BOQ 1H22 Half Year Results Announcement

Thursday, 14 April 2022

Speakers: George Frazis, Managing Director and Chief Executive Officer
Ewen Stafford, Chief Financial Officer and Chief Operating Officer
Chris Screen, Group Executive Business Banking
Cherie Bell, General Manager Investor Relations & Integration

Transcript:

Operator: Thank you for standing by and welcome to the Bank of Queensland Half Year Results 2022 call. 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 Cherie Bell, General Manager of Investor Relations. Please go ahead.

Cherie Bell: Good morning, everyone and welcome to BOQ's First Half 2022 Results presentation. Before we begin, I would like to acknowledge the traditional custodians of the lands upon which we are meeting today, the Gadigal people, and recognise Elders, past, present and emerging. Thank you for taking the time to join us this morning, especially given it's the day before the Easter long weekend.

We received some feedback at our full year results that a shorter management briefing is preferred and as such we would like to keep this morning's session to one hour. Can I please ask that during the Q&A you limit your questions to one per person in order to enable us to get through everyone within the time allowed? I will now hand over to George Frazis, our Managing Director and CEO, to provide an overview of the first half results and an update on the execution of the BOQ strategy.

George Frazis: Thank you Cherie. Good morning, everyone and thank you for joining us. With me this morning is Ewen Stafford, our Chief Financial Officer and Chief Operating Officer and Racheal Kellaway who will succeed Ewen as our CFO on 1 July. Sadly, this will be Ewen's last set of BOQ results. At the outset I would like to personally extend my sincere thanks to Ewen for his counsel and leadership during his time with BOQ. Ewen was instrumental in the development of the refreshed strategy in 2020, helping us execute on our Digital Bank and completing the transformational acquisition of ME Bank.

Now is the right time for us to prepare to hand over to Racheal as we are developing the next phase of our strategy. Racheal has been on my Executive Team over the last two and a half years and I want to congratulate Racheal on her well-deserved new role. Racheal is a highly experienced finance executive and leader and the first woman to hold the CFO position in BOQ's 148 year history.

I also have other members of my Executive Team and Senior Management here available to answer your questions. I am pleased to be able to share with you another solid performance for the first half and you can see the strong continued momentum of the BOQ Group. These results highlight our progress on returning the Group to sustainable profitable growth and they reflect the sharp focus on our strategic priorities, the disciplined execution of the ME integration and the digital transformation plan.

Our cash earnings increased 14% compared to the prior corresponding period, reflecting balance sheet growth, tightly managed costs and improvements in our portfolio quality. Pleasingly, growth momentum continues to build. ME Bank has returned to net growth during the period, the VMA BOQ housing portfolio has continued to outpace the market and our focus on SME lending has delivered a material uplift in business lending growth ahead of market for the half.

The integration program is delivering ahead of plan with accelerated and increased synergies and we remain within the planned integration expense envelope. We are delivering our strategic transformation roadmap with the addition of the first phase of the BOQ brand enabled on the single cloud based digital retail banking platform in March, proving out the multi-brand capability of the Digital Bank.

The quality of our portfolio and improvements in the economic environment has enabled us to reduce our provisioning levels in the half. We continue to have the balance sheet strength to support business growth and the transformation agenda with a CET ratio of 9.68%, 9.76% pro forma.

As a result of this solid performance the Board has determined to pay an interim dividend of $0.22 per share. This represents a 53% cash earnings payout ratio, or around 66% after adjusting LIE to longer term loss rates, which we believe is prudent while we have the opportunity to profitably grow and continue to transform the business.

Turning now to the results in more detail on slide 7. Total income increased 1% while operating expenses remained flat. This resulted in underlying profit growth of 1% to $370 million. The quality of the portfolio and the improving economic environment has resulted in a provision benefit for the half, which combined with the underlying profit growth has produced cash earnings of $268 million, an uplift of 14% compared to PCP. Reported statutory net profit after tax was $212 million.

Cash return on average equity was up 130 basis points to 9.1%, common equity tier 1 remains strong at 9.68%, 9.76% pro forma, and our cash earnings per share increased to $0.411 per share.

The drivers of the result are outlined on slide 8. Total income increased $5 million compared to PCP to $831 million in the half. The drivers of net interest income were strong balance sheet growth during the period for the underlying BOQ business, partly offset by the drag from the legacy ME Bank portfolio run off prior to acquisition and the NIM pressures felt across the sector in the first half.

We remain committed to productivity and improving our costs base and have produced a fifth consecutive period of reductions in expense growth as outlined on slide 9. During the half we have achieved $23 million in productivity and synergy savings, which have offset our increases required to support the ongoing growth across all channels and brands, as well as our investment in our transformation. We remain committed to achieving positive JAWS and expect our long-term cost base to continually improve as we move towards a single cloud based digital retail banking platform.

Turning now to lending and deposit growth on slide 10. Lending growth momentum has continued to accelerate with lending GLAs increasing by $3.2 billion for the half. Pleasingly, the growth has come through both our housing and business lending portfolios. This demonstrates the benefits of our diversified portfolio with our multi-brands and balanced between retail and business banking.

BOQ and VMA housing growth remained strong at 1.8x system and we have returned ME Bank to net growth in the half ahead of our initial acquisition projections. This growth has been high quality with LVR above 90% home lending flows reducing below 2%. We have also achieved strong growth in the business banking portfolio with our focus on SME lending delivering results, reflecting our niche segment strategy, providing high quality relationship banking. We are also achieving growth in BOQS as the impacts of COVID abate in the health sector.

Customer deposits increased by $1.8 billion in the half supporting asset growth and enabling us to broadly maintain the deposit to loan ratio at 74% while further reducing our reliance on term deposits. A highlight was transaction accounts growing at 16% or 31% on an annualised basis.

