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Westpac 1st Half Results

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Analyst Briefing
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Westpac 1st Half Results Announcement.
Analyst Presentation
Dr David Morgan
Westpac Banking Corporation
The following are the speaking notes used by Dr Morgan and should be read in conjunction with the slide presentation which can also be viewed and/or downloaded from the investor relations section of the Westpac website www.westpac.com.au

Slide 1 - Introduction

Welcome to Westpac's first half results briefing for 2001.

I am pleased to introduce our new Chief Financial Officer, Phil Chronican, here with me in Sydney.

And in Melbourne we have Stuart Dyson, our Group Financial Controller and Noel Purcell, our Stakeholder Communications Head.

I would like to extend our welcome to those joining us via satellite in Melbourne, those on the conference call and our growing band of interested parties joining us on our live Web audio broadcast.

Prior to questions I will run through the key features of the results as we saw them and make a few comments on progress.

Slide 2 - Disclaimer

Slide 3 – Highlights

It's a great pleasure to be able to announce yet another record result.

Net profit was up 13% to $924 million, on the same period last year.

This result is not just about a record headline net profit figure, it's about;
- strong revenue growth;
- sound performances across all of our businesses;
- disciplined expense control; and
- continuing good credit quality.

Importantly, this result continues the well established revenue momentum set in motion more than two years ago, and is one that has delivered improved returns to shareholders.

It's a strong, good quality, and well balanced result which shows that our strategy of firmly focussing on broadening and deepening the relationships with our customers in our home markets in Australia and New Zealand is having the affect we knew it would.

And we are confident we will keep delivering because we still have a long way to go to fully harness the potential in our customer base.

Slide 4 – Earnings

In terms of the key financial measures, the trends are solidly in the right direction.

- Profits growth continued to accelerate in the current period. Net profit after tax was $924million, as I have mentioned, up 13% on the same period last year.

- And earnings per share were up 19% to 49.9 cents reflecting not only the improved profitability of the business but also the impact of our capital management initiatives.

- Dividends are up 4 cents or 15%, from 26 to 30 cents fully franked, broadly in line with our profit growth.

The profit momentum is evident in the compound annual growth rates of 4% through the period1997 to 1999 and then 14% over the last two years

Slide 5 - Shareholder Returns

Our return on equity at 20.9% increased by some 330 basis points on the same period last year, and it is now at an historic high.

And we generated $584 million of economic profit for shareholders in the half-year, an increase of 18%.

Slide 6 – Good core earnings growth

The trend evident in this chart clearly demonstrates the revenue and core earnings pick up through the last four reporting periods.

Over the past two years, reported revenues have increased at a compound annual growth rate of 7%, and with a virtually flat expense line have delivered 15% compound annual growth in core earnings.

Slide 7 - Revenue growth a particular strength

Revenue growth has been a particular strength.

This slide clearly shows the strong contribution of net interest income and its components.

And it highlights a substantial improvement in trading income.

The life company tax recoveries on policy holders' earnings, while detracting from reported revenues, is offset in the group tax expense and has no impact on the bottom line. It needs to be adjusted out to look at the true underlying growth.

Slide 8 – Volume growth in core products

We are seeing good volume growth.

In our key Australian markets;

- Home mortgages were up 14%, holding market share steady at 18.2%.

    - And solid growth in our owner occupied housing loans book continues. The latest APRA data shows our growth at 3% for the March quarter, in an intensely competitive market.

- Business loans grew by 13%, increasing market share by 60 bps to 16.6%

- Card outstandings were up 33%, with market share rising 110 bps to 20%.

- And deposits increased by 8%, broadly in line with the market.

Volume growth was also improved in New Zealand

Slide 9 - Funds under management - retail net quarterly inflows

Based on ASSIRT figures, net retail funds inflow during the first half year increased by 191% on the same period last year.

We are solidly back in the top 10, but there is still some way to go.

Based on solid improvements in the key drivers, we are now looking for improved growth.

- Fund performance is up, with more than 80% of funds outperforming the median, which has us as No 1 in the market

- And planner numbers have increased to 628 from 560 since September through better recruitment and retention.

While organic growth has been slow, we are not seeking growth for growth sake, or growth that compromises returns.

Slide 10 – Looking at the earnings

Looking at the earnings in detail, the strong result was built on:

- A 7% growth in revenue, with non interest income up 3%, and net interest income up 10%. (After adjustment for tax recoveries on policy holders' earnings in the life company, non interest income is 8% and total revenue growth is 10%)

- And expenses were held at the same level as the second half of 2000 and 1% higher than the corresponding period last year.

