalibration of some credit settings, given increased confidence in the economic outlook.

Moving now to slide 12 for an overview of our customer-centric focus. Our customer experience and voice is at the heart of everything we do. We have fabulous examples every day of great customer experiences.

We recognise there's always more to be done and we don't get it right all the time. The experience of our legacy platforms is not meeting expectations. We are committed to a continuous improvement journey to better service our customers the way they wish to be served, through both relationship and simple self-help digital experiences, to realise our vision to be the bank customers choose.

Through the half, we consolidated our contact centre and cross-trained our bankers, to support a more seamless customer experience. We've reduced customer friction points and commenced a program of work to improve customer dispute resolution and remediation.

We've improved the experience on our new digital banking apps, measured by improved ratings. We've collaborated with our peers on a whole-of-industry approach to reducing instances of scams and fraud.

We've supported over 220,000 Australians with their home ownership and helped over 170,000 businesses to grow.

We know that our customers have a choice in who they bank with and that we need to earn that choice by delivering a trusted, consistent and differentiated experience, supporting their day-to-day banking needs.

Moving to slide 13, our purpose guides everything that we do. Building social capital through banking is about being a safe and inclusive place for our people to come to work. It's about facilitating the important services our community partners provide to vulnerable Australians and empowering First Nations people. It's how we provide support to our customers in their time of need and build our customers' financial resilience through targeted scam awareness sessions and financial literacy programs.

We are fostering curiosity, developing future fit capabilities, and enriching our people. We recognise the need to think deeply about how we can build on the culture of the organisation to be a more agile and outcome-oriented Group.

Pleasingly, on our most recent employee engagement survey, our people have told us they're increasingly proud to work at BOQ and we have again seen an increase in our people feeling safe to speak up, a reflection of the focus on improving risk culture.

We welcomed Rachel Stock as our new Chief Risk Officer and Alexandra Taylor as our new Chief People Officer. We have a highly capable and right sized executive team passionate about transforming this business and leading our people through this next phase of our transformation.

Moving now to slide 14, transforming the Business. We are confident in the decisions we have made, addressing not only the decade long legacy complexity and under investment but to build a stronger, simpler and digitally enabled Bank.

I will now talk to our strategic pillars in more detail.

Turning to slide 15, strengthening BOQ. We said we would embrace the Court Enforceable Undertakings as a platform to build stronger foundations, and we have done that.

We are committed to working openly and transparently with all of our regulators, while we continue to strengthen BOQ.

Our remedial action plans have been agreed with our regulators. We have mobilised teams, established project governance, and progressed the design phase for both programs. Our independent reviewers have been appointed and successfully completed their first review of the initial phases of the program.

These are multiyear programs of work. Across both programs there are 17 workstreams and 84 deliverables.

For program rQ, in addition to the mobilisation in this half, we’ve enhanced management and Board governance practices and commenced the design phase for all nine workstreams. Progressing the design phase is the primary focus as we go into the second half.

For AML First, which is a program that’s been running for over 12 months now, we’ve completed and closed five deliverables. Nine deliverables are in the implementation phase, and 15 are in the design phase.

Importantly, the uplift of the Group’s anti-money laundering and counter terrorism financing policies and framework has been completed. This is the cornerstone of the program setting the guide rails for the way manage AML and CTF risk.

In the second half, AML First is focused primarily on progressing the design and implementation of activities, particularly our AML and CTF capability and customer risk assessment.

Alongside this important work, we retain focus on the financial resilience of the Bank, prudent provisioning, and as I mentioned earlier, have joined industry wide approaches to protecting customers from an ever-sophisticated scams and fraud landscape and continue to invest in the uplift of our cyber security.

Turning now to slide 16, simplifying BOQ. We said we'd implement a simplification program against four key workstreams to progress against our $200 million productivity target, and we are doing that.

Key highlights in the half, we progressed our operating model optimisation, which has allowed us to reinvest in our in-house projects, risk and technology capabilities.

We consolidated our operations team and contact centres. We completed the divestment of the New Zealand asset portfolio and we've automated further 43 key processes in the half, encompassing customer onboarding, cards management, and regulatory reporting.

We've reduced over 6,000 square metres of floor space, with a strong pathway for the remaining 10,000 square metre reduction. Over the life of the leases, this will provide $40 million in savings.

Turning to side 17, digitising BOQ. We said the significant milestones in 2024 will be the delivery of digital mortgages and commencing the migration of customers from the ME Legacy platform. We are well progressed against this plan.

We are proud of what we've achieved since we announced our 2020 strategy to deliver a cloud based digital end to end Bank.

Our well proven team is delivering against what we committed to, on plan, with our seasoned digital transformation capability now a competitive advantage.

The transaction and savings accounts for all three brands on the cloud-based bank that were delivered, are performing well.

We have 23% of our retail customers now on the digital bank. 56% of our IT assets are in the cloud, and 100% of our people are on one Microsoft 365 platform.

We are in the last testing phases of the digital mortgage. In the second half, we are commencing phase 1 of product launch with a Virgin Money digital mortgage. This will then be extended to ME brand and our broker channel followed by further capability releases to the market over FY25.

The delivery of digital mortgages will enable BOQ to compete at a lower cost, a faster time to yes, with a materially improved customer experience.

Customer migration off legacy platforms will be the most challenging and beneficial period of our transformation. As we said at the full year, this migration will take 12 to 18 months, at which point we will decommission ME Legacy.

We are at an exciting juncture on our digital journey. However, we recognise migrations are not without risk of potential interim disruption for our customers, and careful execution against the plan will reduce this risk.

We have a well-planned and sequenced process, which incorporates learnings from other industry migrations. We will provide extra support to our customers through this period.

Migration of the ME Legacy platform will reduce complexity and risk with end-of-life systems and is an important step in our productivity program.

Cyber security remains a key focus for the Group. In an environment where the threat landscape continues to evolve, we recognise the need to continually monitor and enhance our cyber security posture. We engage leading cyber security consultants to undertake regular independent reviews of our capability and maturity.

Finally, in digitise, our partnership with Microsoft is helping BOQ accelerate our transformation in cloud, customer experience, data and AI.

Turning now to slide 18, optimising BOQ. We are evolving our strategy as the market shifts and elevating our focus on improving shareholder returns, considering initiatives less dependent on home lending margin recovery and growth to achieve our FY26 ROE and CTI targets.

We said at the full year that achieving these targets, required the competitive mortgage and funding market to be cyclical rather than structural.

There could well be elements of the dynamic market shifts that the industry has experienced, that are both cyclical and structural, requiring further action to address this. Our core strategic pillars of strengthen, simplify and digitise support a lower cost to serve higher returning bank and will not change.

We are evaluating the potential to make bolder strategic decisions with respect to our optimised strategic pillar, to address potential structural head winds. These considerations include a shift in our revenue mix, a further simplification of our operating structure, and capital optimisation initiatives.