Diving into our key areas of focus in more detail on slide 11. During the half we have returned ME Bank to growth reversing the declining FY21 trend. Our home buying transformation program has delivered material improvements in the customer, broker and banker experience through reduced turnaround times and improved processes.

We have tilted our business to high quality SME lending which has produced solid growth in the sector compared to prior periods. We have been able to leverage the superior relationship skills and the competitive advantage provided by our owner managers and specialist bankers to drive the uplift and have also invested in our broker relationships. Our BOQ specialist business also continued to perform well growing across both SME and corporate portfolios during the half.

Importantly, lending remains high quality across the business and housing portfolio. We have continued to grow our transaction and savings deposit account balances which has enabled us to reduce our reliance on high-cost term deposits. 45% of the at call portfolio is now priced at less than five basis points and we expect these balances to benefit from a rising cash rate environment. The launch of our VMA and myBOQ mobile banking apps creates additional opportunities to attract new customers and drive increased flows into our transaction and savings accounts.

Turning now to an update on the ME Bank integration on slide 12. The integration program has continued to execute at pace. We remain ahead of the original plan and are delivering within our expense envelope. We have returned ME Bank to growth and have consolidated our business under one ADI licence in February. The technology integration is progressing well with collaboration tools in place, key applications enabled across the network and the ME Bank broker portal implemented.

The risk and remediation program has aligned risk management and capability at ME Bank with the broader BOQ Group. Further consolidation of supply chain arrangements has begun to deliver early synergy benefits which will accelerate in the second half. Our synergies remain ahead of schedule and I am pleased to be able to confirm that we now anticipate additional cost synergy benefits of $20 million in FY24 and beyond. This brings the total to more than $95 million or 125% of our original forecast as ME consolidates on the core banking platform and legacy technologies are decommissioned.

The ME acquisition was transformative for BOQ. The good progress on integration synergies and growth shows the value of the brand. We continue to execute against the transformation roadmap as outlined on slide 13. The transformation is delivering significant improvements in the customer and banker experience.

The simplification, automation and process or engineering initiatives are starting to deliver meaningful efficiencies which is evident in our expense-based reduction in the half. Delivery of the transformation roadmap has been enabled by our ongoing focus on execution capability including upskilling of our people, portfolio management, disciplined delivery, reporting and governance.

Diving into more detail on our Digital Bank progress on slide 14, we have made significant progress towards a single cloud based digital retail banking platform that will benefit from ongoing innovation by our global provider Temenos and other strategic partners. We are transforming BOQ from the bank that was constrained by legacy architecture with batch processing, non-real time complex layered technology, into a cloud based fully digital bank. This will deliver us a scalable solution that is multi-brand enabled providing operational excellence and a high degree of automation that will be fully digitised.

We intend to fully leverage cloud capabilities and benefits and intend to accelerate our proportion of services in the cloud. Our digital transformation will radically simplify and reduce the number of technology systems. We have successfully completed the migration of 300,000 ME customers from the legacy Ultracs core banking platform to version 18 of Temenos. That enables the pathway to the cloud version 20. We have completed the decommissioning of Ultracs, including five apps and 20 servers.

We have launched our mobile first capability for both VMA and BOQ with a focus on everyday banking. Recent declines in our consumer NPS are primarily a result of poor experience with our legacy digital offerings, highlighting further the importance of our new mobile banking apps. The VMA mobile app has enabled us to successfully target a new customer demographic who is younger, urban and digitally savvy.

Since launch, we have seen deposit balances in VMA grow to circa $1.1 billion. These customers have an average balance of $27,000, 41% are saving towards purchasing a home, 54% are under the age of 39 and 94% are new to the BOQ Group. As you can see, our new mobile banking apps are bringing to the Group a new set of attractive customers.

The BOQ mobile app, myBOQ, that has just been released, provides further proof of the multi-brand capabilities of our digital platform. The end state will see all retail brands on a fully digital single platform providing significant scale, productivity and customer experience benefits. The development of our digital home loan product onto the new cloud platform is progressing well and expected to be delivered over the next 12 months which will enable us to meet the home lending needs of our customers with even faster turnaround times and the ability to scale efficiently.

Our cultural transformation is key to our underlying success and I am pleased with the improvements we have been able to achieve from a low base across a number of key measures as outlined on slide 15. The achievements with the ME integration and the digital transformation are testament to the depth of capability and execution experience of our team right across the business.

We have a highly skilled and increasingly motivated workforce with engagement and culture scores trending upwards. Our people are telling us that they are focused on execution of the strategy and that we have created a culture where people feel safe to speak up and contribute to delivering our purpose. We encourage our people to collaborate to achieve great outcomes for our customers.

There is more to do for BOQ to be one of the best and enriching places for people to work and this will be an ongoing focus for me and the Executive Team.

Before I hand over to Ewen I would like to recognise my Executive Team who are highly capable and experienced. I would like to thank them and all our people for their tireless efforts in supporting our customers, improving our business and performing financially in these challenging times. I want to acknowledge all our customers who have shown resilience and trust in us with their banking needs. Over to you Ewen.

Ewen Stafford: Thank you George and good morning, everyone. Turning firstly to the Group financial performance on slide 17. BOQ delivered total income of $831 million for the half, an increase of 1% on PCP and down 2% from the second half 2021. Non-interest income increased 30% or $21 million.

Operating expenses decreased 3% or $12 million compared to the second half 2021 and were broadly flat versus PCP. BOQ has delivered a 1% improvement in underlying operating profit compared to PCP. We continue to manage the business to deliver positive JAWS and in very challenging conditions have achieved 1% positive JAWS compared to both PCP and the prior period.

