



BOQ Half Year Results Announcement

Wednesday, 8 April 2020

Speakers: George Frazis, Managing Director and Chief Executive Officer
Ewen Stafford, Chief Financial Officer Chief Operating Officer
Adam McAnalen, Chief Risk Officer
Tim Ledingham, Treasurer
Cherie Bell, General Manager Investor Relations

Transcript:

Operator: Thank you for standing by and welcome to the Bank of Queensland Half Year Results conference call. I would now like to hand the conference over to Cherie Bell, General Manager Investor Relations.

Cherie Bell: Good morning everyone and welcome to BOQ's first half results presentation for 2020. Before we begin, I would like to acknowledge the traditional owners of the land upon which we meet today and recognise Elders past, present and emerging. I would like to thank you for joining us via the audio webcast today in lieu of our usual results presentation, recognising the present COVID-19 challenges we are all facing.

Joining me today is George Frazis, our Managing Director and CEO; Ewen Stafford, our Chief Financial Officer and Chief Operating Officer; and Adam McAnalen our Chief Risk Officer. We are also joined by members of BOQ's Executive team and senior management.

I will shortly hand over to George to provide an overview of the financial results and an update on our progress against our strategy before Ewen speaks to the results in more detail. George and Adam will then provide additional detail on our response to COVID-19 and our underlying asset quality which we felt was important given the current environment.

Following this, George will provide concluding remarks and observations, after which there will be an opportunity for analysts and investors to ask questions. I will now hand over to George to outline the results.

George Frazis: Thanks Cherie and good morning everyone. I do want to thank you all for joining us in what are absolutely extraordinary times. Now while our primary focus today is the Bank's first half results, given the significant impact of COVID-19, I will provide an update on how we see the economic environment and the impact on our business and industry, and BOQ's response.

As Cherie mentioned, I will be joined by our CFO, Ewen and CRO, Adam to help present and we've got other members of the Senior Executive Team here also to help answer questions. Turning to the headline first half results on slide 4, our cash NPAT is down 10% versus the prior corresponding period and down 1% compared to the second half in 2019.

The decrease is the result of the previously flagged increasing expenses, predominantly due to the regulatory compliance costs and strategic investments. Those investments form part of our focus on delivering a material improvement on past performance. To do that we have a clear strategy in place. We are executing that strategy and are already seeing the benefits start to flow with improved balance sheet and income momentum across the housing and commercial portfolios.



A review of our operating model and implementation of its recommendations is underway, including the restructuring of our workforce and a reprioritisation of our investment portfolio. With a clear transformation program, we maintain the ability to flex this program of work as required in response to changing market dynamics.

The economic landscape has shifted enormously in the six weeks since our strategy update due the fast escalation of COVID-19. While the rapid and welcome response by the government and regulators will cushion the economic hit, the outlook for the economy, our customers, and as a result our business, remains deeply uncertain.

But as I will outline this morning, we have entered this period as a simplified business with a strong capital and liquidity position, a robust risk management framework and a portfolio that provides us flexibility to adapt as required. I'm confident that BOQ is well positioned with a healthy capital buffer to respond to adverse impacts in the current environment and we will continue to execute against our strategy, to position BOQ for strong return to growth when the economic clouds pass.

Turning now to the results themselves on slide 5. Our first half result was solid and is in line with the improved updated guidance provided at the strategy briefing in February. Statutory net profit after tax was \$93 million, impacted by a number of below the line adjustments relating to our restructuring activities. This result was down 40% from the prior corresponding period and 35% lower on the previous half.

Cash earnings after tax decreased 10% to \$151 million for the half and were 1% below second half 2019. Cash return on equity decreased to 7.5%. Common equity tier 1 is materially higher during the half at 9.91%. Overall our cash earnings per share decreased 15% to 35.3 cents per share.

After the market closed yesterday APRA provided a letter to all ADIs and insurers regarding capital management and the deferral of dividend decisions until the outlook is clearer and robust stress testing results have been discussed with APRA. Based on this guidance BOQ has determined to defer the decision on payment of an interim dividend.

The drivers of the first half results are outlined on slide 6. Total lending grew by \$781 million or an annualised rate of 3% during the half representing an uplift of 56% on the prior corresponding period and 79% on the second half of FY19. Improvements in lending growth were seen across both our retail and business banks. NIM reduced by 3 basis points during the half, slightly down on the 2 basis points decline seen in the second half of FY19.

The cost to income ratio increased marginally to 54.0% during the half, due to investments in phase 1 of the Virgin Money Australia (VMA) project and modernisation of our core infrastructure, as well as increases related to risk and regulatory compliance.

Importantly, we have a number of initiatives in train to ensure our cost growth is contained to less than 1% from FY21 onwards, as the benefits of our productivity initiatives begin to flow through.

The loan impairment expense was flat at \$30 million and equates to 13 basis points of gross loans.

It was pleasing to see momentum building in both the housing and commercial portfolios in the half year, as seen on slide 7. Both VMA and BOQ Specialist continued to grow their housing portfolios. BOQ Blue is still contracting, but at a slower rate, thanks to increased acquisitions volumes.

In the commercial portfolio we had some growth in both the BOQ Commercial and Specialist businesses, through their focus on niche segments.



The asset finance business continues to grow at a slower rate, with an emphasis on improving margins and returns.

Moving to Retail banking performance on slide 8, we continue to see growth across NPS metrics, reflecting our focus on improving the experience for our customers. This improved experience is driving the uplift in the lending portfolio and maintenance of the deposit portfolio.

We continued to see good momentum across the VMA product lines, with the lending portfolio now in excess of \$3 billion.

Now to slide 9. The Business bank experienced good growth across the niche segments during the half. Commercial and housing lending both grew materially, compared to the prior corresponding period, supported by solid growth in the deposit portfolio. We maintain a portfolio diversified across a range of industries, the importance of which is amplified during this period of economic volatility.

Turning to slide 10, the first half result was slightly better than what we forecast at the Strategy Day. We have a clear strategy in place to take advantage of a number of shifts in the industry and broader environment. This focus on attractive growth in niche segments with a differentiated business model will enable us to deliver sustainable, profitable growth.

In the current environment, our purpose, that puts empathy at the heart of a customer-led approach, plays a key role in helping us to navigate this period of change for our customers, people and shareholders.

Underpinning this approach is a staged digital transformation that will provide better outcomes for customers, and value for our shareholders.

Now to our strategy progress on slide 11. As I highlighted at our Strategy Update, we are executing on our strategy across five pillars and have delivered a number of initiatives during the first half of FY20. Under our first pillar - our purpose-led empathetic culture sets us apart - we have refreshed the purpose and values and have already seen improvements in both our MFI and lending NPS results.

Under distinctive brands serving attractive niche customer segments, we have built momentum in home and business lending, with new business volumes above system. Under Digital Bank of the future with a personal touch, we have delivered a new mobile app for BOQ Specialist, now on track to deliver the first stage of our VMA Digital Bank in 2020 - the first step in the digital transformation of the wider group.

We are pursuing several initiatives under simple and intuitive business with strong execution capability. We have delivered a material improvement in our 'time to yes' for customers seeking a home loan from five days to an average now of conditional approval in less than one day.

We have identified and largely delivered a number of productivity savings, including a 4% reduction in our spot headcount from FY19 to first half 20. Our investment portfolio can reprioritise, providing timely flexibility around our program in FY21.

Finally, under our fifth pillar - strong financial and risk positions is attractive returns- we have strength in the balance sheet through the capital raising, giving us the flexibility to transform the business and respond to the changing market dynamics. We have a good liquidity position with net stable funding ratio of 133% and a liquidity coverage ratio of 112%. [Correction: the correct figures are net stable funding ratio of 112% and a liquidity coverage ratio of 133%.]