Before I hand over to Racheal, to provide more detail of the financial results, I wanted to reconfirm the confidence I have in our management team, the discipline we’ve shown in executing against our strategy, and the considered way we’ve deployed our capital. Over to you, Rachael.

Racheal Kellaway: Thank you, Patrick, and good morning, everyone.

In the first half of the year, BOQ Group has delivered cash earnings of $172 million. Against the prior comparative period, total income reduced 12% with net interest income falling 13% and stable non-interest income.

Total expenses increased 6%, reflecting the impact of inflation and continued investment. We saw loan impairment expense reduce 56%, driven by a reduction in collective provisions and continued low specific provisions which resulted in cash earnings down 33%.

Statutory profit after tax of $151 million, was up on both prior periods. As announced to the market on 2 April, the sale of the New Zealand asset portfolio has now completed.

We saw small gains on the amortisation of acquisition fair value adjustments and a small loss in hedging ineffectiveness.

Turning now to the key elements of the result on slide 22. $795 million of total income was down 12% on the prior comparative period and 5% half on half.

NIM contracted 24 basis points against the 1H23 with a 3 basis point decline half on half. This reflects intense competition across both lending and deposits. Whilst lending impacts moderated in the half, funding costs continued to increase across both wholesale funding and retail deposits.

The housing portfolio contracted 2% against the prior comparative period. Within this, we targeted our growth. As Patrick mentioned, the ME brand grew broadly in line with system, while our other brand portfolios contracted. We saw a number of property developments complete in the business bank, with this run off being replaced by growth in novated leasing and our prioritised niche segments in healthcare and agriculture.

Customer deposit balances grew against the 1H23, however reduced on the prior half, as our funding position was strong.

The rapidly changing operating environment has required us to make disciplined, and at times difficult, management decisions, in order to find the right balance in optimising revenue returns and ensuring prudent capital, funding and liquidity settings.

We have, for three halves now, spoken to you about tempering and slowing growth in housing, where economic returns have been competed away. This pressure on margin has been further impacted by the rising rate environment, causing customers to rightly seek yield, after a lengthy period of low rates and the repayment of the term funding facility causing a distortion in deposit competition.

This dynamic, combined with not growing our assets at sub-optimal returns, meant we did not have to fund material growth in this environment. It also meant we safely transitioned through this period with careful management in respect of financial resilience, and it allowed us to continue to invest in the long term benefits the transformation will deliver.

Unpacking NIM in more detail on slide 24. Asset pricing and mix had a 3 basis point negative impact. Within this retention pricing continued but at a lesser pace with a 4 basis point impact in the half. The shift from fixed to variable provided a tail wind to margin of 4 basis points. Front to back book compression was 3 basis points, with two in housing and one in business.

Funding costs continued to increase driven by competition in deposits particularly term deposits which impacted NIM by 6 basis points. This was partially offset by a benefit of 3 basis points from at call savings. Wholesale funding has seen a drag of 3 basis points as the TFF was replaced with higher cost funding.

Our overall funding requirement was less than the prior half. We saw a tail wind from liquidity as we normalised our LCR through the period providing a benefit of 3 basis points. We saw a further 4 basis points benefit from the replicating portfolio. On the outlook for NIM, we are expecting very similar themes to what I described at the full year, though pressures are moderating.

Competition will continue mostly impacting mortgages and also deposits as the industry normalises post TFF. The higher cost of funding will continue to flow through. A tailwind will continue, as the remainder of our fixed rate mortgage towers convert to variable and our replicating portfolio will continue to provide a benefit.

Turning now to operating expenses on slide 25. In an environment characterised by declining revenues, we have been disciplined in our cost management. BAU expense growth of 1.2% included the ongoing impacts of inflation and increases in risk, technology and compliance.

This was partially offset by simplification program benefits, lower volumes, and a decrease in marketing spend. As previously flagged, we saw an increase to investment in the OpEx line. We also saw a small reduction in amortisation which I will cover in more detail shortly.

Looking to the second half, we are still on track to deliver low single digit BAU cost growth, though it will be higher than the 1.2% seen in this half. We will see the full half impact of higher risk, technology and compliance spend. Marketing spend will likely increase as we launch the digital mortgage. Simplification will continue to provide benefits.

I do want to reiterate that we have the run and maintenance costs of our legacy platforms, concurrently with the maintenance and build of the new digital bank. Alongside high inflation, this has been a difficult period to manage costs and we're pleased with the outcome in the half.

Total investment spend has reduced and we have seen the nature of investments slightly more weighted towards OpEx. Our amortisation for this half has reduced, predominantly due to post-integration ME assets that we no longer have on the balance sheet.

With the digital mortgage product nearing market launch and infrastructure for customer migration near complete, we have an increase in our assets under construction. This trend will not continue as these assets are expected to commence amortising in FY25 and we now expect amortisation to peak in FY26.

Impairment expense for the half was $15 million, down 56% on the prior comparative period, after a period of building collective provision coverage. This half, we have seen strong underlying asset values and low specific provision activity. Provisions were stable for the half, with a small increase in collective provision offsetting a reduction in specific provision.

We maintain prudent settings, given the current economic cycle and have 41 basis points of provision to GLA coverage.

While the economic outlook is becoming more certain, we have maintained a 45% weighting in our forward-looking models to downside or severe downside economic outcomes. Arrears have increased across all portfolios, driven by sustained cost of living pressures and a higher interest rate environment. These have not translated to increased losses.

We recognise that some customers are feeling the impacts of these dynamics more acutely, which is translating to elevated hardship activity and we are seeing pockets of business customers needing closer support as they manage difficult trading conditions. What we can see, is that most customers are adjusting and while there are customers who are needing closer contact and assistance, on aggregate, we have seen household buffers slightly increase, rather than decrease, in the half and more customers building a buffer than drawing down.

Turning now to funding and liquidity on slide 28, our financial resilience remains strong, and we have continued to take a disciplined approach to liquidity.

Following a significant TFF maturity in the first half, we have reduced our LCR in an orderly manner. We have ended the period of a spot LCR of 132%, ahead of settling a $1 billion securitisation transaction in early March. Repaying the TFF is well progressed, with the final $1.1 billion of repayment due in the second half from an initial $3 billion drawdown.

Growing customer deposits remains a key focus for the Group. In a period of intense competition, deposit funding as a percentage of total funding is the highest it's ever been at 71%.

Turning to capital on slide 29 and we have ended the half with CET1 at 10.76%, as we continue to support investment in the business. Earnings contributed 42 basis points to capital in the half and we saw a five basis point increase from lower RWAs.

The second half dividend, net of the dividend reinvestment plan, returned 31 basis points of capital back to our shareholders and we utilised 10 basis points of capital for investments. There was a one-off impact of five basis points to capital from the sale of the New Zealand asset portfolio.

As completion of the deal occurred post the end of the period, RWA benefit will come through in the second half. We have declared a first-half dividend of 17 cents, with no discount applied to the DRP.

