# TRANSCRIPT

## BENDIGO AND ADELAIDE BANK 2023 HALF YEAR RESULTS

## 20 FEBRUARY 2023

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**Marnie Baker** Good morning, everyone, and welcome to the market briefing for Bendigo Adelaide Bank's Financial Year 2023 Half Year Results. Let me begin today by acknowledging the traditional owners of the land from which we meet today here in Sydney is the Gadigal people of the Eora Nation. I pay my respects to their Elders past and present and extend my respects to the Aboriginal and Torres Strait Islander people who are present on the call today.

I'm Marnie Baker, the CEO and Managing Director of Bendigo and Adelaide Bank, and I'm pleased to have our Chief Financial Officer, Andrew Morgan, presenting with me today. Also joining us on the call is our Chief Risk Officer Taso Corolis, who will be available to take any questions alongside Andrew and I at the end of the presentation.

To ensure we leave time for everyone, I ask that at the end of the presentation today, you please limit your questions to a maximum of two each. Then we can look to cover off on any additional questions later so the time permits.

Today, we are announcing a strong result. Over the first half of financial year 2023, we have seen significant improvements in the performance in our business, with cash earnings, return on equity and capital all improving on the previous period. We have been disciplined in our focus of carefully balancing lending volumes and margins, which has led to a strong first half revenue outcome. We have maintained a strong balance sheet, preserved our credit quality while making real progress on delivering a cost to income ratio towards 50%.

These results were supported by our ongoing transformation journey, delivering sustainable changes across the Group, including an uplift to our risk management framework and capability.

Through first half '23, we reached some key milestones with the launch of our digital home loan, Up Home, the full integration of Delphi Bank and the delivery of PayTo to our e-banking customers. Six months ago, I spoke of our strength and emphasis on returned execution and business sustainability. Today, we will provide you with concrete examples of how we have met these objectives. I'm proud of the progress the organisation has made as we continue to meet and balance the needs of all our stakeholders. I'll spend some time taking you through these key elements of this in the coming slide.

Our overarching strategy has not changed and our purpose-driven commitment to customers, communities, shareholders, and employees is as strong as ever. We are delivering and will deliver what we said we would, bringing our vision to be Australia's bank of choice closer than it has ever been.

Earlier, I spoke of the strength of these results. Cash earnings are up 22.9% on the second half of financial year 2022, driven by a 19-basis-point increase in net interest margin while keeping costs low in a high inflation environment. This has led to an improvement in return on equity, and subsequent increase in the interim dividend to $0.29 fully franked.

From an operating performance perspective, we continue to see strong growth in customer numbers driven through our Bendigo Bank brand and our leading digital proposition with Up. Importantly, we have retained our market leading NPS and further increased our gap to the industry. Our cost to income ratio has improved by 500 basis points over the half to 54.6%, and in line with our commitment of towards 50%. Andrew will cover off on the financial results in greater detail in his section.

Our divisional results mirror those of the Group, with strong cash earnings in both customer facing divisions driven by an increase in net interest margin. Over the half, the consumer division increased cash earnings 44.8% to $345.8 million while the business and agribusiness division grew cash earnings by 12.5% to $155.4 million. Both businesses remain focused on productivity improvements resulting in a more agile and efficient business.

The consumer division has continued its work in building out our digital home loan offering, with the relaunch of BEN Express, a particular highlight, more than doubling the portfolio in the half. We also recorded a positive contribution from government first home owner scheme, and are currently the only participating lender in the New South Wales Shared Equity Home Buyer Helper Scheme, which began last month.

The business and agribusiness division, which now has a refreshed leadership team, is positioning for growth. Lending in the portfolio did contract during the half, driven by a heightened level of competition and high amortisation due to the maturity of the portfolio. We are focused on growing our business while streamlining systems and processes to provide a better experience for our customers.

Six months ago, we came to market with greater emphasis on returns, execution and business sustainability. Our increased emphasis on returns is evident in our financial results. Our return on equity increased 145 basis points, while our cost to income ratio improved 500 basis points. Our disciplined business decisions supported these financial outcomes.

The current environment for housing loans is very hot at the moment with larger peers leveraging their market position through pricing and offering large cashbacks to grow market share. Over the half, we selectively participated in both lending and deposit markets through our disciplined approach to volume and margin management, carefully balancing our decisions to ensure we receive appropriate returns for our shareholders while remaining competitive for our customers. As part of this, we made it easier for our employees to make quality and timely decisions on new business through lifting our reporting capabilities at a range of levels across the organisation.

Our transformation program is on track. With the foundational work, we have completed paving the way for an acceleration in our progress. Although our transformation program has been delivering for some time, we are beginning to see larger shifts towards our financial year 2024 target. Our path to becoming a bigger, better, stronger, and more efficient bank is clear.

In addition to the Delphi and PayTo outcomes I've already mentioned during the half, we delivered a new cloud-based product and pricing engine and a new collateral management system. The product and pricing engine will significantly hollow out our core banking system, and is a key enabler to further product simplification and much faster product development for our customers. While the collateral management system will provide a single and centralised source of truth for the Group, simplifying frontline processes.

Reflecting on our transformation metrics, we have fewer IT applications overall and have moved more of those that remain to the cloud. We have more APIs being reused and have continued to grow the number of customers utilising our digital channels. Our time to decision for home lending is faster again, and we continue to consolidate the number of suppliers we use. We have implemented further improvements to our risk management frameworks and capabilities.