The loan impairment expense for the half was a benefit of $15 million. Cash earnings were $268 million, a 14% uplift. This solid financial performance for the half has resulted in cash EPS of $0.411 and an ROE of 9.1%. BOQ's statutory net profit was $212 million for the half. The two key stat-to-cash adjustments in the half were $25 million of post-tax integration costs and the $26 million loss on the sale of St Andrew's, as advised to the market on 28 October 2021.

Turning to net interest margin on slide 18, NIM declined 12 basis points for the half to 1.74%. The 12-basis-point decline consisted of seven basis points of underlying business decline with a further 5 basis point impact from holding higher levels of liquidity. Stepping through the walk, asset pricing and mix resulted in an adverse impact of 16 basis points. Within this, we saw an 8-basis-point reduction from increased flows into lower margin, fixed rate lending and reducing spreads. There was continued front-to-back book drag of 5 basis points on housing and 2 basis points in relation to business lending and we saw a further 1 basis point impact from the relative shift in the asset portfolio mix toward home lending.

Funding costs had a favourable impact of 10 basis points. We continued to actively manage retail deposit pricing, which had a favourable impact of 6 basis points. More than half of this tailwind comes from the ME Bank deposit portfolio. We had a 2-basis-point benefit from an improving deposit portfolio mix and a 2-basis-point benefit from improved wholesale funding costs, including benefit of the TFF. Heightened liquidity levels relating to the removal of the CLF program reduced NIM by a further 5 basis points in the half.

Given the volatility on NIMs across the sector, we have provided more detail on the outlook on slide 19. Overall we expect to see near-term margin pressure but to a much lesser extent than experienced in the first half 2022 and with medium-term upside from a rising interest rate environment.

Looking to the second half 2022 and whilst there were a number of moving parts and ongoing volatility, we expect the rate of NIM decline to materially slow. To unpack the drivers a little, we expect slowing fixed-rate lending impacts as the current pipeline of loans settle and fixed rate applications continue their reversion to normal levels, consistent front to back book impacts and funding benefits arising from retail and wholesale repricing activities albeit lower than experienced in the first half 2022. We're also mindful that there are early indications that TD pricing will increase in the coming months.

Given the current steepness of the yield curve, we've taken the opportunity that these favourable conditions present to lengthen our replicating portfolio term to a five-year horizon. We've also increased the portfolio's size by $1 billion, reflecting the low-cost deposit growth experienced over the past two years. These changes will bring certainty and accelerate the NIM benefits from a rising rate environment.

We anticipate this will be circa 5 basis points in the second half 2022. Finally, as the CLF handback continues, the liquids portfolio will continue to grow. However and importantly, the impact on NIM will be materially lower in the second half due to the shape of the average liquidity build over the two halves of FY22.

Over the medium term, margin conditions are expected to improve. Some of the key drivers include fixed rate lending applications normalised to long-term averages, ongoing front to back book impacts, the new digital apps will provide further growth in our low-cost deposits, there will be tailwinds on the replicating portfolio and uninvested capital and low-cost deposits and finally, we do expect to see headwinds from rising retail and wholesale funding costs, the refinancing of the TFF and basis hedging costs.

Turning now to slide 20, non-interest income of $90 million increased by $21 million versus PCP. Banking fee income remains stable at $41 million with underlying volume-related increases offset by reductions from fee simplification implemented in the period. There was a $4 million increase in trading income, reflecting a gain on sale of investment securities.

Other income increased by $17 million. This comprised higher revenue from equipment sales in the half but was primarily driven by one-off revenue items including incentive income from an updated card services agreement relating to integration and an insurance provider termination fee. Going forward, we do not expect these one-off items to reoccur.

Moving on to operating expenses on slide 21, expenses have reduced by $12 million or 3% sequentially and have remained broadly flat compared to PCP at $461 million. During the half, we invested an additional $9 million to support business volume growth and the third year of the productivity program delivered a further $10 million in savings. In addition, there has been $13 million of integration synergy benefits in the half.

Spot FTEs decreased by 4% during the half, primarily driven by integration synergies and the conversion of corporate branches to owner managed. Given this performance on costs in the first half, we have increasing momentum with the delivery of our FY22 cost program of at least negative 1%, with the ability to flex further should market conditions require.

The integration program is delivering ahead of plan, as shown on slide 22. During the half we have delivered $13 million of synergies which have a full year run rate benefit of $33 million. Looking forward, we now expect the FY22 P&L synergies to be at the top end of the $30 million to $34 million range communicated at our full year results.

As George has noted, we now anticipate additional cost synergies of $20 million in FY24 and beyond. This brings the total to more than $95 million or 125% of our original forecast, further strengthening the accretion benefits of the ME acquisition.

Integration costs were $36 million in the half, in line with our previously communicated budget of $75 million to $80 million in FY22. Given the acceleration of the integration program, the majority of the $130 million to $140 million integration costs will be incurred in the first two years of the program.

Looking now at the transformation investment program in more detail on slide 23, we are now managing our transformation investment as a full program of work across CapEx, Propex and integration. BOQ's investment spend remains elevated in the half as we execute the digital bank transformation and the integration program. During the first half, we adopted the IFRIC determination recommendation relating to software as a service. We have completed a full assessment of capitalised customisation and configuration costs.

The impacts reflected in this half include a $47 million adjustment to the balance sheet carrying value of software intangibles, a resultant $7 million reduction to amortisation and an $8 million increase to project OpEx as configuration costs are expensed during the period. Looking ahead, we expect CapEx investment to step down in the second half in line with the profile previously communicated to the market. Amortisation is expected to increase in the second half and again in FY23 before plateauing in FY24.

Turning now to provisions and loan impairment expense on slide 24, LIE was a benefit of $15 million. This comprises reductions in both the specific provision as well as the collective provision as economic conditions continue to improve with record low unemployment, low interest rates and strong property prices. Impaired assets decreased by $29 million in the half with improvements across the housing and commercial portfolios in line with low specific provisioning.