We maintain our target capital range at 10.25% to 10.75%, with a dividend payout ratio of 60% to 75% of cash earnings.

In summary, this half again featured heightened competition. We saw that particularly in deposits, as TFF replacement continued across the industry. Arrears increased, as sustained higher costs of living and increased interest rates impacted on household budgets and customers sought relief as they adjusted to these changes.

We have been disciplined in our decisions on where to grow and delivered on our cost management commitment. Investment in transforming the business increased with two key components of the digital transformation moving to delivery in the second half.

With that, I will now hand over to Patrick to provide an outlook and summary.

Patrick Allaway: Thank you, Racheal.

Turning to slide 31 for the second half outlook, despite the continued impacts of high inflation, higher interest rates for longer and geopolitical uncertainty, the Australian economy remains resilient, supported by low unemployment and strong investment.

We anticipate that we are at the peak of the cash rate tightening and the economy is at the bottom of the cycle, though the easing of monetary policy may not occur until late calendar 2024 or early 2025. We acknowledge there will be lagged impacts of this cycle on many Australians, and we will continue to support our customers in need through this period.

With respect to BOQ performance in the second half, we anticipate low single digit BAU cost growth, though higher than the first half, as Racheal mentioned. We anticipate revenue and margin pressures to moderate. We anticipate deposit competition is likely to remain heightened while the industry replaces the term funding facility.

Home lending margin compression is stabilising, and system housing credit is likely to grow over the next 12 months. In this environment, we anticipate our home lending decline to moderate and that our Business Bank growth will increase.

To summarise on slide 32, we are delivering on our commitments and what we can control.

We have a clear strategy in place to address our legacy challenges and deliver BOQ as a stronger and simpler Bank, focused on specialised segments.

We remain in a strong financial position to support our customers and to continue to invest in our transformation through the cycle.

We're on the verge of delivering a market leading digital mortgage experience and commencing migration of customers from our ME legacy banking platform, both material proof points in improving our customers proposition and lowering our cost to serve, enabling us to better compete in a more commoditised home lending market.

We're responding to potential structural market shifts impacting returns and considering additional initiatives, to uplift our return on equity and shareholder returns.

Transformations of this scale are difficult and take time and are particularly challenging with a backdrop of industry headwinds. We recognise that an investment in BOQ requires patient trust in the management team to deliver. We take this responsibility very seriously and we will continue to be transparent about our challenges and what we're doing to address them.

I'd like to take this opportunity to recognise the importance of our shareholders, customers and our people and thank all of you for your continued support. I'll now pass to Jess for questions, thank you.

Jessica Smith: Thank you, Patrick. To ensure we have sufficient time to answer questions from all participants, we ask that you limit your questions to two each please. Operator, can we please have the first question?

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 are on a speakerphone, please pick up the handset to ask your question. Your first question comes from Ed Henning with CLSA. Please go ahead.

Ed Henning: (CLSA, Analyst) Hi, thanks for taking my questions, I've got two. Firstly on costs, can you just run us through in a little bit more detail about the increasing OpEx investment? Previously at FY23 you called it out being materially higher, you've taken out the word materially, maybe it's stepped up a little bit in the first half. If you look at slide 26, you've only capitalised around 26% or so of the investment spend. Can you just run us through how we should think about that, firstly in the second half and then going forward into 2025 and 2026 and how much of a headwind that amortisation is coming through, as a first question?

Then if you go to slide 18 where you're talking about the targets, I'd be just interested in a little bit more detail what you're talking about, potentially thinking about around the cost base optimisation where you talk about there and also the capital optimisation. Within that, if there is structural changes to what's happening around the margin, what would you see your targets currently at for 2026 for cost to income or the ROE, if possible, please?

Patrick Allaway: Thanks for your questions, Ed. I'm going to ask Racheal to respond to your first question and then I'll come back to you on the second question.

Racheal Kellaway: Sure, hi Ed. So there's a couple of things. Just unpacking your question, so the first thing I'll say is we did talk about investment spend. If you exclude ME integration and the provisions we took for the RAPs, we did talk about investment spend increasing into FY24 and you're seeing that on page 26. That will continue to increase slightly at a total investment spend level into the second half, but it does peak in this year, in FY24, and will come off in FY25 and FY26.

We are working towards what we think is probably a more standard PropEx to CapEx mix of that investment, so something looking more like 50% in each, but that will happen later towards the end of our strategic horizon. Given what we're building at the moment are really asset-intensive CapEx platform assets, and then we move more to digital assets at the back end of the program. So, what that does, is it means that amortisation will move out to sort of the peak of amortisation out to FY26. We will continue to see PropEx increase this year and again next year.

Patrick Allaway: Thanks Racheal and Ed, just to your second question, we recognise that in this depressed margin environment we have more to do and we're looking at additional pathways to increase our returns. You raised questions in relation to our cost optimisation program, so we put in place the $200 million productivity program at the end of last year. That was to give us a bigger buffer in the event that we didn't get the margin recovery or the growth that our models were anticipating based on the declines that we have seen.

We are very well progressed in that program, but we continue to look at opportunities to attack our fixed cost structure and look at ways to take cost out. They're really across four key areas. One is the operating model, so we are centralising many activities and moving to a shared service model. We called out that we have already consolidated our contact centre activities and we've consolidated our back-office operations team.

We are reducing our footprint, so we have called out what we have done today has locked in about $40 million in savings to the end of the life of leases. We've got more to do with another 10,000 square metres that we're targeting. Our digitised program and in particular our digital mortgages and our ME migration will provide significant cost savings to the organisation, and they are key programs at work to lower our cost to serve in a more commoditised marketplace.

We're also looking at improved ways of using AI. We're looking at improving and automating our processes, so there are multiple streams of work. We have not identified further pathways as yet, but we are very focused on identifying our cost base and reducing our cost to serve as a major contributor to uplifting margins.

On optimising the balance sheet, this is nothing new. We said at the end of last year we are more focused on return on equity than we are on growth, so you are seeing us being more prudent about how we allocate our capital, ensuring that we get an appropriate return on our capital. We will continue to look at our portfolio of assets to ensure we get appropriate returns.

We also said that we were looking to shift our business mix at the end of last year to grow in higher returning sectors and obviously our Business Bank niche segments that we operate in are absolutely key to that. We have also suggested that we're going to look to grow capital light third party non-interest income and you would have seen in the Retail Bank, we are progressing that initiative as well. So there are a number of initiatives underway, it's nothing new to what we've said previously, but we are very focused on uplifting that ROE.

Ed Henning: (CLSA, Analyst) That's great, thank you. If you did, while some of those are still coming in and if the structural headwinds on margins continue kind of where they are, is there any guide on what 2026 targets would be with what we know now, or you're kind of waiting to hopefully get a few more things in place before coming back on that?

Patrick Allaway: Look, margins are not something that we can forecast. What we are trying to do is control what we can control and the initiatives that I've spoken to support those targets. What we said to you and we said this at the end of last year, if this is structural, we will not achieve those targets with current initiatives, so we are addressing new pathways and additional initiatives to ensure that we meet those targets. We recognise that we need to lift our ROE and it’s not sustainable at current levels.