Our investment in digital continues. We achieved significant milestones for our digital assets with Up reaching over 613,000 customers and $1.3 billion in deposits, and importantly, momentum in Up Home. Up Home was soft launched early in the half, and has shown significant promise with $38 million in settlements. This result is encouraging as it was achieved within Up's current customer base with no external marketing.

Our BEN Express home loan has delivered a milestone of its own and has now settled more than $100 million in lending. The product is reducing time to decision to less than an hour on simple loans, delivering great experiences for customers and lowering costs for the bank. BEN Express remains on a growth, a strong growth trajectory. Pleasingly, more than 80% of Up Home and BEN Express customers are new to bank.

The launch of Qantas Money Home Loans powered by Tic

Finally, our partnership with TicToc has a portfolio of $2.9 billion. It is pleasing to note that expansion continues, attracting investment from IAG Firemark Ventures, to provide insurance within the platform. These developments pave the way for a seamless home loan and insurance experience for customers. These digital channels are currently producing 8.9% of home loan settlements for the Group, presenting significant upside over the medium term.

This next slide illustrates our opportunity. For a number of years, we have been steadfast in our strategy to attract and retain a younger demographic to our Group. This slide demonstrates the progress we have made, and highlights the demographic shift in our customer base over a 10-year period from 2012 to the end of 2022. The average age of our customer base across the organisation has fallen from 46 years to 43, while we have added over 800,000 customers across the same time period.

Up has been a large driver in the increase of millennials within our customer base, but we have also seen a shift within our Bendigo Bank brand. This millennial demographic provides a pipeline of customers with many financial needs over a lifetime, and who require a trusted banking partner. More importantly, they are beginning to enter an important phase of their lives looking to purchase a home. Our growing suite of digital and competitive offerings through our retail and third party channels gives customers a true multi-channel experience.

Our focus on the sustainability of our business is integral to realising the bright future we know exists for our organisation. More than ever, we recognise the importance of each of our stakeholders in building on our 164 years in business, and creating a more sustainable future for the Group. For our customers, we remain focused on relationships, ensuring our value proposition is clear and delivering a competitive edge. Evidence of meeting the needs of our customers can be seen in our market leading NPS and trust scores.

For communities, it is about staying true to our purpose of feeding into their prosperity and not off it. Our community bank network remains a key part of our organisation, with 302 branches across the country and over 5,700 projects funded in the last 12 months. Further, our focus has been on aiding our communities impacted by natural disasters such as bush fires and most recently those impacted by floods.

In the first half, we launched the Bendigo Bank Flood Appeal, which raised over $685,000, while $1.2 million has been distributed throughout the half to flood affected communities and communities affected by recent bushfires.

For shareholders, it is about preserving and sustainably growing shareholder value and delivering a reasonable return on their investment. Through the half, our diligent and sharper focus on capital usage and cautious approach to managing

volume and margin has led to a higher return on equity and a corresponding increase in our interim dividends.

Last but certainly not least, for our employees, it is about investing in their capability and rewarding them appropriately, ensuring the goals of our people align with each of our stakeholders. My apologies, I've got a bit of a frog in my throat.

The achievements we have announced this morning would not have been possible without our great team. I would like to thank each and every member of our team who have worked - who work hard every day to support our customers to achieve their goals and our own.

An examination of our business sustainability would not be complete without discussing the progress we are making in developing and implementing our ESG strategies. In the first half, we launched BENZero, our pathway to net zero emissions by 2040, which includes our operational and finance emissions. We also received a provisional endorsement of our reflect reconciliation plan from Reconciliation Australia, and expect to launch our commitment later this half.

We have reviewed and enhanced our cyber controls and processes in response to increasingly sophisticated external threats and high profile [*unclear*], and continue to enhance our governance structures by incorporating ESG responsibilities into our various Board charters. We also recognise the very real challenges some people are facing given the increased cost of living pressures driven by inflation and increasing interest rate.

Our bank has a strong 164-year track record in supporting our customers dealing with natural disasters, pandemics, and economic uncertainty. We will continue to be there to support our customers when they need us, as we have always done. I'll now pass over to Andrew to run through the financial detail behind the half year result, and to expand on some of the themes that I have outlined. Thanks. Andrew.

**Andrew Morgan** Thanks very much, Marnie, and good morning, everyone. Six months ago, we shared with you our financial priorities, which in simple terms are a heightened focus on cost management and also capital utilisation. We talked about three key areas of focus being managing volumes and margins, a heightened focus on cost efficiency and improving our returns on investment cases.

Through the last six months, we have been delivering against these priorities. On volumes and margins, we've actively focused on growing revenue through selectively competing in our core markets of home lending, deposits and business lending, where it's made sense to do so. Our heightened focus on cost efficiency has seen our targeted cost program ramp up through the half. This has helped us to contain costs in an environment of higher than expected inflation. We also established a new centralised productivity team and appointed a new leader late in the half.

Our focus on improving returns on investment cases has seen us introduce a new profit after capital metric at both the Group and divisional level. We have also reviewed and enhanced the way that we calculate returns on equity in each of our divisions and in our pricing calculators. This is having the effect of sharpening our focus on capital utilisation and returns on capital. As a result of our disciplined execution across these areas, we have achieved strong revenue growth primarily through deposit volume growth and margin management.

Our cost to income ratio has also substantially improved. Careful balancing of volumes and margins has seen a low level of capital utilisation, leading to a strong CET1 ratio and a much improved return on equity. Importantly, we enter 2 Half '23 in a strong funding and liquidity position.