I'll now hand over to Ewen to talk through the financial results in more detail.



Ewen Stafford: Thanks George, and good morning everyone. Turning firstly to the Group financial performance on slide 13.

Total income of \$541 million was flat with PCP. This was the result of a 1% increase in net interest income driven by growth in the balance sheet in both full year 19 and in the first half of FY20, and tight margin management. This NII growth was offset by a \$7 million reduction in non-interest income.

Operating expenses increased 9% as a result of the investment in strategic initiatives and increased spend on regulatory and compliance activities. In line with George's earlier comment, we have taken a \$10 million collective provision overlay in relation to the potential impacts of COVID-19, as they were understood at February 29. Inclusive of this overlay loan impairment expenses remain flat, with PCP at \$30 million, equating to 13 basis points of GLA.

Cash earnings reduced by 10% compared to PCP to \$151 million for the half, with a 1% reduction when compared to the second half 2019. Statutory net profits decreased to \$93 million, impacted by the below-the-line adjustment of \$58 million.

Breaking the financial results down to a segment level on slide 14, the Retail bank was down 17% in cash earnings to \$55 million, with net interest income flat and non-interest income lower, compared to PCP. The business had higher operating expenses with a positive contribution through loan impairment expenses, as a result of the improved arrears profile, partially offset by increases in specific provisions primarily through Western Australian and regional areas.

Cash earnings for BOQ Business decreased by 3%, down to \$99 million for the half. There was strong net interest income growth of 4%, driven by asset growth and supported by 11% growth in deposits, which resulted in a \$10 million increase versus PCP.

This was offset by lower non-interest income, due to the sale of the debtor finance book in second half 19, and the loss of merchant terminal income as we migrated to an outsourcing arrangement for these services. Business banking was also impacted by higher operating expenses and impairment expenses as a result of the \$10 million COVID-19 collective overlay, which sits almost exclusively in BOQ Business.

As can be seen on slide 15, the lending portfolio grew to \$47 billion. As outlined at Investor Day, our new strategy is delivering strong growth in both the housing and commercial portfolios, with 56% higher growth for the half compared to the first half 2019.

VMA and BOQ Specialist have both delivered an uplift in housing volumes, while BOQ Blue is starting to see the benefits from the home lending transformation program with increased new business volumes and a slower contraction in balance sheet. Asset finance grew at a measured lower rate of 1.3% in the first half 20, as the business focused on pricing, margins and improving returns.

Overall, the focus will remain on asset growth, while maintaining the quality of assets and managing margin across our niche businesses, to support sustainable, profitable growth.

Given the current environment, I will spend some time talking through our funding and liquidity position. BOQ is well positioned on funding, which is outlined on slide 16. During the half, we have held customer deposits at \$32 billion, or 69% deposit-to-loan ratio. Reliance on higher cost term deposits has reduced, and savings and investment balances have increased.

Fast track deposit products continue to be well-received, particularly in younger demographics, which has supported the tilt in customer deposit mix, and new customer acquisition. The launch of



Virgin Money digital transaction and savings deposits products later in 2020 will further support growth in this area.

Through the half, we have continued to focus on increasing longer-term wholesale funding sources. Since full year 2017, we have increased long-term wholesale funding by \$2.2 billion, allowing us to reduce reliance on short-term funding. BOQ has a reported liquidity coverage ratio of 133% at the end of first half 2020, and a net stable funding ratio of 112%. BOQ's strong funding and liquidity ratios have us well-positioned in this period of economic uncertainty.

Turning to slide 17, BOQ's wholesale funding objectives are based on capacity, resilience and diversity, while minimising the cost of funds and maintaining the flexibility to take advantage of opportunities in the most appropriate global markets.

This ensures we are well-placed from a liquidity and funding perspective, with diversified funding sources and orderly maturity towers. In second half 2020, we have senior unsecured maturities of \$700 million, and our stable funding profile, coupled with our strong capital position, provides us with the ability to redeem the \$150 million additional Tier 1 notes at the call date in late May, 2020.

We also have diversified access and capacity available through a range of term funding instruments, including domestic and offshore unsecured funding programs, three AAA-rated securitisation programs, and an additional \$1.7 billion capacity in our AAA-rated \$3.25 billion covered bonds program.

Turning to slide 18. The impact of COVID-19 has been significant for financial markets. However, BOQ's good liquidity and capital levels prior to the market disruption, diversified funding base, and continued focus on customer deposit gathering, sees us well-positioned during this period of volatility. Announcements from the RBA and APRA have promoted market liquidity and provided alternative funding options for us.

In addition, BOQ have increased its internal securitisation by approximately \$1.7 billion, to provide coverage of 150% of our \$3.4 billion committed liquidity facility, further strengthening the availability of our contingent liquidity portfolio. This combination of good liquidity and funding, in addition to Central Bank and government stimulus, provides BOQ with access to a range of funding options.

Turning to net interest margin on slide 19. NIM has decreased three basis points in the second half 2019 to 1.89%. Asset pricing and mix delivered a six basis point benefit. Within this, housing repricing activities increased NIM by seven basis points, with a further two basis point increase from commercial and assets finance repricing.

There was also one basis point benefit to NIM as a result of the shifting mix toward higher margin commercial and asset finance lending. These benefits were partially offset by a four basis point reduction from the front to back book drag. Funding costs had an adverse impact of four basis points for customer deposits, and one basis point for wholesale funding. The impacts of hedging costs improved NIM by four basis points in the half, driven by a reduction in basis portfolio spreads from 39 to 24 basis points.

The cash rate cuts and associated lower interest rate environment has reduced BOQ's NIM by four basis points, due to a three basis point reduction on the replicating portfolio and an additional one basis point reduction on the uninvested free funding and low cost deposits. Partially offsetting this decline was a one basis point benefit as a result of a shifting funding mix towards more equity following the capital raise.



Third party costs increased during the half, resulting in a two basis point reduction in NIM, with a further one basis point decrease due to the accounting treatment changes for leases under AASB16, which are now fully embedded. The higher third party costs are a reflection of higher commission payments due to increased volumes through the broker channel and owner-managed branches. Higher average liquidity balances during the first half contributed to a further two basis point decline in NIM.

Looking forward to the NIM outlook in the second half 2020, overall we're expecting NIM to be broadly flat. We anticipate the front to back book drag to continue at approximately four basis points per half. We expect to see significant benefits to NIM as a result of asset pricing changes announced in March. Given current basis costs, we do not expect a material impact to NIM in the second half relating to hedging costs.

As a result of cash rate changes, we expect to see a three basis point decline in NIM in the second half from the capital and low cost deposits replicating portfolio. The impact is expected to continue into FY21 and then flatten into FY22, as the yield curve out to three years remains flat and rates remain low. The impact of funding costs is uncertain and can move quickly, however we anticipate the funding available through the term funding facility to provide an uplift to NIM of two basis points in the second half.

Based on current market conditions, we expect that this will be more than offset by higher funding costs elsewhere in the wholesale and retail funding portfolios. Furthermore, we expect the negative impact of higher average liquidity balances in NIM in the first half 2020 to unwind in the second half.

Non-interest income is outlined on slide 20. We have continued to see pressure across all subcategories, with an overall reduction of \$7 million or 11%. In line with industry trends, the decline was driven by lower bank guarantee volumes, a continued shift towards low and no-fee products and the reduction in merchant fees. In addition, we experienced lower debtor finance fees as a result of the sale of the business in August 2019.

Income in the St Andrews Insurance business continued to decline in the first half 2020 as the business is now closed to new sales of consumer credit insurance. We expect further declines as a result of higher claims experience in the second half 2020 due to the current economic environment.