Ed Henning: (CLSA, Analyst) Okay, thank you very much.

Operator: Your next question comes from John Storey with UBS. Please go ahead.

John Storey: (UBS, Analyst) Great, thanks very much and thanks Patrick for giving the chance to ask a few questions. I think just following on from some of the stuff that Ed was talking about, maybe just particularly around the cost base, I mean one of the things that I would call out there is page 13 of your actual results booklet, you can see that the composition of your costs have moved quite a lot. Your staff costs, up 14% year on year, 7% half on half and appreciate the nature of where that cost or the staff cost build is coming through, it’s ultimately more risk compliance than IT.

But just in terms of some of the discussions that we had last year around $1 billion cost number that was getting thrown around, the increase in the staff cost number and what you’re embedding in this business, is this a run rate that we should think about going forward in terms of the growth of the staff costs line item and in terms of how this mix change would impact from your targets going forward? So that’s the first one.

Then just a second one, obviously in a pretty difficult position, I think, as you’ve outlined you are, I think rightfully so, in a position where you’re trying to defend ROE and obviously not writing as much business in a very competitive market to reflect that, but you’re ultimately also faced with NIM compression that’s coming through at the same time, so there’s clearly quite a lot of revenue pressure just around your business. Related to that, wanted to just find out how quickly can you basically re-intermediate yourself into the market and start growing again? That’s the first part of it. Then how reliant actually is BOQ in terms of the margin expansion or stability story from a falling or declining interest rate environment?

Patrick Allaway: Thanks for those questions, John. There’s quite a lot to answer there. I’ll make some comments on ROE, but I might get Racheal to comment on the cost questions that you had.

Racheal Kellaway: Yes, sure, so you’re right in pointing out, John, that we’ve seen a 14% increase in employee expenses. There’s a couple of things here and one of them is the mix of our business, so we embarked on an operating model review and restructure at the end of last year. That has reduced our FTE by 220 FTE, however, there has been reinvestment in risk, and we’ve called out risk regulation and compliance particularly.

So there’s a mix issue in terms of the cost of resourcing, but it is where you would expect us to be as we deliver the strengthening programs for the organisation and also the digital transformation. I mean it goes without saying that also included in that number is the impact of inflation and particularly wage price inflation as well.

Patrick Allaway: So I think just to re-emphasise what we said at the end of last year as well, John, the target is to hold our cost base, our BAU cost base flat by 2026 and the growth in costs really will come from OpEx and investment spend and amortisation. So that’s certainly what the productivity targets are achieving.

In terms of ROE, and when we return to growth and just how we’re addressing the margin position in the market, we are not comfortable with a declining book, but we have said that we don’t want to allocate capital where we get an inadequate return. We’ve actually gone back and done an exercise where we did look at what our returns would have looked like if we had grown in this marketplace at current margins and our profitability would be lower, our ROE would be lower and we would have used more capital. So we do think it's the right decision.

In terms of when we return to growth, our strategy is addressing this in a couple of ways, so the first is we've been on this journey to build a digital end-to-end Retail Bank, that's really all about cost to serve and that's a key part of our return on equity. We are delivering digital mortgages in the second half and we'll, in FY25, have digital mortgages on an end-to-end basis for our customers. That will halve our cost to serve, so we do see the opportunity to grow our home lending book on the new digital platform with a much lower cost base and improved return.

You would have also seen that whilst we have seen declines in home lending, we're growing ME at about just above system.

Our cost to acquisition in ME is much lower than in our BOQ book. We are growing low LVR, so lower capital usage, higher-returning mortgages through ME. ME will be the first brand that we actually put on the digital platform and decommission legacy. What we did say is that we are seeing margin compression moderating.

We do anticipate with that new digital bank that we will deliver a much enhanced customer experience and we will grow the book through that. But at the same time, we're not going to rely on that. We do see business mix as really, really important. So, we have taken positions in the first - and prepared in the first half to grow our business banking book in the specialist sectors where we do have a competitive advantage and where we get a higher return, so you will see a shift in the mix of our portfolio.

We're also very focused on growing non-interest income and you're starting to see - and as a small bank it's more beneficial to us - in the first half we generated $24 million of third-party insurance, superannuation, and credit card income. That's a growth of about $5 million half-on-half, which is quite material given the cost base that produces those. There are a number of initiatives that we're looking for. We do recognize that we have to grow but at the same time we want to ensure that we focus on quality growth where we get an adequate return.

Operator: Your next question comes from Brian Johnson with MST. Please go ahead.

Brian Johnson: (MST, Analyst) Good morning. Can you hear me?

Patrick Allaway: Yes, we can. Thank you, Brian.

Brian Johnson: (MST, Analyst) Fantastic, thank you. Patrick, thank you very much for the opportunity to ask a question. Patrick, the first one I had, at the last result, the FY26 ROE when we asked had it been mapped out, we were told it had been. Can I just check, I'm sensing that it's a target but now you can't specifically map out how you get there. You've got some levers that you think you can pull but you haven't been able to specifically map it out. Then as a subset of that question can I ask, if it means that basically you can't see how you get there, or how you get to basically then your cost of capital, what strategically do you do? Then I have a second question, if I may.

Patrick Allaway: Thank you, Brian. First of all, we have a very detailed financial model. It's a five-year model but obviously the targets are FY26, which relies on certain assumptions around margin recovery and growth to get to those FY26 targets. Now, we recognise that those targets were set over two years ago and that the market has materially shifted since that time. That's why we initiated the productivity initiative that we did last year to give ourselves a buffer. Those targets do rely on margin recovery and if this margin compression is structural then we do need to find additional pathways to get there.

What we're saying to you today is that we still have financial models and detailed financial models that support those returns but we are looking at additional pathways to get there, recognising that we've had a material decline in margin. Margins are down across the industry 60 to 70 basis points from pre-COVID levels and we're very focused on how we address that. We will certainly come back to you if we don't believe we can meet those targets but we have a plan.

We've got a clear strategy in delivering our digital bank which will improve that proposition, and we're looking at additional initiatives to drive different business mix where we have higher returns, additional productivity initiatives, and we're also looking at optimising our balance sheet. They are important initiatives that we will continue to work on.

In terms of if we can't see how we get there, what's our strategy, we have a Board strategy day every May. These are the sorts of discussions that we have, but we have a clear strategy today that we have high conviction in and we're very committed to that strategy.

Brian Johnson: (MST, Analyst) Patrick, the second question, which is kind of related to it, and I really want to stress that often stock markets aren't fair but they are what they are. Last year, we saw the dividend was $0.41 and you got a first strike on the rem report, it was down from $0.46 the year before. This is all flagged upfront but today we can see the dividend has been cut to $0.17 and it feels as though year-on-year the dividend will still be down.