On this slide, you can see the results of our disciplined execution with all of our key metrics showing improvement. In particular, you can see the 5 percentage point improvement in cost to income ratio to 54.6%, and a 145 basis points improvement in cash return on equity to 8.79%. Our already strong customer deposits franchise has continued to improve through the half back up to 73.9% of total funding, giving us flexibility in the way that we fund asset growth.

Turning now to our results for the half year end of 31 December, 2022, we recorded cash earnings after tax of $294.7 million, which was up 13% on the prior comparative period and up 22.9% on the prior half. Compared to the prior half, total income was up 14.5% and operating expenses were up 4.9%, with the expense outcome mainly reflecting a higher amount of expensed investment spend.

Credit expenses were a $5.6 million charge for the half, mainly reflecting an additional overlay booked into the collective provision. Our statutory net profit after tax was up 49.3% on the prior half, and I'll walk through the key items on the following page.

On this page, you can see the usual two items which represent the difference between cash earnings and statutory profit. The first is Homesafe net adjustments, which represent unrealised gains on open contracts, minus gains on completed contracts which have already been recognised through cash earnings. In this path, we have seen a decline in house prices which has led to a downwards net re-evaluation in the half. This was the substantial contributor to the $35.7 million reduction, which you can see on the page.

The second item includes a number of smaller items, most notably the cost associated with restructuring undertaken in the half and the amortisation of acquired intangibles. Taking those items into account, statutory net profit after tax of $249 million was up 49.3% on the prior half and down 22.5% on the prior comparative period.

Turning now to total income. Compared to the prior half, income of $958.2 million increased 14.5%. The key driver of this growth was net interest income, which was up 19% on the prior half. Over the half, on average, residential lending balances grew 2.8% and deposits grew 4.5%. Business and agri lending was up 0.7% on average. The benefit of this growth was further boosted by 19 basis points expansion in net interest margin.

Other income excluding Homesafe, was slightly lower than the prior half. This was mainly due to lower lending related fees, which were lower due to subdued settlement volumes. For Homesafe, there was a lower level of completed contracts in the half and this led to a $7.5 million reduction in Homesafe income.

I want to spend a few minutes now talking about what is happening with volumes in our largest asset class being home lending. As you all know, home loan pricing is very aggressive at the moment in response to slower system growth. Whilst on a rolling 12-month basis we continue to track system growth, our momentum has slowed this half. There are a few reasons behind this slowing momentum.

Pricing in the refinance market is intense at present and cashbacks are being used by most of our competitors. This has seen a reduced volume of settlements, particularly in our third party channels and in the refinance market. We have chosen to selectively compete in markets where it makes economic sense to do so. Pleasingly, what we've seen in this half is a substantial level of growth in what we believe will become an increasingly important channel for us.

As Marnie mentioned earlier, in this half, we soft launched an online home loan through our Up brand, and we have focused on strengthening our BEN branded digital home loan called BEN Express.

In the half just gone, you can see that the proportion of settlements between our key channels, third party proprietary and digital is starting to shift. This shift is important for a few reasons, (1), a digital home loan broadens our reach into new communities, and (2), a digital home loan costs us materially less to originate and service than one source from our traditional channels.

Finally, we have started to see some momentum return to our book in the last two months of the year. As Marnie mentioned earlier, our aim is to grow at or better than system while generating appropriate returns on equity.

Turning now to net interest margin. Compared to the prior half, there are a number of factors driving our net performance, which improved 19 basis points to 188 basis points. Asset pricing negatively impacted 22 basis points, reflecting a competitive environment in both variable and fixed rate lending. Deposit and funding pricing contributed strongly, adding 36 basis points mix.

Mix and other provided a benefit of 25 basis points and almost all of this number is the benefit from our replicating portfolio for capital and deposits. Our liquids

increased substantially through the half, with growth in deposits outpacing lending. This impacted four basis points. Along with our inaugural covered bonds issue in November, 2022, this puts us in a strong position to begin paying down the term funding facility from April of this year.

Finally, revenue share has increased 16 basis points compared to the prior half, primarily due to the impact of rising rates on deposit markets where our community banks write meaningful volumes.

On key considerations, we see both headwinds and tailwinds ahead of us. We see cash rates continuing to rise potentially to as high as around 4%. We also continue to see customers rolling off fixed rates and mostly favouring variable rate mortgages instead. Variable rate NIMs are typically higher than our fixed rate portfolio NIM. Countering that, competition in both lending and deposits remain strong and we have observed a shift of customers towards term deposits from at-call accounts. Higher funding costs are also likely as we begin paying down the term funding facility.

Turning now to operating expenses. At a headline level, costs increased 4.9% on the prior half and were up just 1.1% on the prior comparative period. The vast majority of the increase on the prior half relates to a higher level of expensed investment spend, as we ramped up the investment in our transformation program.

We also continued to invest in our Ferocia business and specifically into the Up platform. In respect of our BAU costs, they are up just 1.1% on the prior half. Our largest cost item, staff costs, were down 0.2% reflecting some wage inflation but also at 2% reduction in FTE over the half. Technology related costs were higher, reflecting vendor cost pressures, the more extensive use of cloud and non-lending losses were also a little higher.

Offsetting some of the inflationary pressure, we've successfully negotiated a few large supplier contracts and have banked some of that benefit in the half. In respect to future consideration on costs, this is unchanged from the trading update which were made on 13 December, where we see a modest increase in FY23 expenses compared to FY22. Over the medium term, we remain committed to broadly flat costs and to reducing our cost to income ratio towards 50%.