Trading income contributed \$2 million in first half 2020, however is expected to be lower in the second half 2020 due to market volatility. Overall, we expect the decline in non-interest income to continue into the second half as we support our customers by waiving business banking fees and the continued transition to low and no-fee products.

Moving now to operating expenses on slide 21, expenses of \$292 million for the half increased by 9% on PCP and by 4% from the second half 2019. The key drivers of the \$24 million increase were \$8 million project-related technology spend on strategic initiatives, \$17 million on risk and regulatory expenses and \$4 million on general IT expenses. These were partially offset by a reduction in occupancy and general expenditure. Total amortisation expense was \$18 million and flat on PCP, benefiting from the below-the-line adjustments. Given what we know today, the outlook for expenses for FY20 remains as outlined at investor day in late February.

Turning now to portfolio provision and loan impairment expenses on slide 22, provision balances and impaired assets remain stable with the second half 2019 at \$235 million and \$196 million respectively. Loan impairment expense was \$30 million in the first half 2020, in line with PCP and down \$14 million compared to the second half 2019. Specific impairment expense increased by \$10



million compared to PCP as a result of declining property values in Western Australia and regional centres and two top-up provisions on pre-existing large commercial impairments.

The collective impairment expense of \$2 million for the first half 2020 included two key components. Firstly, a net underlying \$5 million reduction comprising changes in credit growth mix (largely in housing), improvements in the underlying data quality relating to collateral, and regular movements through runoff and amortisation.

Secondly, a \$7 million uplift in the collective provision overlay was recognised as a result of the \$10 million COVID-19 estimate, based on best available information at 29 February and utilising scenario stress testing undertaken at that time. This increase was partially offset by the release of \$3 million for the Agri portfolio due to improvements in drought conditions from recent rains and anticipated winter crops. Loan impairment expenses to GLA remain at 13 basis points, consistent with the first half 2019 and an improvement of six basis points from the second half 2019.

Moving on to the capital investment program on slide 23, during the first half we spent \$52 million on capital initiatives, primarily relating to phase one of the VMA digital bank to deliver transaction and savings products, and the modernisation of core infrastructure, including the migration of key data centres to a cloud environment. Both of these investments are foundational to our strategy to become a simpler and digitally enabled bank.

A further number of other smaller capital investments have also been completed during the half, including a new app for BOQ Specialist customers, new CRM tool for our frontline, a replacement of the contact centre telephony platform, phase one of the home lending transformation platform and new regulatory and compliance tools. As part of the intangible asset review, we have made a material adjustment to our software intangibles balance. This includes a \$26 million reduction for a change to our capitalisation threshold policy to \$1 million, which decreased the number of intangible assets from 135 to 55.

Further, the accelerated amortisation of six legacy assets as a result of the strategic reset of the technology road map decreased the intangible balance by \$16 million. We have now completed the review and outside normal impairment testing, we are comfortable with the balance sheet position. The remaining assets on the balance sheet have an average duration of 5.1 years. As mentioned, the amortisation charge for the period was \$18 million. To reiterate comments made at investor day, the transformation strategy contains the flexibility to adjust our capital expenditure to suit shifting markets and customer dynamics.

Slide 24 includes a summary of the non-cash items for the first half. We previously communicated that statutory earnings will be impacted by material one-off below-the-line adjustments of circa \$80 million to \$100 million pre-tax, or circa \$65 million to \$70 million post tax. Further, we noted that the charge was likely to be recognised 70% in the first half and 30% in the second half 2020. As part of the strategy refresh, we have recognised \$47 million post-tax in the first half 2020, reflecting a \$32 million impact on the intangible asset review and a \$15 million restructuring charge.

As explained in the prior slide and talking now in post-tax dollars, the intangible asset review resulted in an \$18 million impact due to our capitalisation threshold policy change, \$11 million accelerated amortisation relating to the strategic reset of the technology road map, and \$3 million in relation to essential upgrades required for the legacy BOQ Blue banking platform.

Restructuring charges incurred in the first half included \$10 million in redundancy charges and \$5 million relating to the development of our pathway to simplify our business and improve cost to income over the medium to longer term. The spot FTE reduction during the first half was 77 or 4%



compared to the full year 2019. There was also \$11 million of other non-cash items in the first half 2020 consistent with the last two halves.

As touched on, the second half 2020 will see further impacts in line with prior guidance, with additional one-off investments relating to the balance of the redundancy costs from the operating model review and accelerated strategic initiatives, including foundational automation work and people and culture programs.

Moving to capital on slide 25, George has already flagged that we're in a very strong capital position, with a CET1 ratio of 9.91%. This represents a large buffer in excess of APRA's unquestionably strong capital requirements to standardised banks and is in excess of BOQ's current CET1 target range of 9% to 9.5%.

The \$340 million capital raise delivered an additional 110 basis points of capital. Importantly, underlying capital generation added six basis points to CET1, compared to the seven basis point of consumption in the second half 2019. This shift was due to lower consumption from risk weighted asset growth given the focus in the half towards lower risk-weighted housing exposures, away from more capital-intensive businesses such as BOQ Finance.

An underlying increase in capital investment in the first half 2020 was partially offset by the impact of the intangible asset review. There was a further five basis point impact from the restructuring charge. We have moved quickly to strengthen the balance sheet through the capital raise and focused on underlying capital generation, positioning us well to execute the refreshed strategy and providing resilience in the current operating environment.

Finally, turning to slide 26 and the potential impact of COVID-19 on our business subsequent to balance date of 29 February 2020, circumstances have evolved significantly since then and as such, we have made a detailed subsequent event disclosure and details of this can be seen in note 5.5.4 in the statutory accounts. The materiality of the likely impact has given rise to a non-adjusted subsequent event disclosure. The impact on the collective provision for FY20 is estimated to be in the range of \$49 million to \$71 million, inclusive of the \$10 million recognised in the first half 2020.

The overlay has been determined based on forward-looking scenarios and the impact on our portfolio, considering the facts, circumstances and forecasts for future economic conditions and supportable information available as at yesterday, 7 April. In assessing the forecast economic conditions, consideration has been given to both the significant government support measures being undertaken and also to relief offered to borrowers by BOQ. The calculation of the estimated impact on the collective provision in this current environment is subject to significant uncertainty, and although BOQ has provided a range for the outcomes of COVID-19, this range may move materially as events unfold. As such, the range of \$49 million to \$71 million should not be seen as firm guidance, nor as a forecast as to the final impacts expected.

Adam will take you through the underlying modelling assumptions and potential impact on our portfolio shortly. On that note I'll hand back to George.

George Frazis: Thank you Ewen. Now moving to slide 28 - a lot has happened since our strategy update six weeks ago. Today the severe impact of the pandemic on the Australian economy and financial systems are clearer but still very unpredictable. We have entered this period with a strong capital and liquidity position and a steadfast commitment to support our customers and our people through the stable and ongoing operation of our business.



We are continuously assessing the impact of the pandemic on our portfolio, ready to respond as necessary. In the meantime however we are focusing on executing against our strategy in the knowledge it will position BOQ for a strong return to growth.

Turning to slide 29, since the onset of COVID-19 BOQ has been actively working with the Australian Banking Association, Federal government and regulators to structure a number of industry responses that complement action by the RBA and APRA. The response by regulators is assisting BOQ to support our customers during this period by providing certainty of cost effective funding and ensuring capital is preserved as customers defer repayments.

As I mentioned earlier BOQ is fundamentally a good business. We have a strong balance sheet supported by good liquidity, funding and underlying credit position. We have taken steps to simplify our business and our investment portfolio provides us flexibility to adapt as required.

We are making it clear to our customers and people that we are here for them and we will work with them through the challenges ahead. As a guide, current scenario analysis gives us the collective provision range of \$49 million to \$71 million, \$10 million of which is recognised in the first half 2020. As Ewen said, Adam will cover the scenario modelling in more detail.