Moving to slide 25, during the first half we have seen housing and commercial arrears improve as a result of the favourable economic conditions and portfolio growth. Asset finance arrears have deteriorated during the half, driven by increases in construction and healthcare sectors and heightened by our approach to collections activity during the lockdowns and over the Christmas period.

Moving on to funding and liquidity on slide 26, during the half we have grown customer deposits by $1.8 billion with the deposit-to-loan ratio remaining broadly stable at 74%. Low-cost transaction account balances have grown by $800 million and term deposit balances reduced by $1.3 billion.

The consolidation of the two long-term wholesale funding programs has enabled us to enhance the funding profile of the Group with greater diversity, length in tenor and increased access to securitisation and covered bond programs. We took advantage of favourable wholesale pricing to increase HQLAs with a liquidity coverage ratio above our usual levels at 151%. The net stable funding ratio of 123% remains strong.

Moving to capital on slide 27, we are in a strong capital position with a CET1 ratio of 9.68%. In addition, a first-half capital initiative, a medical finance securitisation, settled in March, which resulted in an additional 8 basis points of capital and a pro forma CET1 ratio of 9.76%. During the half, we generated 61 basis points of capital through cash earnings; 41 basis points were utilised to support above-system loan growth and 9 basis points of capital was invested in the transformation program.

As first noted at our investor day in 2020, maintaining a strong capital ratio remains a key priority. We continue to maintain a CET1 ratio comfortably above 9.5% as we work towards the final impacts of APRA's Basel III, including changes to RWAs and capital calibration.

In summary, BOQ has delivered a solid financial result for the half, with positive JAWS both sequentially and compared to PCP. We have returned ME to growth and are seeing strong growth momentum across all our brands. We are delivering against the transformation roadmap and the integration program is moving at pace. All of this provides us with confidence in continued improvement in our near- and medium-term returns.

I'll now pass back to George for some closing remarks and the outlook for the full year.

George Frazis: Thank you, Ewen. I'm pleased with the performance of the business during the half and the ongoing quality growth momentum we're seeing across retail and business banking. We've supported our customers, people and communities while continuing to grow our business and deliver against our strategy.

Our thoughts are with those impacted by the recent floods. I'm proud of the response by our people and particularly proud of our owner managers, Jellina in Gympie and Michael in Lismore and their teams for their resilience and community focus. My recent visit to Gympie was truly inspiring to see the team working from a gazebo in the car park to continue to support our customers.

I'm pleased with our financial performance for the half. We have delivered strong, quality loan growth, offsetting heightened industry-wide pressures on margin. We continue to demonstrate and build on our good operating efficiency, allowing us to grow and invest more effectively, whilst reducing costs and the provision write-backs have contributed to the profit uplift for the half.

Our ME Bank integration program is delivering ahead of plan with increased synergies and we've completed the divestment of St Andrew's to simplify our business. We are delivering against the digital transformation roadmap and have now completed the first phase of our retail digital bank program for both the VMA and BOQ brands.

Our transformation is helping us to create real competitive advantage for BOQ through our relationship specialist bankers and owner managers embedded in communities, sustainable and diversified growth across our brands and across retail and business banking, improving operating leverage with strong execution capability and creating an at-scale cloud-based fully digital bank, which will provide a step improvement in productivity and customer experience. We have a strong balance sheet and capital position, providing scope for driving further profitable growth in returns and our asset quality remains sound with prudent provisioning.

Finally to our outlook on slide 30, the economic environment continues to show signs of ongoing improvement. Australia is relatively well placed for economic recovery, with low unemployment, high terms of trade and a large pipeline of residential construction and infrastructure work.

However, uncertainty remains given geopolitical tensions, elevated inflation, rising interest rates and supply chain and labour disruptions.

We remain absolutely committed to achieving quality sustainable profitable growth and have anchored our business around delivering 2% positive JAWS. We are growing ahead of the market across the housing and business portfolio and are optimising revenue quality and returns.

We expect to see NIM headwinds reducing into the second half. We remain focused on achieving integration and productivity benefits, with decreasing costs of at least negative 1%. CET1 is expected to remain comfortably above 9.5%. We understand the importance of dividends for our shareholders and our dividend payout ratio target range remains at 60% to 75% of full year cash earnings.

Thank you very much for your time this morning and with that, I'll hand back to Cherie and open it up for questions.

Cherie Bell: Thanks George. So we'll now move to questions on the phone. As I mentioned at the outset, if you could please be fair to everyone and limit your questions to just one and management will be happy to take any further questions you may have on the results later in the day. Thanks operator.

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

Brendan Sproules: (Citi, Analyst) Good morning team. Look I just had a question today on your dividend policy and the CET1 ratio as we head into the second half. George, your guidance is for much stronger lending growth, but when I look on slide 27, the capital usage when you consider risk weighted asset growth, investment, as well as securitisation is almost as much as the earnings for the period. So can you comment on the impact that those elements will have in the second half, obviously given note to your dividend policy statements today?

George Frazis: Thanks Brendan and I might start off and then hand over to Ewen to provide some colour to that. I mean as we've stated, our objective is to remain comfortably above 9.5% of our CET1 ratio and you can see also that we've now got a business that is sustainably growing across retail and business banking in a quality way and that will continue.

The other key objective we have is we're anchored around the 2% positive JAWS and we're still committed to our digital transformation. So we're dealing towards effectively both growth and transformation and ensuring that we maintain a strong capital position whilst we're also committed to our dividend payout ratio of 60% to 75%. But on that, might hand over to Ewen to comment more.

Ewen Stafford: Thanks Brendan and just to your question about some of the moving parts in the second half, just a few observations I would make. Firstly, the dividend decision and particularly the DRP set at 2.5% will preserve some capital going into the second half.