Turning now to credit quality and credit expenses. We continue to see improvement in our credit metrics, and for the half an expense of $5.6 million was booked. Breaking that down, the charge includes a net increase in the collective provision of $6.6 million and a net right back of $1 million. Gross impaired loans continue to track downwards, representing just 15 basis points of gross loans.

Arrears across the book are pleasingly low and we continue to see arrears rates reducing particularly in 90 plus days residential lending, which is down from 49 basis points in the prior half to 41 basis points as of December. Whilst asset

quality remains sound and arrears are at historic lows, we do expect bad debts to trend upwards and move towards long term averages over time.

This next chart shows the resilience of our residential lending portfolio. Starting from the top right-hand side, you can see that around one-third of our customers are at least two years ahead of scheduled repayments and 16% of customers have no buffer. Breaking down that 16% of customers with no buffer, 85% of those customers have an LVR of less than or equal to 80%.

On the bottom left-hand side, you can see the conservatism in our underwriting standards, where the proportion of our lending to customers above 6 times debt to income remains well below the major banks. On the bottom right-hand side, around 50% of our portfolio has been originated in the last two years, and is sitting at a dynamic LVR of between 50% and 60%.

In terms of provision coverage, the chart on the left shows the breakdown of our credit provisions across collective, general, and specific. Our aggregate provisions have increased marginally since 30 June. Our collective and general provisions have increased while specific provisions have decreased, reflecting a reduced level of impaired loans.

On the right-hand side chart, we show the split of our collective provisions between modelled scenarios and overlays. On modelled outcomes, our scenario weightings are unchanged from 30 June, and we have retained the overlays which we called out at June. We've raised a further overlay, cognisant of the risk of customer stress as fixed rate customers whose loans are maturing move to higher rates.

Whilst we have not seen any meaningful signs of stress at this stage, as evidenced by our improved arrears ratio, we considered it prudent to raise an overlay for this risk, particularly given the interest rate outlook. Overall, we feel comfortable with the level of provisions that we’re carrying and we continue to keep a close eye on credit conditions across the economy and across our exposures.

Our funding and liquidity metrics remain strong and well diversified. With strong ongoing growth in customer deposits over the half, the proportion of customer deposits to overall funding increased to 73.9%. Our coverage of deposits to loans is well above industry average at 17%. Our community bank partnerships importantly provide us with around $10 billion of funding, which provides further diversification, and a relatively cheaper funding source and wholesale funding.

During the half, we further diversified our sources of funding, launching our inaugural covered bonds program in November, 2022. This puts us in a strong position to pay down the term funding facility over the next 18 months.

Turning now to capital and dividends. Our CET1 ratio increased 45 basis points to 10.13% over the half. The increase reflects strong growth in earnings, which contributed 63 basis points. The dividend paid in August 2022 impacted 30 basis points and a 1.7% reduction in risk-related assets over the half added 17 basis points of capital.

The strong capital result reflects the discipline of balancing volumes and margins and ensuring we're writing business at or above our cost of capital. In terms of future considerations, we expect that the new capital standards which became effective on 1 January, 2023, will provide us with a benefit of between 60 and 70 basis points likely towards the top end of the range.

In response to the new capital standards, we have lifted our target CET1 ratio range by 50 basis points to now 10% to 10.5%. Taking these two factors together, we expect our CET1 ratio to improve by 10 to 20 basis points relative to the revised minimum ratio.

Directors have declared a fully franked dividend of $0.29 per share, which represents a 55% payout ratio for the half, and is a 9.4% increase on the prior half. Given our strong capital position, we'll also be neutralising the DRP. In summary, we find ourselves in a strong capital position going into the second half. With that, I'll now hand back to Marnie to make some final comments.

**Marnie Baker** Thanks, Andrew. In focusing on the second half now of 2023, we remain committed to building on our returns, execution and business sustainability. As Andrew mentioned earlier, we are targeting positive lending growth subject to conducive market conditions, whilst maintaining prudent cost management across the business. This along with careful utilisation of capital, will enable the best possible opportunity for returns to continue our upward trajectory.

Key milestones will again be delivered in the half ahead, as we roll out in-app Bendigo Bank products commencing with term deposits, we integrate ANZ's 12,000 margin lending customers and retire three core banking systems before 30 June, this year.

At all times across our 164-year history, we have focused on what we can control. We remain committed to our strategy and are well positioned for the future. Going forward, we anticipate the accelerated pace of change over the last few years to continue. We expect to see customer expectations grow, competition for market share to continue and further house price moderation.

Additionally, the currently benign credit conditions may come under pressure as interest rates and inflation further impacts the Australian economy. We are well positioned for the year ahead. Our multi-channel strategy combined with our customer value propositions, market leading NPS and trust scores set us apart from our competitors. Just as importantly, and noting the uncertainties in the

market, our strong funding and capital position means we are well placed for the challenges ahead.

Finally, we remain committed to delivering better returns and executing our objectives, while continuing to support our customers and evolve our business for the future. With that, I will now open the call up for questions. Please remember in the interest of time to limit your questions to two.

**Operator** Thank you. We will now begin the question and answer session. If you would like to ask a question, please press star 11 on your telephone. To cancel your request, please press star 11. Again, please stand by while we compile the Q&A roster. First question comes from the line of Matt Dunger, Bank of America.

**Matt Dunger** Thank you very much for taking my questions. If I could first congratulate you on optimising the margins and stepping back from a pretty fierce competition in the mortgage market. Just wondering, Marnie, how long you can remain disciplined on market - on margins before needing to look for some more market share and before franchise momentum's impacted.