I would like to talk briefly about what we are seeing in the macroeconomic environment and how governments, regulators and industry are responding as can be seen on slide 30. It goes without saying that the economy is facing a very difficult period, the length and depth of which is unknown. The government and the RBA have taken decisive and significant action and have stated that they will provide whatever further assistance is necessary.

That action will cushion the economic hit, save countless jobs and businesses and provide the nation with the best chance of a V shaped recovery. Australia's sound economic fundamentals will all help to underpin the economic recovery. We see a V-U shaped recovery scenario as the most likely outcome at this stage which our CRO Adam, as I said, will talk to in more detail.

However, there remain major challenges and uncertainties. The impacts will be different by industry segment. Consumer confidence has dropped significantly and we expect to see a notable rise in unemployment and household saving rates decline, although the run-down may be minimised somewhat by the government stimulus.

We expect the housing market to be very soft and prices to decline at least until the economic situation stabilises. However, the combined balance sheet strength of the government, RBA and the banks provide a significant benefit through their alignment to cushion the impacts on the economy.

So what does this all mean for BOQ and our customers? Slide 31 highlights some of the steps BOQ has taken to ensure our people are cared for and there is limited disruption to our business. BOQ remains committed to supporting our customers through these challenging times. I'm proud of how our people have responded and our continuity plans have worked very well.

Our relationship bankers and our people in our branches and call centres right across the business have managed to adapt to this unprecedented event so swiftly and smoothly and ensure our customers get the service they deserve. Our people are here to assist. So a huge thank you to them for their continued dedication during this period.

I will now pass over to Adam to provide more detail on our asset portfolio and scenario analysis as it relates to COVID-19.



Adam McAnalen: Thank you George and good morning. I will start this morning with our asset quality on slide 32. As you can see, BOQ has continued to take a prudent approach to provisioning. Total provision coverage for impaired assets has remained broadly flat at 166%. Specific provisions to impaired assets also remain stable at 43% reflecting a low interest rate environment coupled with low provision activity.

Despite the fires, flooding and ongoing drought conditions in various parts of the country, BOQ did not have any new impaired assets in the first half greater than \$5 million. We continue to manage five existing exposures with impaired balances greater than \$5 million with a combined total exposure of \$56 million.

Our collective coverage of 78 basis points as a proportion of risk weighted assets remains strong compared to both regional bank and major bank peers. Turning to the arrears trends on slide 33 - in spite of the external challenges presented by the first half of the financial year, our loan portfolio continues to perform strongly over the period. Arrears levels have remained low and are broadly similar to where they have been in recent years.

As a demonstration of the portfolio's resilience to those external shocks the Bank received only 71 hardship applications following the bushfires and floods with a total exposure of circa \$20 million. The ongoing solid arrears performance is largely due to the careful and conscious decisions the business has taken over a number of years regarding the desired composition of our lending portfolio.

As can be seen on slide 34, BOQ has built up a carefully diversified lending portfolio leaving us well-placed to weather the current economic dislocation. We have carefully managed levels of risk within our housing portfolio which now has an average LVR of 66%.

While our business lending strategy has focused on leveraging our strengths in specialised niches this has been done with a focus on diversification across a range of industries. Through acquisition and organic growth we have successfully diversified away from property and built up deeper portfolios in sectors including Agriculture and Health Care. This approach also provides counter-cyclical diversification with different sectors likely to experience downturns at different times. Within BOQ finance no singular industry represents more than 20% of the portfolio.

Regarding the impacts of COVID-19 I want to start with the scenario modelling we completed at the beginning of March that was based on economic forecasts available at 29 February, 2020. The modelling assumptions we used at that time were based on a widely accepted belief that the biggest impact would be felt in global supply chains and industries highly dependent on international travel and immigration.

There were external forecasts of a marginal uplift in unemployment but no overall impact on GDP. Given these external economic assumptions we considered that credit risk ratings downgrades across effected industries of up to one notch was appropriate. This represented an increase in the probability of default of up to 2 times. As a result, we took a prudent approach to calculate what was a reasonable collective provision of \$10 million.

Turning to slide 35 and in the month since this early modelling was completed, the breadth and depth of the pandemic impact on the global economy has become increasingly apparent. This has meant that our assumptions for the second half 2020 have necessarily changed. In updating our economic parameters we considered a broad range of scenarios reflective of the uncertain economic conditions and outlook. We have updated our economic assumptions to reflect a greater impact to GDP which we now expect to fall by 3%.



A more prominent rise in unemployment than initially anticipated, now expected to peak at 9% and a likelihood of a reduction to property prices. Based on our scenario analysis, based on the actions already taken by governments and regulators coupled with their openness to provide further support should this prove necessary, we have assessed the likely recovery outcome will initially be a bounce, followed by a longer recovery when it comes.

Under this scenario the housing portfolio will be impacted by high unemployment and a reduction in property prices. But the unemployment impact on property prices and loss given default will be limited.

However for the business portfolio we do expect a broader range of industries to be more heavily impacted, most notably the tourism, hospitality and food services and education sectors. Depending on the degree to which each industry sector is exposed, we have applied credit risk rating modelled downgrades of up to four notches. This results in a PD increase across all industries.

However we have assessed that government support provides a one to two notch improvement which acts to partially offset the PD increase in the modelled scenario. The outcome of this scenario exercise suggests the potential full year 2020 impact on the collective provision in the range of \$49 million to \$71 million. However the environment remains very uncertain and as such we have modelled a number of scenarios and will closely monitor developments as the situation evolves.

I will now hand back to George to take you through his concluding remarks.

George Frazis: Thanks Adam. As you can see on slide 36 we have implemented a range of measures to support both our personal and small business customers. These include a banking relief package for SME customers impacted by the pandemic which provides them with a deferred payment period of up to six months on their small business loans less than \$10 million. Importantly risk weights do not change for these deferred loans which conserves capital.

We know that once SMEs get through this early stage in the COVID-19 crisis they will need to start planning for the longer term. This will include assessments about how their existing business models will adapt when the current constraints on the economic activity are lifted. This will be a challenge because no one knows what longer term adjustments this crisis may cause. BOQ will develop a business plan strategy to assist SMEs through this critical process.

In addition to the six month deferral repayment period available through our banking relief package, our business bankers can also approve a request for business customers who have a variable rate business loan of less than \$3 million to switch to a one year interest-only period or extend an expiring interest-only term for an additional year.

We are also providing SMEs with access to unsecured overdrafts at reduced interest rates to help them keep their businesses operational. This is in addition to business term loan and overdraft interest rate reductions, the waiver of a number of fees and pausing spending criteria on business performance savings accounts. We fully understand the importance of helping our SME customers conserve cash flow in these uncertain times.

Slide 37 provides further detail on the customer requests for support. To date we have received approximately 15,000 requests from customers for assistance of which approximately one third relate to our personal customers. As you can see of the 75,000 personal customers with an LVR of less than 80% we have currently received requests for assistance from circa 5.5% of these customers.



Likewise with those customers with an LVR greater than 80% circa 4.5% of the 20,000 customers have sought assistance at this stage.

Looking at our total retail portfolio and related assistance requests, the average LVR is 59%, with an average loan size of \$319,000. We can also see a relatively balanced distribution across geographic locations aligned to our portfolio.

Moving to slide 38, we have received circa 10,000 requests for assistance from our business customers. Dentists, professional services and some property-related sectors have driven the majority of these requests. Business customers receiving assistance have an average LVR of 51%. As you can see, of the 150 customers with an exposure greater than \$10 million, currently we have received requests from 4% of these customers for support. These customers are operating in the hospitality and tourism, transport services industries and are being managed individually by our relationship bankers.