- On the bad debt line, the increase largely reflected increases in general provisioning for loan growth of 10%, slight deterioration in quality across selected consumer portfolios, and a small number of corporate exposures,

- And as we have seen, after allowing for intangibles and taxes, NPAT was up 13% compared to the same period last year.

Slide 11 - Net interest income

The net interest income growth of 10% on the same period last year is mainly volume related.

Group margins held up during the half year at the same level as for the second half of last year, and there was a 7bp increase on the first half of last year.

- A strong spread on productive loans was attributable to reductions in wholesale funding rates occurring in advance of loan repricing, particularly in the first quarter.

- This was partially offset by a decrease in non-interest bearing liabilities and a reduction in equity through our share buyback program

Slide 12 – Non-interest income growth

On a like-for-like basis core non-interest income growth was up 10%.

- Lending fees increased by 17%, reflecting the solid loan growth and continued improvement in collection rates;

- Fees and commissions were up by 14%, largely reflecting increased transaction activity.

- And underlying life insurance and funds management income improved by 23% before the life company tax recovery impacts

Trading income recovered strongly from the relatively poor performance in the prior corresponding period last year, with an increase of 108%. Our average trading income was $138 million per half over the past three years.

Slide 13 – Containment of expenses

On the cost side, we have delivered on our objective to keep our expenses broadly flat in nominal terms.

And this result was achieved despite one-off costs in the year of $41million for restructuring, as well as $42 million in GST costs, and an increased cost base following the purchase of the Pacific banking assets from Bank of Hawaii.

Staff numbers declined by 3605 during the past year (or 11%).

Staff numbers have come down by 5,523 or 16% since 1H99.

Slide 14 – Expense to income

Reflecting our revenue growth and flat expenses, our expense to income ratio continues to fall, down 3.3 percentage points during the past year to 52.2%.

And it is now below the average of our peers, particularly when adjustments are made for the use of abnormal restructuring provisions by our peers.

Slide 15 - Impaired assets and bad debt expense remain at acceptable levels

Our impaired assets and bad debt expense remain well within acceptable levels.

The increase in the impaired assets ratio to 0.6% of loans relates almost entirely to one well publicised fully secured contingent exposure.

The increased bad debt expense to 27 bps leaves the bad debt charges at a level which is within our expectations.

- The majority of the increase relates to increased dynamic provisioning

- In terms of hard cash out the door, write-offs were up $10million.

Slide 16 – Net impaired assets ratio and total provisioning cover

Net impaired assets represent 5.6% of our equity and general provisions, taking them back up to the relatively low levels seen in 1997.

Despite moving up from historic lows, this is still a healthy position relative to peers.

The impact of the higher level of impaired assets, in large part driven by one contingent exposure, reflects in a decline in our provisioning cover ratio, but at 182% it remains conservative

You may be aware that we arranged for First Manhattan Consulting Group to undertake a review of our dynamic provisioning model.

Provisional findings are that :

- Our provisioning model has been validated, with some recommendations for enhancements.

- Our provisions are appropriate for this stage of the economic cycle.

Slide 17 - Impaired loans and provisions continue to rank well against our peers

As shown in these charts, we continue to rank well against our peers in Australia on the key ratios.

Slide 18 - Personal markets 90 day delinquencies

We are seeing a minor increase in delinquencies in some of the personal lending portfolios, but this is largely confined to products at the higher end of the risk spectrum.

Credit card, personal loan and housing loan delinquencies remain near historical lows.

Slide 19 - Well balanced business banking portfolio

We believe we have the right balance in our business banking portfolio, with a higher share of lower risk business, and a lower share of the higher risk business

Slide 20 - Capital ratios

As at 31 March, our tangible ordinary equity to risk adjusted assets ratio stood at 5.7%, a reduction of 60bp on the 30 September 2000 level of 6.3%,

– Now within our target range of 5.6% - 5.8%

And our tier 1 ratio was 6.1%, down from 6.6% at last year's end.

– Also well within our target range of 6.0% to 6.5%

While we have continued to manage down these capital levels via our buy-back programs, the impact of the weak A$ has led to a more rapid shift to targeted levels.

And because the ratios are currently consistent with our targets, share purchases have been suspended.

Slide 21 – Business Group Results - Australian Retail Financial Services

A very pleasing aspect of the result was the continued strength of our **Australian Retail Financial Services**, which is very much at the core of our franchise.