**Marnie Baker** Thanks, Matt. I think we've sort of tried to outline that as part of the presentation, that if we look on a rolling 12-month basis, we are still at system if we're talking about residential lending. We are focusing our efforts on the opportunities or the gaps that we actually see in the market.

We spoke about our digital mortgages through both Up Home and BEN Express, which is really pleasing. Both of those were - Up Home's very new to market and BEN Express, we really just did a relaunch just recently. Now, that's accounting for about 8.9% of our total loans or lending growth.

I think it was - we probably didn't actually refer to it, but if we look back on one of the slides there, we do account for 25% of digital mortgages in Australia at the moment through all of those channels, whether it's directly through ourselves or providing a balance sheet for [those] who are in the market. We are taking advantage of that at the moment, and I think that has great growth trajectory.

There is some work that's also being done across our proprietary channels as well, and also through our third party businesses. But you know, we have done this in the past, Matt, and as you know, we have stepped out of the market at times when we just think that it's a little crazy. I have heard the market say to me many times that we need to be covering our cost of capital. That's what we're doing in really managing our volumes and margins, and making sure that we are participating in those parts of the market where we actually can grow sustainably and above our cost of capital.

**Matt Dunger** Great. Thank you very much. If you could just follow up on business and agri banking, just wondering, anything on the outlook for volume growth in that

business? I know Andrew talked a lot about the focus on returns. Can you talk to us about how you're seeing returns in that business and deploying capital?

**Marnie Baker** Yes. It has been extremely competitive in that part of the market. We've also got quite a mature book, so we've seen a lot of amortisation in that portfolio as well. We did bring in a new exec in Adam Rowse mid last year, who has cast his eye across that business. He has been putting in place a new team, has been looking at I suppose the operating model that we're operating from, and has been putting in place things so that we can grow from that basis. But you'll see more about that probably in the coming half when we have a bit more to say about that.

**Andrew Morgan** I think the other point, Matt, is that we are starting to look at different channels in respect of how we source business. We've not been particularly prominent in the broker market. We're increasingly in business and in agri. That is becoming a large part of the market. We've been stepping now into the broker marketing business and not far away in respect of agri. Given where we're positioned at the moment, we're confident that there's upside over time.

**Marnie Baker** And along, you know - consistent with our consumer business, we have a multichannel strategy.

**Matt Dunger** Excellent. Thank you very much.

**Operator** Thank you for the questions. One moment for the next question. Next questions come from the line of Andrew Lyons from Goldman Sachs. Please proceed.

**Andrew Lyons** Thanks and good morning. Just a first question just on margins. At the deck 22 trading update, you specifically said that with further rate rises, NIM tailwinds were expected to continue into the second half of 2023. That sort of outlook seems to have been removed in the result in the conference call today. Does that imply you don't think NIMs will rise in the second half like you previously did?

**Andrew Morgan** Andrew, I'm not making any pronouncements on where second half '23 NIMs will go. The key reason for that is that there are more unknowns than knowns right now. The market is incredibly competitive, and very, very intense competition. What we laid out on the slide was our exit NIM. You can see where that is relative to our average NIM.

We also called out though that we do see genuinely tailwinds in the book. In particular, as fixed rate customers are rolling off, they are typically moving towards - when they refinance with us, they're typically moving towards variable rate loans where the NIMs are different and stronger than fixed rate. But also, there are headwinds coming as well. As we know, funding costs will likely increase with the term funding facility rolling off. There are just too many unknowns, Andrew. Even in the last couple of months, things have changed and it's become a more intense environment. For that reason, we've stepped away from that previous guidance.

**Andrew Lyons** Okay, that's really helpful. I appreciate that. Then just a second question, just on your capital position was a small net beneficiary, I think you said 10 to 20 bps of the new capital standards. I guess combined with your strong first half result, you're going to be pretty well placed by the looks of it on into the second half.

Can you maybe just talk about how you're thinking about your capital position more broadly? Whether you might see opportunities for capital returns, or do you actually see some organic or even inorganic opportunities that might be a better use of what will be surplus capital now?

**Andrew Morgan** It's probably a little early to say, Andrew. There's a couple of points you raised there around opportunities to deploy capital into asset growth, potentially capital actions down the track. It's a little too early to say where we go. I think where we've set or where capital is right now, where we've set through the directives, the payout ratio gives us that flexibility given the uncertainty in the environment. Certainly we've got options open to us.

**Andrew Lyons** Thanks Andrew. I appreciate it.

**Operator** Thank you for the questions. One moment for the next questions. Next up, we have the line from Richard Wiles from Morgan Stanley. Please proceed.

**Richard Wiles** Good morning. First question I've got is about your target to grow at or above system in the second half. I'm just wondering why you're committing to that. You've just delivered a good result, certainly demonstrating your increased focus on volume versus margin management. You've got better returns, better cost to income ratio. I think investors probably appreciate that increased focus on returns and margin management. Why is it so important to grow at or above system? Why make that commitment at this time given how competitive the market is?

**Marnie Baker** I'll just say before Andrew answers this, we did say subject to market conditions being conducive. There was that caveat on it, Richard.

**Andrew Morgan** Yes, that that is the key caveat, Richard. We've worked very hard over the last six months to really heighten the focus internally on capital utilisation and making sure that we're writing business at or above our cost of capital. Of course, we would like to grow at or better than system, but it's got to be on the basis that it makes economic sense to do so. What we've shown through this half is that we can be disciplined. Of course it's an aspiration for us to grow, but it'll only be on the basis that we can do it sustainably and economically sustainable.