Now to the closing FY20 observations on slide 39. We see continued pressure on revenue. While our home loan and business loan application volumes are steady, we are acutely aware that this could change quickly in the current environment. Given how we responded to the last RBA rate cut, our income will be impacted by ongoing pricing competition in deposits and business lending, which is offset by improvements in mortgage margins.

Non-interest income revenue will continue to decline, while repayment holidays provide a likely decline in growth in loan balances. FY21 will see a tailwind, due to the low-cost RBA term funding facility. Costs are being timely managed and we are benefiting from the productivity savings we announced at the strategy day in February.

Our frontline and customer support teams are handling increased volumes of queries and requests. We have been able to flex our workforce to meet this demand, while reducing costs in other discretionary areas. Our productivity plans continue to contain cost growth in FY21 to less than 1%.

Continuing on slide 40, the impact of COVID-19 on impairments remains uncertain. While we have had a significant number of requests for support from our customers, the potential impairment is mitigated by the government support that cushions the downside to unemployment. As mentioned, our current modelling suggests the full-year impact will be between \$49 million and \$71 million inclusive of the \$10 million recorded in our first half results. Significant uncertainty remains.

Finally, maintenance of our strong capital funding and liquidity positions remains a key focus of our business, as we enter a period of economic slowdown. We are taking a prudent approach in preserving our capital, by conducting a review and looking at a number of our non-core CapEx projects. We retain a number of funding options, including accessing the term funding facility, securitisation markets and utilising capacity in our covered bonds program.

Moving to slide 41. To conclude, the first half results played out as we foreshadowed during what continues to be a transitional year. Investments we are making over the course of FY20 will see us well-placed to execute on our strategic transformation, going forward. Despite the dramatic shift in the economic environment, we have a clear strategy, a strong capital position, stable funding and a high-quality asset portfolio, and a business demonstrating significant improvements and a shift in momentum.

While we continue to closely monitor this rapidly changing economic environment and adapt our business accordingly, our focus will be on maintaining our balance sheet strength, supporting our customers and ensuring the well-being of our people.



Thank you very much for your time this morning. With that, I will now hand back to Cherie to open it up for questions.

Cherie Bell: Thanks, George. We will now take questions from analysts and investors on the phone. Could I please ask you to limit it to two questions per person? I will now pass to the operator.

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

Andrew Lyons: (Goldman Sachs, Analyst) Yes, thanks, team and good morning. I just wanted to ask some questions just around the CP modelling that you've provided quite a lot of detail around, so thank you for that. Just on slide 35, if we look at the industry impact assessment and the subsequent impact that that has on the probability of default multipliers across the portfolio, the portfolio that you've stress-tested, it implies about a 3 times increase in the probability of default. Then across the whole portfolio, if we skim across the whole portfolio, it's about a 1.5 times increase in the PD.

I'm just wondering, just in light of the extent of the slowdown, which has been described as the greatest since the Depression, I'm just wondering if you think that that PD, just from a very high level, really captures the extent of the likely weakness we're going to see in the portfolio? I guess, just related to that within the Retail book, the assumption around property price movements of just down 5% in the second quarter and then for the full year as well, just how you're thinking about - how you came up with that number? Thanks.

George Frazis: Thanks, Andrew. I might start off and then hand over to Adam to provide some more detail. I think, there's two things to note here. Then, obviously, this is a very uncertain environment. What we're presenting is a range of scenarios to the best of the information we've got at the time. So, there are views on (1) how deep will this decline be? and (2) the uncertainty around how quickly this will recover and what the recovery will look like?

Our view is that the way we've done this is (1) looked at what we thought in terms of how deep the impact will be. We have looked at adjustments to GDP and property prices beyond that. But one of the key things that drives this is unemployment. I'll have to say, when we look at the government packages, that really does provide a cushion to that unemployment rate, which we've got there peaking at 9%. Now, you could argue that they may be a bit higher than that. But that's one of the key measures that really drives the results of the provisioning.

The other impact that we've done on this is effectively determine the impact of the stimulus. As we know, the government stimulus is close to double digits, which is comes to a proportion of GDP. So, it is significant. The critical question will be how long this takes to recover. As I said, the likelihood is that we are potentially going to see a V-shaped path recovery. But then for some industries, where there's going to be more structural change and more permanent change, you're likely to see an experience of more of a U-shape.

So, what's going to be important for us, going forward, is really taking an industry by industry view of our portfolio. Then the only other point I'd like to make before handing over to Adam is that we've got a very diversified portfolio now, in terms of geography and industry. In fact, even though you've got quite a specialised niche segment approach, the balances within each of those niches is quite modest, outside of the healthcare sector. But I'll hand over to Adam.

Adam McAnalen: Thank you, George. I think you've covered off that question very well. The only element I would add is where our assessment is applied across the respective industry is reflective of our own customer base, not the industry more broadly. I'll hand back to you, George.



George Frazis: Thanks, Adam. Next question?

Operator: Thank you. Your next question comes from Brian Johnson, from Jefferies.

Brian Johnson: (Jefferies Securities, Managing Director) Good morning, George. I'm just intrigued on two things. The first one is that could we get a feeling - so, the sensitivity, on slide 30, you've said unemployment could be anywhere between 8.5% to 10%. You've done it on 9%. Could we get a feeling of what the upper band would basically do to that assumption?

George Frazis: Yes. So, Brian, we haven't actually disclosed the furthest scenario analysis that we've done. But the scenario analysis that we've done to date, the critical thing we were looking at is what is the impact on our CET 1 ratio? The type of scenarios that we've looked at to date, and as I've said, it's a very uncertain environment, so, a critical - how deep does this go? You could argue that the depth of it in the second quarter will be what it will be. It's all about then how quickly does it recover, that really makes the impact.

What we've seen on our broader scenario testing is that we still maintain our management stand on CET1 of 9% to 9.5%. So, we're very comfortable with our capital position and also our liquidity position. So, we've got a strong position.

Brian Johnson: (Jefferies Securities, Managing Director) Okay. George, the second one was, if we have a look yesterday, we've got our noble leaders basically not only saying that landlords can't evict their tenants, but now talking about a mandatory waiving of rent. I'm just intrigued, what would it do to your earnings, if you were basically mandated to actually waive interest on that similar proportional model for landlords?

George Frazis: Yes, Brian, look, obviously, the one thing I've been really pleased about is how well government, the regulators and the banks have been working together to make sure that, as the government has pointed out, this is all about building a bridge across this and also cushioning the impact. Now, in those discussions, which have been extremely fruitful, it's just been all about how do we, particularly on the smaller end of the business customers, which is where really the balance sheets are not as strong, how do we support those?

So, there's been no indication, or talk, about not charging interest, et cetera, or not being able to capitalise interest. Because I'll have to say, that would be a huge dislocation, in terms of how the whole economy works and would create flow-on effects that would not be great.

But the whole emphasis has been on how we support customers through this. If you look at the programs that we've got in place, up to \$10 million for business customers, that effectively covers 99% of our business banking customers and 72% of our business banking book. What it does is it really gives an opportunity over that period as the information gets better, to, in a very measured way, be able to assist our customers to adjust their businesses to get through this as best they can.

Again, that's a similar program, in terms of mortgages, where there's a program of deferring payments for three months, with an option of extending that for a further three months. Again, that then covers off a big part of our lending book. The critical thing on this, by the way, Brian, is the fact that APRA does not require us to increase the risk weights, as we do these deferments. So, that period doesn't actually chew up valuable capital support.

Brian Johnson: (Jefferies Securities, Managing Director) So, George, just to clarify, if we were to get the powers that be come out and talk about a mandatory waiving of interest for landlords on the same proportional model that would actually be quite significantly bad for you guys.



