Stephen Higgins: Good morning everybody, and welcome to the call this morning, which will go for around 30 minutes. We'll have some introductory remarks from our CEO, Michael Smith, and our CFO, Peter Marriott, after which we'll open it up to questions. Mike, would you like to lead off?

Michael Smith: Okay, thank you Steve. Good morning to you all and thank you for joining us. Whilst we're still finalising our interim results, we have made an announcement this morning to update the market on changes to the environment that is operating in, and the impact on provisions which has occurred since I spoke to you in February. We believe that this is a responsible step in light of the various issues that we are continuing to manage. In this changed environment, it's only reasonable to anticipate other issues will emerge as the credit cycle changes and we should provide for these.

First, I'm going to make some general observations about the environment and the issues that we are managing at ANZ at present, and Peter will then provide you with some additional details. We'll then take any questions that you have.

Overall, the key point is that ANZ's underlying business is now in very good shape. Revenue growth is strong, probably just above expectations, at around 11%. As I said in February, our Asia Pacific Institutional and Personal divisions are delivering really good growth, and New Zealand is solid. So, profit before provisions is tracking well, and in line with market expectations, and that, I have to say, is very pleasing.

But the reason for talking to you today, however, is that the turmoil in global markets is still playing out. The US economy is slowing, and if it's not in recession, then it certainly is in something that looks like it. World growth will be off more than 1% with weakness in the US and Europe.

That will be partially offset by growth in Asia, and here in Australia, the economy is well placed, but tighter monetary policy and credit conditions mean the economy will begin to slow, and there is certainly some evidence already emerging of that, particularly around retail sales.

What's clear in the credit cycle is that it is beginning to change, so we intend to continue to take a very conservative approach in reviewing our provisioning requirements to ensure that we operate prudently and from a position of strength. You could say that this is pre-emptive. As I said before, we believe that this is a responsible step, and a means of managing this issue.

The flow-on effect of the change in the cycle is now being seen in ANZ's commercial lending portfolio. For the first half, total provisions will be about $975 million. I told you in February that last year provisions were unsustainably low and that we expected them to increase.

The reason for talking to you today is that the figure is higher than current market expectations. First, I want to be clear that individual provisions – the IP – are contained, and have not changed materially since we spoke back in February.

However, we are going to take a collective provision charge of around $350 million to reflect the risks inherent in the current institutional portfolio and this amount reflects the three key issues. The first is that there have been some rating downgrades in certain parts of the commercial property and the broking industries, as you will well know. The second is strong asset growth as our commercial clients return to banks as their main source of credit, rather than the capital markets. This is good news in terms of generating future profits, but our collective provision methodology under the IFRS accounting standards require that an upfront provision needs to be made for this portfolio growth.

The third thing is that we want to ensure that the ripple effects of the global turmoil are appropriately recognised so that we are also taking an additional amount to our collective provision to reflect the secondary impacts of the market turmoil generally.

I've heard some people calling the bottom after the Lehman and UBS recapitalisations, but I think it's too early. I think it's going to take, as I said before, two quarters of clear results without adverse news from the major US banks before we can say we're through this.

Some things are holding up very well, though. Asset quality in the consumer, rural and small and medium size business portfolios remains very strong. There is little change in provisioning levels from prior period. Turmoil in global markets and the volatility in the equities markets appears to be playing out in really some very specific segments of the economy rather than being a generalised or generic issue.

Let me also make a few remarks on the world economy. Banks' short-term funding spreads remain unusually wide, and in turn these funding costs have to be passed on. The overall availability of credit and tightening lending standards will lead to slower growth in bank lending which will, in turn, lead to slower economic growth. As I said earlier, on the other hand, China and the economies of Asia are actually continuing to grow strongly. That's good news for Australia, which is increasingly part of the region, and its economic future.

If we move back to ANZ, as I said at the last trading update, we are making real progress in restoring the performance of the business, with momentum starting to rebuild in institutional. That's what I promised you as my first priority back in December. I am pleased to say that both our institutional and Asian strategies are paying off already. At the same time, our personal business is very good, and results from New Zealand are solid. We continue to be very focused on growing top line, while also driving productivity.