Secondly, we are anticipating lower system growth. So hence lower GLA growth into the second half. So a lower utilisation than the 41 points that you called out.

Thirdly, because of the way the investment profile is elevated in the first half of '22 and you may recall that was a similar profile as we initiated a number of large initiatives in the second half of '21. There'll be a much less draw on capital from our investment profile and a lot of the investment will be either expensed through Propex or will be a continuation of the integration.

So that'll have a much less impact and then finally, we will formally see the 8 basis points of the securitisation come through and then there are further securitisation initiatives that the Treasury team have lined up for the second half as well. So we'll see that as quite a positive contribution to capital in the second half as well.

Brendan Sproules: (Citi, Analyst) Thank you.

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

Azib Khan: (Morgans Financial, Analyst) Thanks very much. George, you were previously guiding to positive JAWS of at least 2% for this year. It seems as though you've scrapped the at least part. Can I take that to mean that you've ruled out JAWS greater than 2% for this year?

George Frazis: Thanks, Azib. We are anchoring around 2% positive JAWS. Now, the key components of that, as stated, we will see margin pressure abating but there's still quite a bit of uncertainty around that. So the two key drivers of that is really what's happened to the significant customer flows into fixed home lending.

Now, that has actually normalised quite well. So if we look at the flows in the first half, we had about 47% of our flows into fixed home loans. Our application flows, let's take the last four weeks, are down to 18%. So that is normalising. However, there's still settlements from fixed rate lending from the first half still coming into the second half.

The other key issue is what we've seen in terms of the volatility in the swap rates. This is volatility that we haven't seen since the GFC. So that makes it difficult as well and then the final thing I'll state is that what we've done is, we've really improved our operating leverage when it comes to cost and able to really flex that.

We're committed to at least negative 1% cost which net-net anchors us around the 2% as you stated. So that is a change but Ewen, I don't know if there's anything else on that?

Ewen Stafford: No, nothing else from me, George.

George Frazis: Thanks, Azib.

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

Ed Henning: (CLSA, Analyst) Thanks for taking my question. Just on the NIM in the second half and then in FY23. In the second half, just excluding the liquidity impacts given the benefit of the replicating portfolio you've locked in, can the underlying NIM increase?

Then looking into FY23, can you just touch on the potential delta you think that'll be of benefit from the rotation back into variable rate lending? Or what has been the total impact of the switching to date and is there any more delta from the impact of the hedge of the beyond the 5 basis points if you hold interest rates flat at this point?

George Frazis: Thanks, Ed. I mean, the starting point to note is there's no doubt the NIM pressures in the second half and then long term are abating. We've actually spent a lot of time looking into this so in our interest rate increasing environment, BOQ will be advantaged under that scenario.

Now, I'll touch on the fixed. The fixed definitely has reduced back to normal. As stated, the flows in the first half were 47%. Our applications are now back to 18% and actually declining from that but I'll hand over to Ewen to give you a bit more info on your other parts of the question.

Ewen Stafford: Thanks, Ed. Just to your question about the underlying moving parts and if I anchor my answer on the second half back to what we experienced in the first half, we're - we are anticipating less of a head wind on asset pricing and mix. The majority of that is coming from a lower impact from fixed spreads.

George has spoken to that but I think it is worth noting that our applications have now normalised to 18%. There are still a few settlements from that November, December period in the pipeline. However, the rate locks on those have all expired and they're being settled at the higher rates and we have been very active on repricing in that area.

So we anticipate to be back to longer term trends in the coming weeks and I think it's also worth noting, just as a small comment, that we are two months further into this cycle than some of the recent reporting.

On the funding costs, definitely seeing continuation of tail winds into that second half. Albeit a little less than experienced in the first half. There'll still benefits coming through on the work that's been done on the savings accounts and the term deposits.

On the wholesale side, there will be benefit from the wholesale funding but in terms of benefits from the TFF, that has now been fully embedded in the numbers and then we move into the broader conversations about the replicating portfolio and also liquidity, but I think your question was - at the heart of it, was about the asset pricing and funding cost.

Ed Henning: (CLSA, Analyst) So just going back to that, if I look at second half on an underlying basis, ex the liquids impact, are you guys expecting that to be broadly flat or still down?

Then just on 23, you've talked about the improving delta on the switch back to variable rate lending. Is - how big is that? Obviously you've called out 8 basis points this half but how big in total has that been for you as a headwind and how should we think about that going forward? If you can…

George Frazis: Yes, so Ed, the starting point would be to say the headwinds have materially abated compared to the first half. There's still impacts from the settlements of fixed rate loans coming through. So there's a pipeline when it comes to mortgages but from now, if we look at applications and settlements, they're definitely back down to normalised levels. So that headwind abates in terms of NIM.

I think the other thing, and I'll let Ewen add to this if there is anything he wants to add. The other thing to note is if you look at the ME Bank balance sheet, effectively - I mean, this is not NIM related but there was a headwind this year on revenue because of the previous reduction in the balance sheet prior to ownership.

Now, because we've been able to return ME Bank to growth and net growth, that's going to provide us a tailwind next year on revenue as well but Ewen?

Ewen Stafford: Yes. No, Ed, just to answer your question directly. So including the capital low cost deposits, your comment about broadly flat is broadly right. So it'd be broadly flat to potentially 1 or 2 basis points down.

Then on the liquidity, I would - I know you haven't actually asked this question specifically but it is worth noting. We did have a very high build-up of liquids early in the half and in fact, we had a situation - for reasons which I'm happy to explain.

So we actually had a situation where our average liquids for the period was about the same number as the spot number at the end of the half. So it had a very material impact, that 5 basis points. We are not anticipating anywhere near that impact in the second half just because of how the averages work but also that we had an LCR up at 151% so there's opportunity to draw down on some of that as well.