George Frazis: I think it would be bad, it would be bad for the industry as a whole and the market as a whole as it works. Because the other thing we need to do, banking is really what helps us get back to normality in terms of market. So the quicker we can get back to open markets where they operate without requiring support from the RBA the better. So those type of issues would not help getting us to that point. So that's - there has been no implication or discussions or even suggestions down that line that I am aware of.

Operator: Thank you. Your next question is from Richard Wiles from Morgan Stanley.

Richard Wiles: (Morgan Stanley, Analyst) Good morning George. I just wanted to ask a couple of questions on your decision around the dividend. Does your - does deferral of the dividend mean you certainly won't pay an interim dividend? Or might you still pay one? When are you going to have the discussion with APRA on stress testing? Does your 70% to 80% payout ratio target for the medium-term still stand? Or do you think it's no longer appropriate?

George Frazis: Thanks Richard. The starting point is we definitely recognise the importance of dividends to our shareholders. We've got a very large retail shareholder base which particularly in these times when many other income streams are under pressure, the dividend is important.

But I'd have to say I'm supportive of APRA's move on this. They have been very consistent in the sense that they're about conserving capital to ensure the banks are in a position to really lean into assisting customers get through this. It's evident by the fact that the risk rates don't increase as we provide deferrals. They have talked about the potential of going into our buffers.

Now really what they're saying is, given the uncertainty and they have been pretty clear that their view will be that potentially will become more certain over the coming months. So don't think this is all about us doing a stress test today. It's really getting certain in terms of how we think the recovery options may look. Then agree a stress test with APRA, and then determine if we are able to pay a dividend given that stress test.

The thing I would say though is we've got a very strong capital position. As you saw our CET1 ratio is at 9.91%. We're very confident about our business. It is uncertain at the moment so we would have to think through, what are the potential stress test scenarios. Agree those with APRA, and then conduct the analysis, and then go from there.

Now in terms of the short-term, the other thing that APRA has stated is that their expectations on any dividend that is paid is reduced. What that would mean is that obviously in the short-term the 70% to 80%, both on the profit test criteria and the new guidance from APRA would mean it would be below that. If there was a dividend determined.

Richard Wiles: (Morgan Stanley, Analyst) Okay, so your comments around the timing of this stress test discussion with APRA suggest that you still might pay an interim dividend. That these discussions could be completed before the end of the year and the timing of the final dividend. So deferral means - doesn't mean cancellation. It currently means deferral.

George Frazis: It absolutely means deferral Richard. But I do want to stress it will depend on if there is clarity in what we're leaning into over the next couple of months. So if there's clarity around that then an agreement of what a stress test scenario, or a range of stress test scenarios could look like. Then obviously going through that process with APRA. Given that confidence with our strong capital position then obviously we would go through that process once there is clarity around the environment.

Operator: Thank you. Your next question comes from Andrew Triggs from JP Morgan.



Andrew Triggs: (JP Morgan, Analyst) Good morning George and team. A couple of questions please along I guess a similar theme. So firstly, just hoping to get some more details on commercial property exposure. I think it showed, that the presentation disclosed that 35% of the business lending portfolio sat in property and construction. In the past that's an area where BOQ has I guess seen significant losses in downtowns what - I note that it's not listed as one of the key high-impact or medium-impact areas. Just your thoughts around that property cycle this time around? Then just a follow-up on the modelling - where do you expect mortgage loan losses to run at in your sort of base case assumptions please?

George Frazis: Okay, thanks Andrew. I'll hand over to Adam to give you a bit more detail on both of those. But just before I do, if you look at the commercial portfolio exposure and the make-up of our business during the last global financial crisis versus now it is completely different. So we've got a much more diversified business both in geography and in segment. But I can let Adam detail that.

The other thing to note just on housing is that the LVR in terms of the customers that are requesting assistance on this is quite low at 59%, as we've stated in the presentation. Obviously our objective is going to be to help our customers through this. Basically the JobKeeper assists in that, somewhat in terms of dampening the level of unemployment.

But the real impact really is where does unemployment get to, number one, but more importantly how does it actually recover to something a bit more normal. Because - and then effectively seeing through customers through that period, as opposed to forcing any action. But I'll hand over to Adam to provide some detail.

Adam McAnalen: Thank you George. I might just firstly turn to the question around the commercial portfolio and just reflect on the diversification or the composition of that portfolio today versus the sort of time period that you refer to, which was back in 2012. The composition is substantially different to that point in time, both in terms of the geography and asset mix. The Bank was over-indexed in retail commercial property. In fact 90% of the impairments in 2012 were originated post-GFC, with 70% of those in Queensland. Since 2012 risk appetite has diversified away from particularly land banking and retail property, with the majority of our assets now in commercial property. So at this point we see the impact to commercial property different to that of retail. Obviously the retail component is a substantial topic of conversation that we stare into at this point in time.

In terms of the housing portfolio, George I think has covered that off quite well. In terms of the main driver of impairments that would come across the housing portfolio is actually driven by unemployment. Then of course the time that it actually takes for a recovery to come back. But with the average LVR of 66% the portfolio is rather well-shaped to withstand any downturn, or some downturn in the property market. I will hand back to you George.

Ewen Stafford: It's Ewen, I'll just jump in quickly there. So Andrew's kind of specific question and just to talk to the range, the \$49 million to \$71 million range in the subsequent event note Andrew. So the housing book of that range is about 40%, commercial was about 20%, finance at about 25%, and then the specialist business at about 15%. So hopefully that gives you some sense of the orders of magnitude across the portfolio, as we see across that range at the moment.

Operator: Thank you. Your next question comes from Jon Mott from UBS.

Jon Mott: (UBS, Analyst) Yeah, hi guys. I just wanted to follow up on I think BJ's question when he asked about this sort of downside scenario. You were talking about the CET1 still settling in that 9% to 9.5% range. I just wanted to follow up on that, that would assume that you didn't pay a dividend



in that half you would still have underlying profit of, say, \$250 million that you generate. On top of that you would be losing at least 50 basis points of risk weighted assets. So will you be talking that scenario sort of \$500 million to \$700 million in loss to the CET? Is that the numbers that you're talking about in that stress scenario?

George Frazis: Thanks Jon. Look, under the stress scenario obviously it's not business as usual. So there's a number of factors that we have considered in that. Firstly, we've already talked about the deferral of non-critical investments, but that - and in fact that the program, the plans on that are already underway. So in the order of around 30% of our capital investment. The other thing that occurs under a stress scenario is obviously the risk weighted asset growth is not there. So that has an impact on capital as well. So they're kind of the dynamics that played to that.

Jon Mott: (UBS, Analyst) Okay, but I just wanted to make sure, to get your capital to go backwards you're in a loss-making situation. You'd have to lose your pre-provisioned profit, which currently are \$250 million per half. Then you'd have to lose between 50 basis points and 100 basis points of risk weighted assets, which is probably another \$150 million to \$300 million. So you're talking \$0.5 billion-plus of losses. So I just wanted to make sure.

Then on top of this pulling back on other non-critical investment as well. So that would make it an even larger loss. So when you're giving us a base case which is an unbiased probability weighted, which is the one you're getting to here, and you've disclosed on Page 35. You also gave us some scenarios where you land at 9% to 9.5% CET1 that you mentioned to Brian. I just wanted to make sure, to get to that 9% to 9.5% you're talking a very large loss. So can you just confirm that's correct?

George Frazis: Yes, so the starting point would be to say, if you looked - there's two ways of looking at this Jon, right. So one is, number one, how deep is it. Then secondly, how long the downturn is. So the scenario analysis that we've done to date still has us in a profitable outcome in terms of our business. There's very limited growth. We have taken actions however to make sure that we're optimising the business and we're within that range. So we're not at the bottom end of that range, we're in that range. We're also assuming that we're paying a dividend, but a much reduced dividend.