**Richard Wiles** Okay. My second question, Marnie, relates to your M&A ambitions. You've been quite vocal on your interest in Suncorp Bank. The media's recently mentioned that you would consider a merger with BOQ. Could you comment on that directly? Could you talk more broadly about your appetite for acquisitions and what criteria you would have in deciding whether to make acquisitions?

**Marnie Baker** Well, Richard, you know that we've never commented on market speculation. If I could have $1 for every time I get asked that question, I'd be a rich lady on these calls. In my time, I can go back many, many years and the same questions are popping up.

I will say more generally though that we have undertaken M&A activity in the past. It is made up who - what the Group looks like today. Under the right conditions and so forth, we would we would look at that. It would have to be beneficial and accretive for our shareholders, it would have to make strategic sense for us as a business. But we have been in that position before. I'll leave it at that. They're the general comments that I'd make.

**Richard Wiles** Just to clarify there, Marnie, when you say accretive for shareholders, are you talking about EPS accretion or ROE accretion? Are you talking specifically about financial accretion rather than just being financial viewed as strategically beneficial?

**Marnie Baker** Yes, financial.

**Richard Wiles** Thank you.

**Operator** Thank you for the questions. One moment for the next questions. Next questions comes from the line of Josh Freiman from Macquarie. Please proceed.

**Josh Freiman** Hey, good morning. Thanks for the opportunity to ask questions. Just first question for me, it's in particular around the housing book. Are you guys able to provide some more colour around housing book given balances reduced particularly in the proprietary channel? I mean, are you able to provide any colour on, you know, mix of whether that was retention versus reduction inflow? I guess how do you guys expect to manage that moving forward, given that I expect the proprietary channel is far more economic?

**Andrew Morgan** Thanks, Josh, it's Andrew here. Slide 21, we give a picture of settlements. What you can see there is the absolute dollars of settlement. What you can see is reduction across both our third party channels and retail. Our discharge experience has been fairly consistent, so nothing to be really noted there. Then in respect of where to from here, as we've just talked about, we are cautiously optimistic on our digital channels. We've seen some good momentum in the half just gone.

We do want to step into the market where it makes sense to do so, but it's got to be on the right economic terms. Through a combination of opening up channels and staying disciplined, we hope to continue to deliver the sort of results you've seen today.

**Josh Freiman** Perfect. Thank you. I guess second question from me is just around the investment spend. Your OpEx portion normalised somewhat in this half. How should we sort

of consider the breakup of that investment spend just in the short term, in the context of your task to rationalise seven core systems down to four, and then down to one a year later?

**Andrew Morgan** Investment spend and the decisions we make on capitalising or not capitalising is really about a combination of accounting standards and accounting policy. It really comes down to the nature of the spend, and whether it's got measurable and ongoing benefit. In the prior half leading up to June, 2022 we had slowed down some spend which would've qualified as expensing.

In this half, given our revenue's been stronger than what we expected, we decided to ramp things up. We're very keen to get through our transformation program, because ultimately over the next couple of years with that combining of core systems or rationalising down to fewer systems, that gives us the opportunity to then deliver on that medium term cost outlook that we've talked about and that medium term cost to income ratio that we've talked about.

**Josh Freiman** Thank you.

**Operator** Thank you for the questions. Next questions comes from the line of Jonathan Mott from Barrenjoey. Please proceed.

**Jonathan Mott** Hi Marnie. I'm just going to keep going with the margin/volume trade-off, because I think this is going to be a really important issue for the next 6 to 12 months. When we look at the fixed rate that you've got coming up to mature, around 21% of your entire mortgage book is on a fixed rate which matures over the next 12 months. These customers are going to be rolling from somewhere in the 2s to potentially somewhere in the 6s.

You can understand these customers are going to go to their brokers or whoever they speak to, to get some financial advice and to see where they can get a better deal because they're under a lot of financial stress. On top of that, you've got the natural rollover of the book coming through. You've got your biggest competitor saying mortgages are being written below the cost of capital at the moment. That is only likely to increase given this intensification of competition that we're seeing.

I understand and totally agree with your view that you need to look at division ROE and you need to get your cost of capital up. But how long can you stand there and say, yes, we want to grow at system as long as the economics make sense? If we're an environment where the ROE isn't attractive, at what stage do you have to say, we're now prepared to compete? Because otherwise, your book is going to amortise extremely quickly over the next 12 months.

**Marnie Baker** I think it's all good points, John. I think it's worth actually noting that we are not necessarily seeing that in our book at this point in time. Our retention of our existing book has remained fairly steady so\o the engagement and the

relationships that we have with our customers. I can understand through the broker book but remembering that we are also targeting in on channels which are still direct to customer channels through the digital channels as well.

We're not overly concerned at this point in time. Competition, you are right, is rife, but I think the strategy that we have in place we feel is going to be able to get us to what we talked about at system or slightly better than system over the next 12 months, all things remaining equal. We'll just see how that sort of pans out. Andrew, I don't know whether you've got anything more to offer there.

**Andrew Morgan** Yes, good points, John. The experience that we are seeing in our fixed rate book in particular when those customers are coming up to maturity is we are still retaining a very high proportion of those customers. We're not the cheapest in market and we've never been cheapest in market. We're kind of middle of the pack if you like, or towards the bottom end, but the customers love our service proposition. That shows up in our NPS.