So, while it's appropriate to make some provisions for the potential risks in our portfolio and the broader environment, ANZ is actually progressing very well. We have a clear aspiration to build a super regional bank over the next five years, and although in the short term we will need to manage the impact of global economic environment so we can continue to operate from a position of strength. I see no issues with that.

On that note, I will now hand you over to Peter who will cover some of the more detailed issues, although of course this will be more fully covered in our results which are finalised on 23 April. And after that, we will take some questions. Peter, over to you.

Peter Marriott: Thanks, Mike. As Mike just said, yes, we are only two weeks away from our final results, so we won't be going into a lot of detail here. Of course, the results that we're talking about here are still subject to the final Board and Board of reviews and so forth leading up to the formal announcements on the 23rd. Nevertheless, as Mike was saying, it's appropriate that we bring you up to date on the way we've changed some of our assessments around the outlook for provisions.

But I first would like to emphasise on a positive note just how strong the revenue has been in this six months. There's certainly no sign of any loss of momentum in the business; indeed, if anything, there may be some increase in the momentum in the business.

So as Mike said, we're looking at income growth of around 11%. Remember, that 11% includes absorbing around 1½% from the exchange rate effects associated with the stronger Australian dollar.

So, it's been a good, strong income, and very pleasingly, good strong income now coming out of the institutional part of the portfolio, which was one of the priorities that we were focusing on and there's been both good markets income and good incomes growth coming out of the relationship lending part of the business as well.

From a costs point of view, I think we mentioned to you at the last update that costs will continue to be high, reflecting a lot of costs within the pipeline. I don't think that's been fully reflected in the market expectations, and that's why overall we're saying that our result from a profit before provisions point of view is around market expectations, but with stronger income.

But clearly your principal focus today is around the comments that we've made in the release on provisions, and what's changed in the last seven weeks since the previous update.

First of all I think I'd comment that I don't think that the market consensus numbers fully reflect the comments we made at the last update. I think it was probably around 10% or more short based on what was known at that time, and I think people were perhaps a little light on the expectations around individual provisions. Remember, we mentioned there was a $51 million individual provision and that compared to $66 million in total for the second half of last year, so clearly we were going to be well up on that line. I don't think there's been enough allowance made for the effect of growth on the collective provision.

Moving on from February, what's changed? Clearly, as we come to the end of the half, we undertake our formal review leading up to the publication of the results, and as we looked at that, there was a need to revisit some of the assumptions and think about some of the provisioning outlooks on institutional, and to try and get ahead of the game here rather than new adjustments coming out as time went by.

You would notice that around 90% of the growth in our – in fact, over 90% of the growth in our provision charges, half is out of Institutional; the rest of the portfolio is in very good condition.

That then comes down to looking at the individual components of that Institutional provision growth. The biggest chunk there is clearly the $350 million or thereabouts additional collective provision. As Mike said, that consists of three components: first of all, the rating downgrades that were mentioned. There's around six or seven accounts, so it's a small number impacting that. The largest one, I think you're well aware of, but since then there's been a number of additional downgrades within the broking portfolio which I think will come as no surprise to you, and that works its way through our standard methodology to lead to a higher collective provision, and some smaller modest downgrades principally related to property – but all reflecting the ripple effects coming from the broader market turmoil.

The second component is obviously around growth, and that's probably around a little bit less than 20% of the collective provision charge. I should have mentioned before, actually, when I was talking about the rating downgrades, that's a little bit less than half of the 350, the total effect, so the rating downgrades a little bit less than half, and growth a bit less than 20%.

The final component is a new additional charge that we've taken up, that really is recognising that these ripple effects cannot realistically have flowed through to all of our customer ratings to this point. You'll know that the reflective provision is calculated as a portfolio provision that is derived from customer ratings and the level of security. Obviously the ripple effects have not passed through to change all of our customer ratings. You have to assume that some customers will be further affected, and there'll be some further impact on their ratings. So, rather than just simply waiting for those losses to emerge, and an [additional reflective provision charge] at least to emerge, we've tried to get ahead of the game and to estimate what is likely to be in the pipeline but simply not yet formally reflected in those customer ratings.