Ewen Stafford: We're continuing to invest, albeit at a...

George Frazis: Much lower rate.

Ewen Stafford: ...at a lower rate.

Jon Mott: (UBS, Analyst) So is it realistic that you pay a dividend in that scenario, given what APRA came out with yesterday?

George Frazis: Well, back to what - it's just how we mould it, right. So even if we're paying a low dividend we're still within that range. So now what decision the Board takes or the discussions with APRA, if that stress scenario occurred that's a different discussion.

The main thing about that, so Jon, if you think it through those type of scenarios, my point is - and would you pay a dividend or not - the point when you're kind of into that type of scenario is not necessarily the outcome of that scenario. Because actually when we look at the numbers when we model those scenarios the outcome is still quite strong. So we - the 9% to 9.5% is quite a healthy buffer above the unquestionably strong. The issue is when you're into that type of scenario it creates a whole lot of uncertainty of the outcome going forward. So you do actually conserve capital further as a result of that uncertainty.



Ewen Stafford: George, the only other point, Jon, I would make, I mean APRA only came out after the market closed yesterday. Obviously we did all our modelling and the scenario work in the 10 days leading up to these, well really since balance date and leading up to these results, so we now need to go back and reassess that modelling.

Operator: Thank you. Your next question is from Josh Freiman from Macquarie.

Joshua Freiman: (Macquarie Group, Analyst) Hi all, so thanks guys for having me, I hope you're safe in the current setting and fine. Just a couple of questions from me, first off, in slide 7 you disclose a material decrease in the growth rate of asset finance and you called out a focus on margin management. Would you mind just providing a bit more colour in this area? Then secondly, you did note some flexibility in your investment suite with regard to the economic environment. Just with that in mind, I just wanted to check how you're progressing with your investment agenda and would you consider delaying it, including some of your transformation program, just to preserve capital and reinstate dividends?

George Frazis: I'll hand over to Ewen to talk about the investment plan, but let me cover off on the first question with the asset finance business. So it was quite a deliberate strategy to make sure we broadened our mix of growth in terms of industries and geographies and product types when it came to business banking.

So as you can see in first half 2019, there was a considerable reliance on asset finance, in the first half 2020 we've considerably shifted that. The focus on asset finance there has been on ensuring that we optimise our margins and in fact the big emphasis on all of the business bank growth has been on margin management. Now what that's enabled us to do in terms of our more balanced growth and also the growth in our mortgages, it's meant that we've been able to generate six basis points of organic capital in the half, compared to if you look at first half 2019, that mix of growth really chewed up seven basis points of capital.

The other thing to note on asset finance is that market as a whole has declined quite significantly, so we're still not losing share in it, we're just making sure that it's good growth with the required returns that we should be achieving. But I'll hand over to Ewen to talk about how we're thinking about the investment portfolio.

Ewen Stafford: Thanks George. So on 27 February, as part of the investor day, the strategy day, we laid out that clear strategy and then the investment profile to support that. But we're also clear that we do have a lot of strategic flexibility, we're quite fortunate in a lot of ways that there are a number of significant pieces of work that have either completed in the first half of the more significant ones will deliver into the second half. So the carry forward inflight into 2021 and beyond is low. The notable exception to that is obviously the critical VMA stages two and three.

We've had a strong first half in project delivery and I took you through some and George spoke to some of those deliverables. Having said that, what we are doing now is just really sitting back and looking at that investment swathe and I think you can expect to see the number come down in the second half of this year and certainly into 2021 and probably even more so in the first half of 2021.

The advantage of the strategy is we have a really clear view on the critical path through the delivery, being those large digital projects, as well as the risk and regulation and that's going to enable us, I think, very quickly, I mean we've already done the high level work and we're now just doing the detailed work around what smaller projects we will put on hold for a period and changing and sequencing of the regulatory projects, perhaps we won't be pushing out some of the acceleration as much as we'd previously considered in terms of the digital projects.



But I think you can expect to see a lower number than we'd originally planned in the second half and probably even a smaller number into the first half of 2021 and then we'll obviously assess market conditions and the environment from there.

Operator: Thank you. Your next question is from Ed Henning from CLSA.

George Frazis: Hi Ed. We can't hear Ed. Ed we can't hear you, might be on mute.

Cherie Bell: Operator, we might move to the next question from Brett Le Mesurier.

Brett Le Mesurier: (Shaw and Partners, Analyst) Did I hear you say that in your stress scenario there would be no risk weighted asset growth?

George Frazis: So what we've assumed, these are not in the current scenarios that we presented, so the scenarios you've got in the pack do assume that there's risk weighted asset growth. We have looked at more severe scenarios where growth would be subdued, yes.

Brett Le Mesurier: (Shaw and Partners, Analyst) So, what would be the increase in risk weighted assets in that stress scenario that you're talking about? It has to be something, right, because you've got a reduction in credit rating, a few notches down for different categories.

George Frazis: I see what you mean. Yes, so when we say there's no increase in risk weighted assets, we're talking about growth of new business as opposed to movement in the risk weight due to downgrades.

Brett Le Mesurier: (Shaw and Partners, Analyst) Could you give an indication as to what that increase in risk weighted assets would be in that scenario, that stress scenario that you've identified?

George Frazis: Well haven't really disclosed at this stage the more stressed scenario. So what we're saying is that when you look at a number of those scenarios and it's very unclear at the moment what a stress scenario would look like, so we have had a go at that. What we're saying is that even in those scenarios at this stage, we stay well within our management capital ratios. What will happen over the next couple of months is for us to get clarity of what likely stressed case scenarios are, agree those without them, then do the work, if that makes sense.

Brett Le Mesurier: (Shaw and Partners, Analyst) Right. You've not allowed for an increase in the LGD in the stress scenario, if you look at it, it's just the PD you've increased, is that correct?

George Frazis: Let me just - I might hand over to Adam. The other thing to note on this, just before I hand it to Adam, is that if you look at the first six months of the deferrals, so we've got about 90%, as I said, 99% of our customers are covered by that deferral and a lot of our mortgage customers are covered by that deferral and then at an asset level, that represents something in the order of 72% covered by the deferral in terms of our business lending book. What that means is during that deferral process, we don't need to adjust the risk weight as we get through this, so that's an APRA change to their requirement. But I'll hand over now to Adam.

Adam McAnalen: Thank you George. Yes, I can confirm that we have applied a LGD impact through the model. Obviously from the housing portfolio, that is driven by property prices. When we consider that our commercial portfolio is predominantly well secured and the conservative lending values that we use to secure those assets that the property downturn does not have a material impact on the commercial property. For BOQ Finance of course, where it is secured by assets that obviously does have an impact, but it's not linked directly to property prices, obviously, because it's secured by other assets.



Brett Le Mesurier: (Shaw and Partners, Analyst) Lastly, I gather from what you were saying, you've had no contact with APRA at all on stress testing.

George Frazis: No, so the APRA notice came out late last night. There was a requirement to do some scenario analysis early on, but that was quite early on in this whole crisis.

Ewen Stafford: First week of March.

George Frazis: First week of March, which all banks were required - all ADIs were required to do. I have to say, that was even a more uncertain period in terms of what the outlook would have been.

Brett Le Mesurier: (Shaw and Partners, Analyst) Right, so you really have no idea whether or not your stress test would be satisfactory to APRA?

George Frazis: I think I would state, the answer to that is no, so we haven't had a conversation in terms of taking APRA through our stress test scenarios. But I would say two things. My sense, a clear sense from conversations I've had with APRA and the letter, is that their viewpoint would be that it would be a couple of months or more before there's clarity on what a likely stress case scenario might be and then we'd have to undertake the stress case scenario [inaudible].