**Marnie Baker** And we don't offer upfront cashbacks.

**Andrew Morgan** Yes. Cashbacks are negligible. It's not just about price. There's definitely a service offering there that customers are attracted to. The customers that are rolling off the evidence would say that a high proportion are staying with us. Then a high proportion that are staying with us are then moving more towards variable rather than fixed rate loans, again, where margins are more attractive in a variable sense relative to fixed rate. As long as that dynamic continues, we're confident at least in the short term. But again, it's such an uncertain market, John. It's one that we'll continue to keep a close eye on.

**Jonathan Mott** Thank you. If I can just follow up with, well, it's a similar point. If you go to page 48, which just states the community bank footing, I can see is a very large slowdown. For the first time since the GSE, you've actually seen the loan book in the community bank contract. You talked a lot about digital and the dynamic move towards broker. Is the community bank model now getting tired, or is this a price volume trade-off that led to that contracting?

**Marnie Baker** There's a price/volume sort of trade-off there. Of course all of our models need to continue to evolve to remain relevant. The community bank model is no different than our corporate model, et cetera. We are very mindful of that. It is an important part of our business. It's a connection into communities, it's the connection with customers. It brings a significant deposit franchise for us as an organisation, and from our perspective will play an important part going forward. But like all parts of our business, it will continue to evolve to ensure it remains as relevant as all of our other channels do.

**Jonathan Mott** Thank you.

**Operator** Thank you for the questions. One moment for the next questions. Next up, we have the line from Ed Henning from CLSA. Please proceed.

**Ed Henning** Thank you for taking my questions. A couple from me. Firstly, on the margin, while we can't see it yet in the [APRA stats] you highlighted today you saw some improved growth at the back end of the period in mortgages. If you look at your exit margin, it grew from November to December. Are there any more additional tailwinds or more so headwinds, that you see coming through that are going to potentially offset the benefits of cash rates coming through in your margin at the moment?

**Andrew Morgan** Ed, thanks for the question. The headwinds and the tailwinds that we articulated on and in slide I think are the key ones there. There may well be other ones, but those are the ones that are most prominent in our minds. Not wanting to belabour the point, but competition on the headwind side is a factor, that migration that we're starting to see in others are seeing with customers moving out of transaction accounts towards term deposits and funding costs.

But also then, the dynamic that I just talked about with fixed rate customers that are maturing, moving more towards variable rates is a genuine tailwind. So they're the key ones I think, Ed.

**Ed Henning** Okay, No worries. I'll leave it there. Thank you. Then just one on cost, you talked about transforming your business and you highlighted reducing brand systems and applications between now and '24. Can you just talk a little bit more about the roll off period, how long you need to run dual systems? I imagine running these dual systems, and you talked about the median term cost target of broadly flat with '22. You're pulling forward some of your investments spend and you're trying to do this a little bit quicker. Does this likely see with running dual systems, '24's up again, but potentially from '25 you can start to see things roll off, which will help your cost base potentially head back down towards that '22 level?

**Andrew Morgan** Let me see if I can unpick that a little bit. Our transformation program and the spend is mostly done through '24 and then a little bit into '25. Whilst I'm not going to call where our investment spending aggregate, we'll go post '24, '25 because there may well be other things that we determine to do. The spend related to our transformation program in particular will start to drop from that time period.

In respect of the systems, yes, you're right. When you're doing system migrations, there's typically double run costs. We've thought about that; we've taken it into account. I would say though that it's not a new system that we're migrating to, if you like. It's an existing call banking system that is in place today, that is the bulk of our ledger if you like. That's what we're doing. We're migrating other systems, which don't necessarily have the functionality that we need, onto that new system, or sorry, that that existing system.

Part of what we're doing in that existing system is hollowing it out so that it's more like just a ledger. Then things like product and pricing engines and collateral engines we're building on the side. That will give us a very powerful both core system and ancillary systems. Certainly as we think about them, the cost outlook as we simplify the technology stack as we move towards fewer systems, our belief is over time we can generate productivity savings and then achieve that medium term cost outlook.

**Ed Henning** Can you just touch on, when you're migrating these systems, how long do you need to run dual systems to make sure the migration's done well? When do the costs drop out? I'm just trying to - is it six months afterwards, is it a year afterwards? Is that the main drop in costs or is the main drop in costs the spend? I imagine a lot of that's capitalised, so that'll just come through an amortisation.

**Andrew Morgan** Yes. I can't give you the exact timeframes for the dual run, but based on experience, it's somewhere between six and 12 months when you double run systems. Where the cost will come out over time is in the improvement of the underwriting process in particular, in the less touched by back-office staff if you like, in particular because there are fewer systems to be across, and to an extent the run costs associated with those retiring core systems. That's where the cost will come out.

**Marnie Baker** Just to clarify that too, we aren't dual running the system, there'll be a cutover. We won't be dual running the system, so we won't have that additional cost. But the benefit comes from when you retire those systems, and the applications and the subsystems that actually hang off that core banking system. Then the processes and all of those things as well that also hang off that, and what that does to change the productivity levels in the organisation. You don't get a big bang, necessarily a big bang. You'll see as we retire systems, you'll get a good cost improvement. But over a period of time, you'll see as it actually extends into the organisation, the productivity savings.

**Ed Henning** Okay. No, that's clear. Thank you very much.

**Operator** Thank you for the questions. Next questions we have the line from Brian Johnson from Jefferies. Please proceed.