That can be modelled in various ways and obviously involves a reasonable amount of judgment on the part of our risk folk. But what we really sought to allow for here is a small number of further accounts exhibiting rating deteriorations so that the collective provision has that in it rather than waiting for that to emerge over time.

As for the Institutional individual provisions, I think the comments we've made in the release around the US monoline exposure are of course well known. We touched on those last time.

This provision is a function of the mark to market at any one point in time, and the mark to market at 31 March was $226 million – just slightly higher than when Mike gave you the last update, but that's very small. We believe that this mark to market will be substantially recovered due to the size of the first loss tranche in the structure that takes the losses before any come to us and the level of defaults which would be required. But nonetheless, the market to market value of the protection that we've purchased at the moment is effectively zero and hence the need for the provision.

Excluding the monoline exposure, our individual provisions and institutional are around about double what they were in the second half of last year, but of course, in the second half of last year they were very low, and excluding the monoline exposure, individual provisions continue to be below expected loss. So there's no real material change there, as Mike was saying before. If you look at the Institutional provisions, around five accounts constitute 90% of those individual provisions, so again it's a relatively small number of customers that are involved here.

Elsewhere within the portfolio, things are very strong. Indeed, provisions in the personal portfolio are slightly down. Arrears levels continue to be very good. Provisions are up in New Zealand but off a very low base. You recall last year that there were a number of recoveries and also reduction in risk in some of the portfolios that resulted in some elements of write-backs, so it's a reasonably large percentage increase, but it's only about around the $30 million mark, so small in the total scheme of things. The rest of the portfolio is holding up very well.

In summary then, we've had a result for this half which has seen very pleasing income growth, despite the market turmoil, despite the higher funding costs on the strength of the Australian dollar. We have very good revenue growth. Credit quality generally is very strong, with little growth in provisions aside from within the Institutional portfolio, where we think we've taken appropriate provisions to reflect the likely impact of the current conditions. In that portfolio, it's only a small number of customers that have been impacted, but we have to recognise that there's likely to be a small number of further customers that we're just yet to identify, and hence we've tried to get ahead of the game by an additional provision which is being included in that overall $350 million.

With these charges, I'm sure the inevitable question is: what does this mean from a capital ratio point of view. This has trivial impact on the capital ratio. It's less than about 10 basis points, so it's not a major impact from that point of view. With those comments, I'll now pass back to Stephen Higgins.

Stephen Higgins: Thank you, Peter. On that note, we will open it up for questions. As usual, we would appreciate if you can limit it to one question per person in the interests of fairness. Bearing in mind that we are less than three weeks from results, we will need you to limit your questions to the issues in this release.

Question: (Jeff Emmanuel from UBS) Hi guys. My question relates to the second half of 08: if you take your $975 million from the first half, I guess the things you've highlighted are the $350 million collective, 226 on the US monoline, 51 for this resources company, and 90 for an unidentified property company; that leaves you with 400. I'm just trying to get a feel for where you see the second half, and what you could point us to that?

Peter Marriott: I think in your arithmetic in there, Jeff, you need to also pick up obviously what the provisions are in the Personal and New Zealand businesses as well, to reconcile that back. The objective here is to try and fully reflect the current market conditions. We've built into our collective provision and into the current individual provisions everything we currently know. Obviously, in the second half, there can be new events that emerge, but we think we've allowed for all of the current events. So, we would like to believe therefore that the individual provision that arise in the second half can in part be covered by the additional collective provisions we've taken up in the first half, so therefore you'd expect to see a reduction in overall levels of provisions into the second half. But I'm just cautioning that you can't allow for what you don't currently know about. We think that we've taken a very prudent approach and got ahead of the game on this, and therefore the provisions should be substantially lower in the second half, but that all depends what happens with market conditions from here.

Michael Smith: Yes. I'd just like to also make the point here, Jeff, that the credit cycle has turned, and we are beginning to see a return to normality. I think that's the important thing that we have to understand here. The last 10 years have been incredibly benign, and the last five years have been incredibly benign throughout the world. We're now going to see a return to what I would call a more normalised level of provision.