Can I just ask, having got a first strike at the rem report last year, does this have any consequences for the near-term strategic performance of BOQ if you were to garner - what does the risk of a second strike mean for the near-term performance of BOQ? Please, I'd really stress that if I was advising, I'd suggest that these things happen and you shouldn't short-term anything but I'd be interested in your perspective on this.

Patrick Allaway: Yes. Brian, just in relation to the dividend, we have consistently said that we have a target payout ratio, so if earnings are down the dividend is going to be down. We've also said that while we're investing heavily in the business, we will continue to pay at the lower end of the payout ratio. There should be no surprises in relation to the dividend. We also said at the end of last year that earnings would be down, so I think the market will have implied from that that the dividend would be down as well.

What I can say to you is we are controlling what we can control. I can't forecast to you how shareholders might respond to where the dividend is or what impact that might have on a strike. We've got a very clear strategy. The Board and the management team have very high conviction in that strategy and we will continue to execute against the plans and to call it as it is.

Brian Johnson: (MST, Analyst) Thank you.

Operator: Your next question comes from Jonathan Mott with Barrenjoey. Please go ahead.

Jonathan Mott: (Barrenjoey, Analyst) Thank you, Patrick. Just a couple of questions on similar topics. You've talked a lot about the digital mortgage offering being tested in the second half and then rolled out after that in FY25. You've also talked about industry margin, is it structural or is it cyclical, and then some hope there'll be some recovery. If we assume that current industry pricing is permanently lower on mortgages, will you be able to cover your cost of capital with the new digital offering? It is lower cost; you talked about a much lower cost base, but with current margins will the digital mortgage still cover its cost of capital?

Patrick Allaway: Thanks for that question, Jonathan. Look, what we look at when we look at our returns is our business mix and our portfolio. There will always be aspects of the book where we don't get a return above our cost of capital. We have taken the view that given the size of our portfolio in mortgages that adding to that at this time where margins are today is not prudent. We will get a decent uplift from halving our cost to serve in FY25 in relation to home lending, but you've got to look at it on a portfolio basis. We will grow parts of the book that don't provide an adequate return. It really comes down to our business mix.

Jonathan Mott: (Barrenjoey, Analyst) Okay, and then one of the other points that you talked about on slide 18 where you talked about the additional considerations to improve your targets is talk about simplifying the distribution channels. Can you elaborate on what that means, especially in the context of the owner-managed branch channels?

Patrick Allaway: Jonathan, we are looking at the cost, like all banks do, of the distribution channels that we currently distribute to. We are looking at ways to optimise that. I've got nothing more to say about that today and we will continue to focus on how we can reduce our acquisition costs and how we can reduce our cost to serve.

Jonathan Mott: (Barrenjoey, Analyst) Thank you.

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

Andrew Lyons: (Goldman Sachs, Analyst) Thanks and good morning. Just two questions if I may, just starting with the margin. Looking at your divisional performance, your retail NII to GLAs was down 10 basis points in the half and commercial was down 11bps and yet obviously your Group margin was down just 3bps in the half. Now, clearly some of this relates to liquids but it would appear there are some other moving parts effectively impacting the retail/commercial versus the overall Group NIM. Can you maybe just explain exactly what they are, and then I have a quick second question as well.

Racheal Kellaway: Yes, sure. If I just take a step back for a second and talk about the Group margin for a second and then I can piece together the divisional differences as well. If you take the 3 basis point impact relating to lending, that is primarily impacting the retail bank, so you've got negative 4 in terms of retention discounting. That is largely offset by fixed to variable mix benefits, but the housing front-to-back book reduction whilst moderating, and particularly moderating over the last few years, is still an impact. More so business front-to-back book is also a negative 1 but is obviously less than mortgages.

Now, don't forget that the business bank does actually still have a mortgage portfolio, so there are impacts in that division on NII to GLA number relating to mortgages in the business bank. Funding costs are relatively even although what we've seen in the business bank is that the deposits are lower. We've seen highly competitive corporate deposit action. We think that is probably largely driven by the fact that the major banks are looking for big chunks of money as they replace the TFF and they've been pricing quite highly.

So, we have taken a margin optimisation view there. We've found it more beneficial to raise funds through retail deposits in this time. So, there's that impact there in the business bank as well. Then as you called out, liquidity is a benefit along with the capital and low-cost deposit replicating portfolio benefit that comes through and benefits both sides.

Andrew Lyons: (Goldman Sachs, Analyst) Can I just - I guess looking at the divisional disclosures on page 32 of the 4D, it does seem as if there has been a pretty - well, a reasonably material swing, call it a $10 million, $11 million swing in NII in the other business unit, which appears to be put down to timing of break costs and benefits and other ongoing interest rate management. Can you just give us a feel, will they be sustained going forward or will we see those reversed within the other business unit?

Racheal Kellaway: We typically don't - and we're talking reasonably small numbers, but I take your point on there being a $10 million swing, but we don't see material other segment revenues come through. The one piece, as you've called out, is the break costs, and that really depends on where interest rates go in the next couple of periods in terms of customer behaviours around that.

Andrew Lyons: (Goldman Sachs, Analyst) Okay, thanks. Appreciate that. Then just a very quick one. Can you just provide a bit of detail just around the 27 basis point rise in your commercial past dues? I think you've mentioned a few small teething issues for a small number of your companies, but can you just go into a little bit more detail around that and just your comfort around collateralisation and what that might mean for losses down the track?

Racheal Kellaway: Yes. We're obviously very closely monitoring arrears given the tick-up. What I would say is that about half of the commercial arrears increase relates to expired facilities. These are customers we're working with largely to just confirm documentation. The vast majority of those customers are still paying their loan on time.

When we look at the remainder of that arrears portfolio, we're not seeing any real trends in terms of particularly in one industry. There's obviously impacts in consumer-facing industries. We've also seen some pressure in dentists and GPs as they're dealing with post-COVID impacts, but it is a really strongly secured portfolio, well above 90% secured lending, and so whilst arrears are ticking up, that combined with the fact that we're really strongly provisioned and very few actual losses, gives us some comfort.

Andrew Lyons: (Goldman Sachs, Analyst) Thank you.

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

Richard Wiles: (Morgan Stanley, Analyst) Good morning. I've got two questions, please. Firstly, can you give us more of a breakdown of the $200 million of productivity savings you're targeting?

Secondly, you've mentioned deposit composition a few times, do you think rate cuts would be good for deposit competition or bad? Would they make deposit competition better or worse in this environment?

Racheal Kellaway: I'll start with deposits. I mean, it's a really interesting dynamic at the moment given how close we all are to repaying the TFF. I'm going to start with retail deposits. We've actually seen competition start to moderate I would say in the retail space, but as I just talked to competition in the corporate space is still a very, very highly competitive market.

We think that the impact of lower interest rates, if I take the fact that we hedge our portfolio against interest rates movements, that's obviously the replicating portfolio, we do that to smooth earnings, so that would be the first thing.