Ed Henning: (CLSA, Analyst) Okay, thank you for that.

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

Andrew Triggs: (JP Morgan, Analyst) Thanks. Thanks very much for the question. My question just relates to the approach to loan book growth, George. In your time at BOQ, you've emphasised loan book growth well above system but this is coming at the expense of both higher than peer asset pricing and mixed headwind as well as now necessitating a discounted DRP program.

So just wondering if you think this is the right strategy? Clearly you do but just some comments around what looks to be very much a price-driven strategy on mortgage growth.

Just playing into the margin side of that. Deposit growth, we note from the APRA stats has tailed off late in the half and Ewen did, I think, reference some emerging TD price competition. Just interested in any thoughts around that side of things with Macquarie in particular being very aggressive on TD rates.

George Frazis: Yes, thanks Andrew and I'll take those three questions and hand over to Ewen to add to that. I mean, our objective has been effectively to optimise revenue quality and return when we go for growth. So this is not about a growth strategy for growth's sake.

Now, having said that, if you think about the size of our Bank representing 3% of mortgages and about 1.7% in business lending, growing mortgages at around about 1.8 times really just shows that our strategy is working.

Now, what's driven that growth has been almost entirely the improvements we've made to time to yes. Also being able to actually really respond quickly when we've had spikes in applications and getting our service levels back.

So we look at pricing really carefully. The pricing of mortgages is all centralised so we understand exactly where the market is and where we want to compete and where we don't want to compete.

As I said, we optimise revenue and effectively what you had is really two industry impacts that created some challenges in the last six months on margin. We optimise within that - those constraints.

If you look at the pricing changes that we made since October, we had five pricing changes for fixed in BOQ, four for VMA and actually seven for ME Bank. Obviously all upwards. The other thing I would note is that over the last two-and-a-half years, we've really worked hard at improving the construct of our deposit portfolio book. As you can see, we've grown transaction account balances by 16% for the half so 31% annualised. So we're really pleased about that.

You can also see that if you look at our at call deposits, over 40% of those are priced at under 5 basis points which I think will benefit from a rate rising environment and the other thing to note is, if you look at the way we've prioritised our digital transformation, it's all been about every day banking. So the mobile banking app in VMA has really shown that that's working.

We're really pleased now, we have a multi-brand version of that with myBOQ launched last month. So there's improving our deposit rate - structure, in terms of towards transaction and salary credits will continue but Ewen, was there anything else?

Ewen Stafford: Yes, George. Andrew, just a couple of - just to build on George's comments there on deposits and we are pleased with the progress. It is a real focus area as George has called out on the 16% for the half and I think it's about 26% or 27% for year-on-year.

I mean, we - with ME Bank, important to remember that had a very low transaction account balance. So we have work to do there and that is really being targeted through the digital asset build out.

Just a couple of areas George did not touch on, which is the owner-managed network is a really strong deposit gathering channel for us. Then of course we have the business bank as well and you will have seen they had - they experienced very strong deposit growth over the half and that is very high quality sticky deposits.

Just back on your - the capital comment. A couple of comments I would make, just to provide, I think, some context. We are in a period in terms of the broader market of high growth opportunity and opportunity to grow in a quality way. We're also in a period of high investment.

It is also worth remembering that we did make a decision at the time of the acquisition and the capital raise and notwithstanding how over-subscribed that capital raise was, that we would selffund the integration cost. So the $140 million of integration costs which represent about 22 basis points of capital.

Now, what we've seen since then is much stronger system growth than we had anticipated. So I think when you factor that in, the self-funding of the dividend cost, the high growth, high investment. Just the general uncertainty in the macro environment as well as just being a little cautious as we head to Basel III, they were all considerations that came into that decision around the DRP.

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

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

Richard Wiles: (Morgan Stanley, Analyst) Good morning, George. I wanted to ask you about term deposits. The industry as a whole has benefited from this massive mix shift over the last couple of years. When rates start going up, there's going to be a shift back into the term deposits so it's not going to be as easy for the industry to grow transaction accounts.

So my question is, do you think you can buck that industry trend? Do you think your transaction account growth will continue to outstrip your term deposit growth when rates go up? Also, based on your experience, George, do you think there's a tipping point where term deposit rates go up faster than cash rates where customers start to get better rates on term deposits?

George Frazis: Yes, thanks, Richard. I suppose just to make a few comments on this, the starting point is you know, there's no doubt the industry has benefited from the reduction in TDs and that without a doubt is likely on the verge of turning around.

My sense is, if you look at BOQ historically, although we've been able to improve the structure of our deposit portfolio, which we're really pleased with, we were kind of disadvantaged by not having a leading mobile banking app that's focussed on transaction and savings accounts.

Now that we've got both our VMA and BOQ brands on this new mobile banking app - and I encourage everyone to sign up if you haven't, just to experience how good it is. I think that is - that's taken away a significant disadvantage that we had.

The other thing we've been able to do, Richard, is over the last two-and-a-half years, we've really been able to engage our owner-managers. We started off in the home lending space so effectively that was a key part of our turnaround from negative growth in mortgages to growing above system.

We then engaged our owner-managers on SME lending and again, that's proven to be extremely successful. Their long-term relationships within the communities have made a big difference but more recently, we've now engaged them on low cost deposits, transaction accounts and salary credits.

Again, we're starting to see some real benefits coming out of that network. In fact, if you take the last six months, over 50% of our low cost deposits, both on the retail side and the business banking side, are driven from our owner managers. So there's a real advantage on that.

So although there will be a shift towards TDs without a doubt, the cost of those TDs will increase, I think that the historic disadvantage we've had relative to the majors has definitely reduced from my perspective and we'll be able, given what we've got, in terms of our digital assets, to manage through that in a more effective way when it comes to margin and funding. Thanks, Richard.