**Brian Johnson** Thank you very much and congratulations on a result, on a great result. If we actually have a look at slide 40 however, we can see notwithstanding the fact you did $6.7 billion of lending over the half year, the housing loan book was exactly flat, didn't grow at all, and it's lasting only about four years. Andrew, I'm just wondering, how should we think about growth going forward? Because I understand, you know, when you basically tighten everything up, you don't grow. It makes everything look good, but your book actually starts to shrink at some point. Can we just get a feeling on the trade-off between that please?

**Andrew Morgan** Yes. Similar to what we talked about for some earlier questions, Brian, there's a couple of ways to think about it. One is the fixed rate maturing experience that we have seen. We are retaining a high proportion of customers, our discharge rates are consistent across the last few halves, so nothing really to see there. With the emergence of new channels and new partnerships, that gives us some cause for optimism, that that will provide volumes which we have not previously had.

Now, they are small of course, but we are again, cautiously optimistic that over time through the Qantas partnership, through Tic

**Brian Johnson** Andrew, the next one is and it's fantastic that we hear about profit after capital charge, but I can't see anywhere where it's disclosed. I can see on note 2.3.1, that the capitalised software balance continues to basically grow. Should we think of the profit after capital charge as being on the net tangible assets or the net book value? Could we get a feel about what you're doing?

Because even though the ROE is up, it struck off a very low loan loss charge, it's still - if you put a normalised loan loss charge in there, I'd suggest that the ROE would probably still be below the cost of capital. Is it warranted to be thinking about doing a review in particular of the $1.5 billion of goodwill, and that now growing balance of $289 million of capitalised software which is up, I don’t know, another $40 million over the half year? Should we be reviewing those carrying values?

**Andrew Morgan** Brian, under the accounting standards, there are limitations in respect of what we can do. Even if we're reminded to think about goodwill impairment or software impairment, there are some limitations. We have cash generating units. Those cash generating units have got to be fair value. The extent to which the fair value sits above the carrying value, there is no impairment. If there was a situation where the fair value fell below the carrying value, then that would provide the impetus to look at goodwill.

But before you can even think about software impairment, goodwill needs to be impaired first. There are limitations there. All of that said, we do periodic reviews. We've just been through a half year process and we do periodic reviews of the carrying value of our software. We look to see whether there's any form of obsolescence. If there were obsolescence in the assets, then that would give us cause to write off those assets, but that's not apparent today.

What I'd also say though, Brian, is we have a software capitalisation policy, which we've continued to look at and tighten up, to make sure that whatever is capitalised meets the definition of enduring assets. That discipline is heightened.

**Brian Johnson** Just going back on that, Andrew, the actual profit after capital charge is not disclosed anywhere?

**Andrew Morgan** That's right, Brian. It's not disclosed.

**Brian Johnson** Despite the fact that we see it going up, if we're to put a normal loan loss charge through, just by inference, it's suggesting you would probably be earning below your cost of capital.

**Andrew Morgan** Not based on our [accounts], Brian. Remember our cost to income ratios come down. Whilst loan losses are down, loan losses are not a big factor in the calculation. Risk weights on the type of assets that we're writing are reflective of the capital standards, and we're not doing cashbacks. All of that is a different dynamic potentially of how you might think about it otherwise.

**Brian Johnson** Thank you very much.

**Operator** Thank you for the questions. We now have the last questions from Azib Khan from E&P. Please proceed.

**Azib Khan** Thank you very much. Marnie and Andrew, you've had a lot of questions on the margin/volume trade-off, but there's going to be another couple on that from me. Apologies in advance for that. You're saying you'll only grow at or in line with system in the second half if it makes economic sense to do so. If home lending competition remains as intense as it is today, can we expect you to grow below system?

**Andrew Morgan** Well as we've said, we would like to grow at or above system, but it's got to be on an economically sound basis to do so. In the short term, we are seeing good signs through some of these new channels that we've talked about today of growth. We're seeing continued good retention of the fixed rate maturities that have been occurring. We are writing profitable business right now at or above our cost of capital.

As it stands right now, at least in the short term, we are optimistic, but it's a balance. It's not about saying, let's just go write lots of volume and it's not about just saying, let's just write return on equity - good return on equity business. We're trying to balance up the two things. At the moment, we're comfortable with the settings that we've adopted.

**Azib Khan** Andrew, can I take that to mean that you're most - it makes the most economic sense for you to write business through the digital channel because maybe that's where the costs are lower?

**Andrew Morgan** That's a reasonable basis of conclusion. As we talked about earlier, there are different distribution costs associated with digital loans, and there are different processing costs associated with digital loans.

**Azib Khan** Right. Is that what would explain why loan momentum improved in the last two months, it's because of that digital pickup? In the first four months of the half, you kind of didn't have that digital growth and that's why you were below system.

**Andrew Morgan** Yes, that's a fair conclusion.

**Azib Khan** Thank you.

**Operator** Thank you for the questions. We do have our last questions, follow-up questions from Brian Johnson from Jefferies. Please proceed.

**Brian Johnson** Hi. Andrew, just looking at the result, the reality is today is 20 February. Can we get a feeling on what the margin was in January relative to that exit run rate in December, please? Was it up or down?

**Andrew Morgan** Brian, we're not disclosing that, and we're not going to provide guidance as I talked about earlier for second half.

**Brian Johnson** Okay. Thank you.

**Operator** Thank you. With that, I'll now like to hand the conference back to the Company for closing remarks.

**Marnie Baker** Thank you. We'll now draw the call to a close, but I do want to thank you for your time today and of course your continued interest in our bank. We look forward to speaking to many of you over the remainder of the week. Thank you.

**Operator** This concludes today's conference call. Thank you for your participation. You may now disconnect.

**[End of Transcript]**