In terms of how the market responds, I mean we've seen some pretty interesting market dynamics over the past few periods so I think it would be a dangerous place to talk about where we think market dynamics will go as interest rates reduce. However, we've got a really, really strong product team who, particularly when interest rates move, whether that be up or down, they are looking to optimise at every opportunity.

Patrick Allaway: Richard, I'll comment just on the breakdown of the $200 million. I think what we'd say to you is we're on track in delivering against those targets. As I said, there are four aspects to that. One is that at the end of last year we restructured our operating model to consolidate like activities into a shared service model and that has produced material savings. We won't give you detail of the breakdown, but these are contributing.

The second is our property footprint, which I've spoken to. The third piece is the digital rollout and the big impacts are going to in FY25 and FY26 from digitising mortgages and decommissioning our ME legacy platform and the final one is that we're working actively through procurement with our third-party service providers and looking to significantly reduce our cost base and third-party service providers as well.

It wouldn't be appropriate to give you a breakdown across those, but we've made really good progress in the first half and we'll continue to execute against that.

Richard Wiles: (Morgan Stanley, Analyst) Thanks Patrick. Could I just follow up Racheal on your comments around deposit pricing? I think in retail markets there hasn't been much competition recently. The deposit rates, the savings accounts rates haven't gone up since December.

But I'm more interested in what would happen when rates fall. There are some very, very low rates on standard online saver accounts. The major banks are all offering rates that are well below the cash rate. Yes, there are some good introductory rates, but they only last for three to five months.

I'm sort of wondering whether you think when rates start falling, what happens to those standard online saver accounts? Can they go down as much as the cash rate, because they certainly haven't gone up as much.

Racheal Kellaway: Yes, I mean you can see we've actually outlined some analysis in terms of where the bandings are for where we have customers sitting on different rates, so that is absolutely a floor to, as cash rates come down how much banks can also bring customer rates down.

As you pointed out, deposit rates in the retail space have stabilised and we've seen much less switching as you would expect as interest rates have stabilised, so much less switching into higher yielding accounts for customers.

Ultimately, this is exactly why we have a replicating portfolio to protect against the downside and so we've got five-year duration on our replicating portfolio. At the moment that's still providing benefits to margin and that will be a hedge against interest rates reducing as well.

Richard Wiles: (Morgan Stanley, Analyst) Thank you.

Operator: Your next question comes from Andrew Triggs with JP Morgan. Please go ahead.

Andrew Triggs: (JP Morgan, Analyst) Thank you, good morning. First question just on Slide 29 on capital. You saw negative organic capital generation in the period despite RWA being a tail wind to capital. I'm just interested in your settings for growth, Patrick and Racheal and what, I guess, limitations that puts on your ambitions for growth and is there anything that would meaningfully change, or move the dial on organic capital generation in the near term please?

Patrick Allaway: I might make some opening comments Andrew and see if Racheal wants to add to that. I think what we've said to you is we are very focused on ensuring that we get an adequate return on capital and that we do generate capital through our asset portfolio.

As you look at our capital base today, we have a number of levers that we can pull, but we've talked about growing the business bank in the second half. We think that will generate growth and capital through the returns that we get from that and we are right at the top end of our capital range where we are currently trading and feel comfortable with the investment profile that we have, the asset growth profile we're looking at the second half that we will still operate in our target band that we've currently set.

Andrew Triggs: (JP Morgan, Analyst) I'll follow up on that Patrick. Most banks described their perhaps similar style ranges around their capital ratios, but most banks would want to be at the top end of the range when they pay a dividend given the impacts it has on capital in the following weeks and months. Is that not the way that you think about it too and, as a result, are you comfortable moving more into the middle of the range?

Patrick Allaway: We currently are, Andrew, at the top end of our range today. In fact, we're slightly above the top end of the range. We are very comfortable sitting in the middle of the range as well. We have strong buffers on [rotary] buffers and so the management target range is a range that we would be comfortable to operate in through the cycle.

Andrew Triggs: (JP Morgan, Analyst) Thank you.

Operator: Your next question comes from Matthew Wilson with Jefferies. Please go ahead.

Matthew Wilson: (Jefferies, Analyst) Good morning. Matthew Wilson, Jefferies. Hopefully you can hear me okay?

Patrick Allaway: We can thanks Matthew.

Matthew Wilson: (Jefferies, Analyst) There has been lots of talk today about assets et cetera, but really one of your key challenges, if not the biggest challenge, is your deposit profile. Transaction deposits are only 8% of your book and they're shrinking. That's less than half Bendigo, it's a third of the size of the major banks and indeed now, your mortgage offset accounts exceed your transaction balances which is obviously very damaging to NIM.

Can you talk about your strategy to sort of grow your transaction accounts, change your deposit profile, because that's the thing that's really driving your margin pressure.

Then, secondly, if you think the economy is anticipated to improve over 2024, why will interest rates be cut?

Patrick Allaway: Thanks for your questions, Matthew. First of all, on deposits, we have recognised for a long time that we have a lower transaction account base than our peers and that's due to the poor customer experience on our legacy banking platform.

The digital strategy and the digital banking apps that we've launched are a key part of the strategy to shift customers on to a better banking experience and to have their main financial institution banking accounts with BOQ. We've got 23% of our customers now on that platform. It's a deposit of about $6 billion. We recognise that will take time to grow, but in the space of 18 months, we've seen significant growth on the new banking platform and we see it as our strategy to address this ongoing legacy issue.

In relation to your question about the economy, the real question is really where inflation is going and obviously inflation has come down quite significantly over the past period. We think the Reserve Bank activity really is focused on the inflation band that they are targeting and if inflation does continue to come off, we do expect an interest rate cut and I think the market is, if you look at the yield curve, either late this year or early next year.

Whilst the economy is resilient, there are still parts of the economy that are really suffering. Disposable income is at the lowest level we've seen probably in 50 years. That's impacting consumer sentiment. It's impacting a number of sectors in the economy, so whilst we do think the economy has bottomed, we are not suggesting significant growth from the current levels. We do see small growth into next year. We do see the unemployment rate going higher, so our view is when you've balanced all of those things, we think the interest rate cycle has peaked and we would expect interest rates to come off next year.

Matthew Wilson: (Jefferies, Analyst) Just as a follow up on the deposits, because really digitisation is a defence strategy, not an attacking strategy, so can you sort of add more colour as to how you're going to acquire new customers? Customers aren't captivated by apps, they just keep you at that bank. How do you win customers?

Patrick Allaway: We win customers by an exceptional customer experience with BOQ. We go above and beyond for our customers. It's all of their interactions across a seamless experience, whether it be through the digital banking app, whether it be through our contact centre, whether it be through our owner manager branches or interaction with our bankers. We recognise as a smaller bank that's where we can differentiate and that's a very, very important part of what we do.