Richard Wiles: (Morgan Stanley, Analyst) George, tipping point? Do you think there's a point where TD rates go up more aggressively than cash rates?

George Frazis: Yes, probably the other point I didn't - missed, is I'm not sure that that will be the case, Richard. Although it's hard for me to tell but the other driver of this is that we've got an - a likely interest rate increasing environment. The first one potentially being in June.

So towards the end of that interest rate increasing environment, it does start to impact somewhat in terms of housing growth which then will take off some pressure in terms of the need to grow deposits. So I think that's the other thing to take into account but it's hard to be definitive.

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

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

Josh Freiman: (Macquarie, Analyst) Hi, thanks for the opportunity. I'd just like to expand on Richard Wiles, question that he just asked earlier. I know historically you've had a smaller relative replicating portfolio just on a size basis to peers, given your deposit mix.

But with the increase and restructure of that replicating portfolio, it kind of implies that you've seen an improvement in deposit franchise quality. I know you've mentioned the OMBs in that respect but I mean, lots of your peers have also had that same increase in low cost deposits in this environment. What sort of colour can you provide on why you… expect that low-cost deposit change to be permanent?

George Frazis: Yes, Josh. I suppose I'll start off and hand over to Ewen. As I said previously, this is an area we've really looked into a lot of detail, as you would expect. We know we're going into a rate-increasing environment so understanding the structure of our deposits and how we respond to that has been a focus of ours over the last six months, and obviously over the last two-and-a-half years we've made great strides in terms of improving the structure of our deposit portfolio.

We're confident that net-net in an interest rate-increasing environment it benefits BOQ. Obviously, it's a benefit for the industry as a whole. You've seen what we've done in terms of the replicating portfolio and I can let Ewen talk to that. The other critical thing is our focus on transaction accounts has provided good growth for the half of 16% and as I've also previously said, these new digital assets really changed the game for us in terms of our ability to continue growing transaction accounts.

Now, I also think there definitely has been a structural change in consumer behaviour from the historical view of a regional or smaller player versus the big four when it comes to security around deposits. Now, there will be a differential still between the majors and the regional banks but I think that structurally has reduced more permanently.

Ewen Stafford: George, Josh, I would only add, just to reiterate two points I made earlier in addition. Firstly, ME Bank, not traditionally considered a primary banking - a great home lending business, but there's a massive opportunity for us there, largely untapped. Of course, we have the business bank as well and the growth agenda through that. All of those issues combined, together with George's points, I think do provide us with optimism that we can continue to grow that mix.

George Frazis: Maybe just to add to that, Ewen, if you look at our refocus on SMEs, Josh, you look at the RBA data, that market is growing now at around about 5% from zero to negative growth not that long ago during the pandemic. We're growing at 12.9% in SMEs, so that turnaround and that focus of our strategy on SMEs has been really successful. Our sense is the stickiness of a lot of those deposits from our SME base is quite high. That's another hedge that we've got when it comes to deposits as well.

Josh Freiman: (Macquarie, Analyst) Sorry, just quickly following up. Do you guys still then expect to see benefit from higher rates on that unhedged deposit book, because you would have lowered your sensitivity? Do you guys quantify that at all, or can you?

Ewen Stafford: Josh, is your question about the uninvested, in which case the answer is...

Josh Freiman: (Macquarie, Analyst) Yes, effectively your unhedged deposit book.

Ewen Stafford: Yes. The answer is absolutely. As that portfolio now rolls out over five years, we absolutely expect to see that - apologies, sorry, I have slipped into the replicating portfolio. No, we absolutely do see that coming through as cash rates rise in addition to the benefits I've called out on the replicating portfolio.

Josh: Thank you.

Ewen Stafford: It's definitely an and.

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

Brian Johnson: (Jefferies, Analyst) Good morning and thanks for the opportunity to ask a question. George, if we have a look at the result today your share price is down 4.4% to around $8.14. You've got net book value, which is sitting at $10 a share. We're hearing more and more about growth, don't worry about capital because we're going to be issuing DRP shares.

When we have a look at the guidance, it's a bit hard to see on a sustainable basis you earning your cost of capital despite the fact the cost of capital is going to increase as bond rates basically rise. Could we get some comments on a target ROE please and what we can see, a long-term sustainable ROE for BOQ or is that not appropriate that we should be thinking that way? Thank you.

George Frazis: Brian, thanks for your question. If you think about what our absolute focus is, Brian, is achieving sustainable profitable growth and improving our returns. That is our focus, and a critical part of that has been our digital transformation and our increasing operating leverage that we've demonstrated.

If I take the short-term initiatives that we've taken on automation, the improvements of process, et cetera, that has all been about reducing costs whilst we've been able to grow, and we've shown that we're making really good progress on that with half-on-half costs coming down by 3% and we see that ability to respond on the cost base continuing.

Now, the other critical thing that we're doing is we're investing in a digital transformation, and just to be really clear, we're going to have an at-scale bank that's fully digital end-to-end. This is not just about having a digital app at the front end, it's saying that every single one of our processes will be digital end-to-end, which dramatically reduces our complexity, our systems, and improves our cost-to-income ratio.

We're going to be providing a lot more detail around that at the analyst strategy update mid this year, so that will, Brian, give you targets in terms of where we expect ROE and where we expect cost-to-income to be. Both of those will be improved and our objective is definitely to be achieving more than our cost of capital.

Brian Johnson: (Jefferies, Analyst) Thank you.

Operator: Thank you. Your next question is from Jonathan Mott from Barrenjoey. Please go ahead.

Jonathan Mott: (Barrenjoey, Analyst) Thank you. I'm just going to follow up from BJ on that question, and it comes down to that cost base, which I think - which really comes down to where the profitability can go. If you think about pro forma costs, you called out $933 million and then you've increased synergies again, which as you both have said, are $95 million, so somewhere around about $835 million should be your starting cost base, but we know that there's a substantial digital investment coming through and amortisation costs, which are also rising through this period.