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

Ed Henning: (CLSA, Analyst) Attempt two, George, can you hear me?

George Frazis: Yes, hi Ed, sorry about that.

Ed Henning: (CLSA, Analyst) No, that's fine, I don't know what happened there. A couple of questions from me please, just looking at your business assistance package and obviously a lot of people asking for help and you're talking about repayment holidays and that, can you just run through the impacts of those people taking repayment holidays or moving to interest only on the second half profit? That's the first question.

George Frazis: Yes. Have you got another question?

Ed Henning: (CLSA, Analyst) Yes, the second question, I just wanted to dive into the [inaudible – microphone inaccessible] just to run through what you're exposed to there and also when you talk about security against the assets, is that just the assets of the business or is it housing backing up some of these lines?

George Frazis: Sorry, can you repeat your second question Ed? You just cut out.

Ed Henning: (CLSA, Analyst) Oh okay, sorry. The second question was just around the healthcare segment, can you just run through a little bit more on your exposure there of the individual businesses and when you talk about LVR and the security of these business assets, is it just the business assets that it's secured by?

George Frazis: I might hand over to Adam to give you a bit more information on your second question. On the first one, I'll start off and Ewen might want to add on to that. So what happens on deferrals is effectively you're deferring both your capital and - so your P&I payments and your interest, then that's capitalised at the end of the six month deferral, so effectively you're still accruing income for that, so it doesn't actually change your P&L in any way.

What it does do, at the end of that period and then that's the other important point about the fact that the risk weights don't change either, because then it's not chewing up your capital as a result of all those deferrals. What would happen at the end of that six month process is you would then



recontract with the customer to either extend the loan, in the order of six to 12 months, or if they're able to pay at a higher rate, so be up to them in terms of what their business can, then the loan can stay as it is, with a higher repayment, but that's effectively how that's treated.

Ewen Stafford: That's correct, just continuing to accrue interest, so the NII line, no impact. I did comment though on there will be some impact on the non-interest income line, particularly around those waiving of business banking fees, but that is a continuation of, I mean more broadly, a continuation of the trend that we've seen over the last number of halves.

George Frazis: Yes, because if you look at the last, just to add a bit more on that, if you look at the last rate reduction by the RBA, effectively the way we've treated that is by not passing on that rate to mortgages, we were able then to provide better rates for business customers and also be more competitive on deposits. Those two things kind of net each other out.

You will see a slight decline in volumes as a result of the activity being lower, but at the same time you'll also get a significant reduction in turnover and churn. That's really what's going to be driving the reduction non-interest income. A final point, obviously, the low-cost term funding facility from the RBA, that benefit really starts kicking in in FY21, so there will be a tailwind as a result of that. I'll hand over to Adam to add to the second question.

Adam McAnalen: Yes, thank you, George. Just in response to your question around the security of those loans; so, the term debt is secured by a property, and then the asset finance, which for some of the customers is obviously equipment, and that is obviously secured by equipment in its own right.

Ed Henning: (CLSA, Analyst) Is that property of the business, or of someone's house?

Adam McAnalen: It will be a combination of both, depending on the customer. If we think about BOQ Specialist, the majority of that will be their residential property as security.

Ed Henning: (CLSA, Analyst) Okay. Can you just run through the split of health care, like dentist, GP, doctor, specialist, if you can?

Adam McAnalen: I'd need to come back to you specifically on that answer, if I...

Ed Henning: (CLSA, Analyst) Okay. No worries, thank you.

George Frazis: Just to add to that, if you look at the request for assistance from that sector, the majority of that has been from dentists, because basically where they're at at the moment, as you can imagine in this environment, not too many people are going in to get their either elective dentistry stuff done, or cleaning. In fact, only emergency work is allowed to be done going forward. So, you can see those businesses without a doubt, once we get through this, the majority if not all of them will be back up running strongly. So, we don't have any concerns of that sector.

George Frazis: Have we got time for one more question, given the timing, or two questions?

Cherie Bell: Yes. Thanks Operator, two more questions please.

Operator: Thank you. Your next question is from Tom Strong from Citi.

Tom Strong: (Citi, Analyst) Hi there. Just a couple of quick questions on costs if, I may. I just want to understand how confident you are with keeping costs managed in FY20, given the pretty seismic shift to working from home and the disruptions. We've seen a pretty big demand on technology, and also I would imagine you'd be directing a lot of resources into contact centres, to deal with the



customer enquiries. How deep are the offsets elsewhere and the cost base to keep your comfort of keeping costs relatively well maintained?

George Frazis: Yes, I'll hand over to Ewen to say a few words, but you're right in the sense that our absolute priority has been to make sure that we've moved resources where the needs are. Our branches are open for business, our call centres have got extra staff to make sure that we're dealing with the increased volume on that business. Obviously, all our specialist relationship bankers are working quite hard in this period. I'll hand over to Ewen.

Ewen Stafford: Yes, and Tom, I think there's - it's fairly finely balanced. As I commented on the expense slide, as we sit here today we still think that 8% year-on-year expense guidance is right. As you point out, and George has commented on, there's definitely additional costs coming through in certain areas, but on the flipside some of the discretionary - well, travel, entertainment, accommodation, and also if we - as we slow down the project portfolio, there will be project operating costs associated with that capital investment as well. We feel net-net second half, and then the full year, will land as we previously guided.

I think then as we - just while we're on costs and as we look to FY21, and as the COVID-19 situation unfolds and we get more clarity on issues around timing and so on, obviously we will be then looking at what is the appropriate cost structure to take into FY21. We've previously guided on the less than 1%, but we'll just need to make an assessment on that as the next month unfolds.

Tom Strong: (Citi, Analyst) Right, that's helpful. Thank you.

Operator: Thank you. Your last question comes from Matthew Wilson, from Evans and Partners.

Matthew Wilson: (Evans and Partners, Analyst) Yes, good afternoon team and thank you for the opportunity. Just a question on liquidity coverage ratios. Could you walk us through the impact the mortgage and business deferrals will have, given the coverage ratio assumes contractual cash flows? Obviously those contracts are not being met for at least six months. So, the impact of the deferrals on the LCR.

Then secondly, do you have to refinance and complete that refinance of the Wholesale Capital Note before you buy back on 25 May? Obviously, it's a difficult market and we've seen some of those refinances not complete.

George Frazis: Yes, thanks Matthew. I might hand over to Tim, our Treasurer, to answer both of those questions. Obviously, our regulators on both of these fronts have been extremely helpful, both APRA and the Reserve Bank of Australia. So, I'll hand over to Tim.

Tim Ledingham: Yes, hi Matthew. Look, in terms of the effective deferment on the calculation of the LCR, really the LCR is driven off the required stable funding against - and the run-off factors against those mortgages. So, the deferment as such doesn't really change those run-off factors. So it has very immaterial impact on the LCR.

In terms of your second question, yes, obviously we have gained approval from APRA to redeem the additional Tier 1, the wholesale additional Tier 1 note, on 25 May. In terms of the refinance, that has been deferred until after - or until markets become more functional, and less disrupted. There is a condition on that approval that we will need to refinance the wholesale note at some stage.

Matthew Wilson: (Evans and Partners, Analyst) Okay. So, just to confirm that, I've actually assumed you've had 48 basis points as capital.

Tim Ledingham: Correct, 48 basis points of total Tier 1 capital, so it's not [inaudible] Tier 1.



Matthew Wilson: (Evans and Partners, Analyst) That's right. All right, thanks for that guys. Good luck.

Operator: Thank you ladies and gentlemen. That concludes that our results presentation this morning.

END OF TRANSCRIPT