Question: (Richard Wiles from Morgan Stanley) Good morning. I'm wondering if the additional provision takes into account the implications of the slowing domestic economy, or whether it just relates to an expectation that a small number of large corporate exposures could deteriorate given what's happened in the global economy?

Michael Smith: At present, Richard, the provision is primarily around what is happening in the Institutional space. We are not seeing any increase in arrears in the personal banking space at the moment. However, with rates rising and credit tightening, again we would expect there to be as I said earlier, a return to normality. I think though this particular provision cover is in relation to the effects of the global market and the knock-on effect - the ripple effect, that that will have into the corporate world in Australia.

Question: (Matthew Davison from Merrill Lynch): Good morning, gentlemen. I guess a question for Mike a bit more broadly on the business banking strategy. You've talked about momentum is starting to rebuild in the Institutional business. Just wondering if all these sort of continuing issues that keep emerging are changing your strategy towards investment in that business for the year going forward, and I guess if we focus at the smaller end of the business bank, do you expect much fallout in terms of customers relating to the latest issues that are in the media of late, and how do you propose to stop customers leaving the bank on the back of that?

Michael Smith: Sorry, I don't understand – leaving the bank on the back of what?

Question: I guess a lot of the bad press around the current issues relating to Opus Prime and whether you see any fallout for your small business bank more broadly from that?

Michael Smith: Well, no I don't. I mean, Opus Prime is a certain issue, and we could talk about that a little bit more if you like, but the issue around small business – it is a very critical part of our business strategy and is moving very well. Sorry, the first part of your question was concerning?–

Question: My first part was concerning the Institutional business.

Michael Smith: Okay, well, you know you've got to remember what the size of this business is, and yes, there has been a number of issues that have come to light, but after 15 years of very, very positive growth and a benign environment, you inevitably are going to get one or two problems when that environment changes.

You've seen in the market there have been a number of issues, some we have been involved in and some we have not, but this is what happens when the cycle changes. We have to manage the issues out. Does it actually affect the strategy? No, it doesn't. But of course, it does deflect some management time in sorting the thing out.

Question: But it hasn't changed your opinion about, I guess, the risk management issues or anything within that division?

Michael Smith: Well, we're obviously looking a number of issues, as you can imagine. However, that is what I would call responsible management. There will be areas of the business that we don't wish to do. I mean, I think the credit intermediation deals were a case in point which I talked about in February, and Peter Hodgson is now doing a review of the risks involved in the securities lending business. But other than that, as these things emerge, then of course we deal with them.

Question: (Craig Williams from Citibank) Thank you, gentlemen. With respect to the current funding cost pressures which ANZ and other banks are facing, could you talk about the Group's attitude toward growing its lending book in light of those rising funding costs? Is there a need to pull back on the rate of credit growth?

Michael Smith: Well, I think what has happened is that the credit growth that happened at the end of last year and beginning of this year, was really a result of the re-intermediation as the capital markets closed and corporates had to come back to the banks. What we have seen subsequently is that demand has slowed. Corporates have actually been delaying investment opportunities; they've been putting on hold expansion plans and whatever waiting to see what's happening in the world economy which I think is probably very sensible and prudent. So we are actually seeing the reduction in loan demands right now.

As you say, I mean, the cost of funding is an issue. Whilst our liquidity is very high at present, we're about 80% over where we were last year, there is a cost to that, but there has been a repricing of risk, and I think that that needed to happen. So, on one side there is an increase in cost; on the other side, there's an increase in income.

Question: (Tom Quamby from Macquarie) Thanks, gentlemen; it's a shame, I guess, to see the Visa IPO proceeds offset by a provision of similar magnitude. I guess my question is: how much of this provision is pre-emptive or prudency, and therefore for future periods, and how much is for problems that you're experiencing at the moment?

Michael Smith: I think we've gone through that fairly carefully – we can probably go into a little bit more detail at the results, but at the moment we are taking a figure which we anticipate we may need in terms of the changing environment. You can run the numbers and it's not that difficult.