Profits were up a healthy 15%, on the back of a 12% increase in core earnings.

- The strong performance was driven by good growth in lending volumes, up 15%

As we saw on an earlier slide these results represent increased or steady market shares in the core products.

The result also reflected improved operating efficiency continuing to flow from the branch network re-configuration initiatives; standardisation of service delivery; and successful channel migration initiatives.

ROE was up 4 percentage points to 21%

And the number of customers now registered for internet banking continues to increase substantially, up 231% from a year ago, and now accounting for about 10% of the personal customer base.

Slide 22 - Business Group Results - Westpac Institutional Bank

The performance of our **Institutional Bank** also improved strongly, with profits up 20%.

- Loans and acceptances grew by a healthy 14%
- And deposits were up 28%

Increased core earnings more than covered higher bad debt provisions arising from downgrades of a few corporate customers

ROE remained steady at 20%

Slide 23 - Business Group Results - New Zealand Retail

And profit for our New Zealand retail arm was up 8% in local currency terms, and 10% in $A terms.

Growth has been assisted by several sales initiatives including product packaging, the targeting of broker originated business, and a greater focus on private, priority and business customers.

Volume growth improved with business lending up 7% and funds under management up 15%.

ROE remained steady at 18%.

Slide 24 - Organic growth strategy is delivering

The clear message in this result is that our organic growth strategy is delivering.

Today's result demonstrates that the potential in our customer base is now being realised.

Slide 25 - Successfully deepening customer relationships

Through the strategy we are successfully enhancing relationships with our customers.

In the year, we increased the number of priority customers (those with whom we have significant, typically multi-product, relationships) to over 1.2 million from 952,000 a year ago, an increase of 28%

This demonstrates the benefit of our total customer focus.

Slide 26 - Rapid growth in on-line registrations

Our track record on Internet banking and broking is growing and we have a leadership position in our markets.

As at 31 March we had over 786,000 Internet banking customers in Australia and NZ. In Australia, and this represents about 10% of the consumer customer base.

And our Australian on-line discount broking had grown rapidly to in excess of 70,000 customers at 31 March.

Slide 27 - Realigning resources to enhance value creation

We continue to make progress in improving the productivity of processing and servicing areas, and the slide shows the extent of progress in outsourcing initiatives over the past year

The last point relates to the mortgage processing centre in Adelaide and our announcement earlier this week.

The outsourcing deals to date equate to about 15% of our expense base, (not including the Mortgage Company proposal).

Slide 28 - Clear view on strategic opportunities

Without compromising our organic growth success, we remain open to strategic opportunities.

Opportunities for in-market consolidation exist, and industry convergence is continuing.

Hence we will maintain a close watch for opportunities

When considering any opportunities we will strictly adhere to the criteria we have set. So any acquisition must

- Be a good strategic fit
- The price must be right
- And it must not overly distract us from our organic growth strategy.

Slide 29 – Delivering on performance goals

In terms of our performance scorecard, we continued to make good progress.

- Our 19% EPS growth is significantly above the estimated peer average (8.6%),
- Our return on capital was 8.9% above our cost of capital, substantially above our objective.
- On a 3-year basis, our Total Shareholder Return ranking declined during the period, finishing at the 52nd percentile. This reflects in part the short term peak in bank share prices 3 years ago, and also the recent volatility due to sector rotation by institutional investors. In December our TSR ranking was around the 70th percentile

- With our cost to income ratio at 52.2% , we have not only closed the efficiency gap with our peers but are now below the peer average.
- On the back of our earnings growth and asset quality, our AA risk profile remains firm.
- And our capital position is now in line with our targets

Slide 30 - Full year outlook

We continue to have a positive outlook for earnings improvement in the remainder of the year.

But revenue growth may be more subdued depending upon the depth and breadth of the current economic downturn.

- Our current view is that we expect a modest recovery to around 2% GDP growth in the second half of this year, up from our estimate of 1% growth for the first half.

As I have said, we expect to again see the benefits of delivering broadly flat expenses for the full year flow through.

And while there is likely to be some further rise in bad debt charges consistent with the cycle, we remain well positioned on both asset quality and provision cover.

Slide 31 - Recap - a well balanced result

To recap…

We believe it was a good quality, clean, and well balanced result.

- Revenue growth was good
- Costs have been held flat
- Credit quality remains good
- All of our businesses are performing well
- We are sustaining the growth momentum