It will take time to grow those accounts. We do not see it as a defensive strategy. There is no question also that customers are focused on yield and that you are seeing customers shifting out of low-cost transaction accounts across the industry into high yielding term deposits and savings accounts. We don't think that trend is going to change with the spread and the increase that we've seen in interest rates, we think that will continue. We are really focused on what we can control in this market and we think our digital banking offering is an exceptional offering, it's been rated really well, that will grow our customer base and grow our transaction accounts.

Matthew Wilson: (Jefferies, Analyst) Thank you.

Operator: Your next question comes from Matt Dunger with Bank of America. Please go ahead.

Matt Dunger: (Bank of America, Analyst) Thank you very much Patrick and Racheal. I was just wondering if you could help me understand why your mortgage margin pressures are stabilising in the context of some above system growth in February and assumedly some more retention pricing needed after that peak of fixed to variable rate rolls. Why are you assuming that - what are you assuming on the retention pricing versus those outflows?

Patrick Allaway: The pressure on retention pricing has eased, that's across the industry. We have seen obviously the bank to front book spread come in and we are seeing front book pricing moderating, so the pressures and the steep decline that we'd previously seen and the pressures that we'd previously seen are moderating. We're not saying that it's stopped, but certainly that's what's been experienced across the industry.

Matt Dunger: (Bank of America, Analyst) Thanks Patrick. Just relatedly, are you able to talk to where the exit NIM landed or how the NIM trended throughout the period, given we don't see quarterly updates?

Patrick Allaway: We don't provide an exit NIM, but NIM is down 3 basis points half on half, so you have seen a significant moderation in the impact of our NIM from the previous prior year period comparison, but we don't give an exit NIM outlook, but I think what we've told you in the outlook statement is that we are seeing NIM pressure moderating, particularly on the asset side. We do anticipate there will be continued pressure on the deposit side until the TFF runs off.

Matt Dunger: (Bank of America, Analyst) Thank you.

Operator: Your next question comes from Azib Khan with E&P. Please go head.

Azib Khan: (E&P, Analyst) Thank you very much. Patrick, one of the objectives of the digital transformation is to become a simpler, lower cost bank. With that in mind, as you work through the digital transformation and as you progress through the AUSTRAC enforceable undertaking, is there thought being given to whether you want to continue to bank the more complex customers?

Patrick Allaway: Thanks for that. Clearly, we are looking through our digital bank to provide a very simple, exceptional customer experience, fast time DS, low cost to serve, and they are largely PAYG customers. There will be customers that own their own businesses that more complex within our relationship bank that we will continue to bank. That is a higher cost to serve and that will be reflected in differential pricing between relationship banking and digital banking.

Azib Khan: (E&P, Analyst) Can we expect the customer mix to change in that regard in terms of more straightforward customers, less complex customers and does that mean there's more pressure on your margin outlook and making it more difficult to hit those FY26 targets?

Patrick Allaway: So Azib, I think you would expect that simple customers are certainly more scalable. Where there's very little human touch involved and where we have automated processes, you would expect that that would be a faster growing, scalable platform than our relationship banking platform.

Azib Khan: (E&P, Analyst) Just a second question specifically on the AUSTRAC EU, how far are you through the remediation of customer files on that front and what sort of issues are you uncovering as you go through the remediation process?

Patrick Allaway: So look this is a multi-year program, it's a three- to four-year program. As I've said, we've made really, really good progress in terms of the deliverables of where we are. I'm not going to comment on customer files or where we are. What we are telling you today is that we are on track. We have sign off on the first phase of the program from the independent assurance providers and we are meeting the expectations of our regulators in terms of the workstreams and the timeframes of the deliverables.

Azib Khan: (E&P, Analyst) Thank you.

Operator: Your next question comes from Brendan Sproules with Citi. Please go ahead.

Brendan Sproules: (Citi, Analyst) Good morning, thanks for taking my questions. The first question I have on the business banking division, you've talked about trying to grow in more niche sectors and in slide 11 you called out the strong growth in the novated leasing business. But you've also got a number of portfolios that are either being run down or slowed like large commercial real estate, targeted slowing of household growth and then within asset finance, you've got a number of non-core portfolios.

When you combine that with obviously the deposit competition, how quickly can the revenue in this division turn around and how quickly will it be before these new niche sectors really start to drive the growth of this division?

Patrick Allaway: Thanks for that question, Brendan. We did say at the end of last year we would be cautious at this stage of the economic cycle and that we would retain credit settings, preferring to wait until we saw a more certain economic outlook. In addition to that, we did call out that our finance business had had a significant growth post COVID into last year and it would be difficult to replicate that growth this year. We are also calling out that we're rebalancing the book to focus on the specialist sectors where we have a competitive advantage. So with all of that, we've seen flat growth in the first half.

With the restructure and where we are, we have recalibrated some of our credit settings with a more confident outlook for the economy. We have a strong pipeline into the second half and so we are feeling more confident about returning aspects of that book to growth. But the business mix will take time, so it's not going to happen quickly, but what we're saying to you is we are operating in a number of sectors where we do have a competitive advantage, where we have a dominant market position or we are not competing against the majors on our cost to capital, but rather than competing with the non-bank sector. You should anticipate that we will grow those higher-returning sectors where we do have that competitive advantage.

Brendan Sproules: (Citi, Analyst) Terrific, thank you. Then my second question is just around these FY26 targets which obviously you've outlined on slide 18 some additional considerations. But given where you're sitting today with an ROE below 6%, a cost to income ratio on a case basis of mid-60s, it seems quite a long way from the targets. The time to 2026 is slowly closing. When is it prudent to make a decision either way on these? It does feel like we're meandering along in the wrong direction and the gap's just getting bigger and bigger and I'm just wondering when the time will come to make a decision with more bold decisions and initiatives to get there or an acceptance that the market has just unfortunately moved the wrong way for you?

Patrick Allaway: Yes, so look I've said quite a lot of that already on the call. We do recognise that the challenge is large and that if this is structural, we won't get there with the current pathway. So we are very, very focused on the additional pathways that I've spoken to. We are going to be bold, so we recognise that we need to do something bold to address this. We will call it, if we're not going to get there, but we do see, as we said, margins moderating. So if this is a combination of cyclical and structural, we do see pathways where we can change our business mix. We do see pathways where we can optimise our balance sheet where we can get to those targets. But clearly if we felt there was no way we could get there under any pathway, we will let you know.

Brendan Sproules: (Citi, Analyst) Just quickly on a follow-up to that, is portfolio optimisation the bold plan here? Is selling off parts or portfolios of the business the type of bold strategy that you may be considering?

Patrick Allaway: I'm not going to speculate on that. We are looking at multiple opportunities to pursue additional pathways to get to where we need to get to. If we have anything to tell you, we'd certainly tell you at the appropriate time.

Brendan Sproules: (Citi, Analyst) No worries, thank you.

Operator: Your next question comes from Nathan Lead with Morgans. Please go ahead.