Can you give us a feel on where that cost base should actually be landing, go out when you get the synergies and all the productivity has come through, everything is amortised, there's a lot of moving parts here but where should we be thinking the cost base of the Group should land?

George Frazis: I'll start off on this one. Jonathan, our objective, if you think about where we get to at the end of our digital transformation, and I do want to stress that the addition of myBOQ was a really significant milestone for us because effectively we have now proven out that new cloud-based end-to-end digital platform in a multi-brand capability, so our ability now to migrate ME Bank, which is on version 18, to the version 20 becomes quite straightforward. You can see a scenario where fairly quickly we've got our three - all our retail brands on this end-to-end digital platform.

Now, we do have to add mortgages to that, which we plan to do over the next 12 months. That does give us actually a step change and that goes beyond the $95 million that you've just stated in terms of the synergies. It gives us a step change in our whole cost base, Jonathan. My sense is if you look at cost-to-income ratios between regional banks and the four majors, this potentially gives us the opportunity to get very competitive to the average of the four majors.

Now, we're going to be providing more detail of that in midyear because we'll be laying out exactly what needs to be done over what period and then when do we actually start closing - migrating customers, retiring systems, and achieving the cost base. That will all be laid out in a lot of detail midyear.

Jonathan Mott: (Barrenjoey, Analyst) Okay. So, cost base is therefore settled substantially below the $835 million?

George Frazis: Yes. Yes.

Jonathan Mott: (Barrenjoey, Analyst) Okay. I'm looking forward to hearing more.

George Frazis: Because if you look at the - sorry, Jonathan. If you look at the $95 million, that's synergy related to the migration. There's $20 million of that that's related to the migration to the new digital cloud base but that doesn't take into account the overall cost saving we're going to achieve by the three brands all being on a single, fully digital cloud-based banking platform.

Jonathan Mott: (Barrenjoey, Analyst) Okay, and when will that be achieved? This is beyond 2024?

George Frazis: We will lay out the details of that midyear, Jonathan, but what you will see is - there's no doubt you get the full benefit when you've migrated all customers and retired the systems, but there are benefits on the way as well. We will lay out - because what you effectively do, we've got a strategy for each of our retail and business bank laid out now.

For those legacy systems that we're not actually taking forward because they're not our fully digital platforms, we start reducing the cost of maintaining those systems so you get benefits on that. You still have to do work on those and you effectively focus all your investment on your new digital platform. There will be benefits on the way but the majority of it comes when you get all of your systems and your customers migrated.

To give you an example of how we are thinking about phasing this to get benefits early, the simple mortgages would be our first priority. If you look at our focus on ME Bank through the broker channel, that tends to now be simple mortgages so we've been able to really improve the quality of mortgages coming through ME Bank, to be PAYG, low LVR.

You can see a scenario where the ME Bank brand effectively gets onto a fully digital environment early on in this process that will provide a whole lot of benefits as we think about the rest of the phasing of the program. As I said, that detail will be provided midyear.

Jonathan Mott: (Barrenjoey, Analyst) Okay. Thank you. Look forward to that.

Operator: Thank you. Once again, if you wish to ask a question, please press star one on your telephone and wait for your name to be announced. Your next question is from Andrew Lyons from Goldman Sachs. Please go ahead.

Andrew Lyons: (Goldman Sachs, Analyst) Thanks and good morning. Slide 53 gives some further disclosure on your balance sheet mix. I'm particularly interested just around the construction where your business bank is 9% exposed to construction and asset finance is 18%.

Can you perhaps just give a little bit more detail around the type of lending done in that part of the book, particularly in the asset finance space given the size of that exposure? Then maybe how those exposures are performing given the fairly difficult environment for that part of the market right now. Thanks.

George Frazis: Thanks, Andrew. You probably would have noticed that we've actually provided a bit of a deep dive on what we've called some of our emerging risks in the industry. The two areas that we've looked at is both floods and construction. Just really quickly on floods, I know that wasn't your question, but we've done a postcode-by-postcode analysis of that, so we've got very little exposure even though our thoughts go out those communities that have been impacted. In fact, we've only got about 200 customers requesting - that's both retail and business - requesting support.

On the construction side, as you state, what we've seen is obviously shortages of labour, increasing costs, and this is an industry that historically has had fixed contracts and low margins. We've done a very detailed look at our construction book. It is very diversified and then on the larger parts of our book where we've got really longstanding customers, we've had one-on-one sessions with those customers.

Given all that, at this stage we don't have any concerns with our book. It's high quality, the players that we're supporting have been around and really understand this and know how to manage it. I don't know if David or Chris wanted to add anything to that.

Chris Screen: I'd only add, George, on the asset finance side that it's a very well-diversified portfolio predominantly in the SME segment and we're seeing reasonably good performance through that portfolio.

Andrew Lyons: (Goldman Sachs, Analyst) Predominantly equipment for construction, is that the right way to think about it in the asset finance book?

Chris Screen: Yes, that’s correct.

Cherie Bell: Thanks, Andrew. That brings us to an end of the Q&A. I will now pass to George for some closing remarks.

George Frazis: Thanks, Cherie and I'd like to thank everyone for joining us this morning we really appreciate your time so close to Easter. As you can see, this has been another big half for BOQ. We're pleased with the financial results and particularly the progress we have made on our business momentum, digital transformation, and the ME Bank integration.

We have another big half ahead of us. We're really looking forward to speaking to you all midyear when we've got our detailed next three-year plan laid out. We're focused on executing against our strategy and driving the business to deliver sustainable, profitable growth. We wish everyone a relaxing break over Easter, and once again, thank you for your time and for your ongoing support of BOQ.

End of Transcript