I think that the suggestion though that we are using the Visa proceeds is not correct. Provisions are part of the bank's business – an ongoing business – and we are not utilising the Visa proceeds. We are still going to be using that for our re-engineering of the operations process and process re-engineering, and the transformational process that will evolve. So, it's not a question of utilising the Visa money.

Question: I guess, just then to go to your other statement, Mike, that we're heading towards normality, what would you say is the normal charge for ANZ?

Michael Smith: Peter, do you want to give the historical numbers?

Peter Marriott: From an ELP point of view is probably the best way of looking at this. I'm just turning up the numbers for that for you. The ELP number at the moment is running around $950m to $1 billion mark as the normal charge. The other factor in here, of course, is the collective provision is very volatile, and that will of course tend to come through in advance of the individual provisions, and then when the cycle is improving, it will tend to go back the other way. So, the ELP now is only relevant to a comparison to the individual provision.

Michael Smith: I think in terms of basis points, if you look at the collective provision, ANZ has traditionally had a slightly higher collective provision. It's been around 73 basis points, and that will increase somewhat.

Steve: Thanks, Mike. We have time for one last question.

Question: (Victor German from Deutsche Bank) Hi guys. Just a quick question. This looks like it's going to be a down year in terms of earnings growth. Can you just provide some comments on how this may change your thought processes around the dividend policy?

Michael Smith: I don't expect there'll be any change in the dividend payout.

Question: So the payout ratio is likely to remain the same as it was last year?

Michael Smith: Yes.

Peter Marriott: Just to clarify, the level of dividend payment will remain the same.

Question: Okay. So your payout ratio remains –

Peter Marriott: That would come within our expectation.

Question: Okay. So, in terms of absolute dollar terms, it will likely to remain constant?

Peter Marriott: In terms per share, we plan our capital management on the basis of maintaining the level of dividend in the event of unexpected credit losses and this still fits within the scenarios that we run. It doesn't require us to make any change to that approach.

Question: Okay, thank you.

Stephen Higgins: Thanks, Victor. We will wrap up the call there shortly, but just before we do, Mike, did you want to make any comments on Opus which has obviously had quite a bit of attention lately?

Michael Smith: Yes. I mean, the Opus Prime matter is currently before the court, so I can only make broad remarks. Firstly, I think we all need to remember that ANZ would still be supporting this business if irregularities had not been discovered inside the company. ASIC are of course investigating this, and we are helping them with that process.

While we'll continue to work with our other clients in the broker segment, as I mentioned earlier, I've asked Peter Hodgson to undertake a full review of the risks involved in the securities lending business, and that should be ready fairly soon. In the meantime, we have to protect our commercial position and our shareholders' interests. We're doing that in a measured and in a careful way which includes working very closely with regulators to resolve some of the very complex issues which have emerged in the last few days, or the last 10 days.

But it's tough for everybody, and I know that. When irregularities of this nature occur within a company, there are no winners. Although we don't expect any material losses from this, or other broker exposures, I am mindful of the effects on our reputation, and on the many Opus clients who are being impacted by the fallout from the actions of Opus Prime. But that's really all I can say at the moment, given the matter is before the court.

Stephen Higgins: Thanks Mike. On that note, did you want to say some closing remarks, and then we'll close off the call?

Michael Smith: Yes, thanks Steve. Just in closing, I just want to say to you that we have a very clear understanding of what is happening in the global environment, and just how our portfolio's positioned, and what we need to do to manage the business.

ANZ is progressing well. We have a clear aspiration to build a super regional bank over the next five years, but that doesn't mean there won't be issues. What it does mean, though, is that in the short term, although we need to manage the impact of the global economic environment and ensure that we've made appropriate provision for the potential risks in our portfolio, and indeed for the broader environment, we have as I mentioned the highest level of collective provisions cover of any of the major banks, and the additional provisions we take this half will strengthen that.

That will ensure that we continue to operate from a position of strength in order that we can build our business for the long term. On that note, I guess I'd just like to thank you all for joining us today, and I look forward to speaking to you again on the 23rd when we release our interim results. So, many thanks indeed.

Stephen Higgins: Thank you, Mike. On that note, we'll close off the call. A replay will be available on anz.com later on this afternoon. So, thank you for joining us at short notice.

End of Transcript