Nathan Lead: (Morgans, Analyst) Thanks for your presentations, Patrick and Racheal, just two questions from me. So first up obviously the four-basis point benefit from the fixed to variable housing mix shift, but the spike, I suppose, in maturities is quite high in the first half. Is the NIM contribution likely as significant going into the second half and beyond that? I suppose I'm thinking about the averaging impact coming through the balance sheet.

Racheal Kellaway: Yes, it is actually close to being about the same impact in the second half and that's two factors. One, we'll see the full second half benefit of those customers that rolled in the first half and then the second is we still actually do have - and the profile is outlined in the slides, but we still actually do have some towers and reasonably material towers coming off on the second half again.

Nathan Lead: (Morgans, Analyst) Okay, great. Then the second question for me is just your replicating portfolio, the earnings rate still mid-2%, five-year swap rates are over 5%, can you give us a bit of a steer about how quickly the earnings rate can converge on the swap rate if swap rates remain relatively stable? Is it a smooth path upwards or is there a bit of a step change to it?

Racheal Kellaway: I would say at this point it's a smoother path compared to a step change, I would say.

Nathan Lead: (Morgans, Analyst) Okay, thank you.

Operator: Your next question comes from Victor German with Macquarie. Please go ahead. Victor German, your line is now live, please proceed with your question.

Jason Shao: (Macquarie, Analyst) Sorry, this is Jason in place of Victor. Victor is away at the moment. You mentioned digital bank as a way to win more transaction deposits, but your digital bank currently offers some of the highest savings rates in the market at the moment. What are the behaviours of customers you're seeing coming across the digital bank offering? Are they bringing in many transaction deposits from other banks or are they mostly using it as a savings account feature?

Patrick Allaway: So we're seeing increased activity on our digital bank in savings account and transactions accounts. We are not the highest rate in the marketplace, we are not feeling like we've got to be the pointiest price to attract customers to that channel. We continue to see growth on the channel and we continue to see that as a really great opportunity for us to both fund our liquidity, but also provide our customers with a solution across both transaction banking, savings accounts and deposits.

Jason Shao: (Macquarie, Analyst) So if I ask that question another way, what is the approximate deposit mix of your digital bank offering at the moment, between transaction and other types of accounts?

Racheal Kellaway: We'll come back with the detail.

Patrick Allaway: Yes, can we get back to you with that detail? Thanks Jason.

Jason Shao: (Macquarie, Analyst) Okay, thanks. Second question, you also raised your Bank interest rates on your digital bank recently as well. Given credit growth isn't actually that strong at the moment, what was the rationale behind raising some of the savings rates on those accounts? I appreciate it's probably not much, but just want to hear your thoughts on it.

Patrick Allaway: Yes, look we manage that channel appropriately, so wholesale markets are more expensive than funding through retail at the moment and you might see times when we have maturities coming up with term funding facilities or other funding maturities coming through, that we would use that channel to raise liquidity and you would see movement and rates to reflect that. I think that's just a normal part of managing our liquidity and managing our maturity profile. But there's a cheap part of our funding base compared to wholesale funding and as Racheal said in her presentation, we have significantly lifted the deposit to loan ratio.

Jason Shao: (Macquarie, Analyst) Okay, thanks.

Operator: The final question today comes from Brian Johnson with MST. Please go ahead.

Brian Johnson: (MST Financial, Analyst) Thank you and thank you very much for the opportunity to ask a second question. Patrick, in the wake of Silicon Valley Bank collapsing, we've got regulators around the world kind of flagging what they should do. One of the things that APRA has said, perhaps they should raise - or lower the bar on what's deemed to be systemically important and certainly have a look at the way liquidity works for smaller players.

At the moment the liquidity reforms seem to - the LCR is still based on a 5% stable deposit outflow, which is exactly the same as Commonwealth Bank. I was just wondering, could we get your read on what APRA are thinking about and how potentially lowering the bar on systemically important and perhaps even calibrating the liquidity coverage ratio slightly differently, could we get a feeling on what you think these reforms might mean for BOQ?

Patrick Allaway: Yes, so Brian I can't give you a read on what APRA are thinking, but I can certainly talk to how we manage our liquidity and we do think for a resilient banking sector that liquidity thresholds for smaller banks are really important and I think what they experienced in the US regional banking crisis was really a function of not having regulatory requirements and particular on liquidity for those banks.

So we are very focused on liquidity levels that are appropriate for us. We are holding liquidity and stable funding ratios well above the prudential requirements, so irrespective of those changes, we think that's appropriate and we will shift our liquidity levels based on the environment that we're trading in and operating in. You would have seen that last year we held much higher liquidity levels during wholesale markets being closed for a period because of the Ukraine war and the regional banking crisis in the US.

We've also held high liquidity levels through repayment of the term funding facility. So I think probably what's most important for us is the appropriate liquidity level for the risk environment that we're trading in and we feel that the regulatory limits and prudential limits that we have are appropriate and we'll continue to manage our liquidity prudently.

Brian Johnson: (MST Financial, Analyst) On lowering the bar for what's deemed to be systemically an important bank, Patrick, what potentially would that do, if you in fact had to hold more capital?

Patrick Allaway: Look we currently hold between 20% and 30% more capital than the majors. We do think that that's an unfair playing field for a portfolio that we have which is probably less risky given the percentage of home lending we have on the portfolio and the high level of security we have across the portfolio. So certainly we will continue to push for a fair playing field in relation to capital. Basel III has helped bring that playing field a little bit closer together, but we still are of the view that there is a significant advantage for advanced model compared to standardised models. It is very, very difficult for us to get to an advanced model accreditation, so that certainly is something that prevents competition and prevents us from providing a viable alternative to the majors for Australians.

Brian Johnson: (MST Financial, Analyst) Patrick, just a final one to pre-empt a question you're going to get from everyone, is the mid-cycle loan loss charge still 12 basis points?

Racheal Kellaway: I might jump in there. It's interesting, so we've actually been saying that our portfolio long-term LAE rate is about 14 basis points. Obviously, it depends on business mix. You're right, given we're at the low point or close to from an economic perspective and our current level of actual losses in the portfolio, we are hopeful that over time we would see that long-term average reduce.

Patrick Allaway: I think the only thing, Brian, that we should just add to Racheal's comment, is sometimes there is a lagged impact of interest rate rises where customers hold out and hold out and it's difficult. So I think if this cycle continues with rates higher for longer, then that might well change. But based on our views about where the economy is and our expectations on interest rates, we don't expect any material change.

Brian Johnson: (MST Financial, Analyst) Patrick, so the greater than 9.25% 2026 ROE target, that's premised on a 14 basis point loan loss charge.

Patrick Allaway: It's premised on a normalised credit market, that's correct.

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

Patrick Allaway: Thanks Brian.

Operator: Thank you. That concludes the question-and-answer session. I'll now hand back to Ms Jessica Smith.

Jessica Smith: Thank you again everyone for joining us today. If you have any further questions, please reach out to the Investor Relations team and we look forward to connecting with many of you over the coming days. Thank you.

End of Transcript