ASX Release

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Transcript of Full Year 2019 Results Presentation

A transcript of the presentation of ANZ's Full Year 2019 results by ANZ's CEO Shayne Elliott and CFO Michelle Jablko follows.

This document should be read in conjunction with ANZ's Full Year Financial materials released via the ASX, which are available in the Shareholder Centre on the ANZ website.

All results materials are available on shareholder.anz.com

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TRANSCRIPTION

Company: **ANZ - Full Year Results Announcement**
Date: **Thursday 31 October 2019**
Time: **10:00am (AEDT)**

[START OF TRANSCRIPT]

Jill Campbell: Hi everybody, good morning. I'm Jill Campbell. I'm the Head of Investor Relations for ANZ. Welcome to everyone joining us in Sydney today, listening in by phone or webcast for the presentation of our full year 2019 financial results. We're live streaming today's presentation on social media, through Periscope and Twitter and you can access the feed by searching at ANZ News.

The result materials lodged earlier this morning with the ASX are all available on the ANZ website in the shareholder centre. A replay of the presentation, along with the Q&A, will be available via the website from around mid-afternoon. Our CEO, Shayne Elliott and CFO, Michelle Jablko, will present for around 25 minutes and after that we'll go to Q&A, thanks Shayne.

Shayne Elliott: Thank you. Good morning. Today is about result and it's important to cover where we are, but frankly it's more important to share what we will do from here. I could spend some significant time talking about how challenging the environment is, but you all know that. More regulation, intense competition, low rates and slow growth, we get it, but we are prepared well. Earnings this year were stable, we further strengthened the balance sheet, exited more non-core businesses and we kept costs flat while absorbing a significant increase in investment.

The number of shares on issue reduced again and earnings per share increased 2% and net tangible assets per share, 6%. I am pleased that we are able to maintain our dividend at $0.80, although I acknowledge that some shareholders will be disappointed that we're reducing franking to 70%. Our decision to reduce franking to a new base reflects the changed shape of our business, but recognises how important the dividend, franking and predictability is to our shareholders.

Our balance sheet has never been stronger. We've delivered significant change in the past four years, rebalancing our portfolio and improving capital efficiency and 2019 was no exception. That allowed us to return $5.6 billion to shareholders while still increasing our capital.

In a large organisation there will always be a lot of things we can do, but it's our job to ensure that our resources are focused on those things that make a real difference. We've tweaked words and tightened up the language, but the strategy we launched in 2016 remains relevant and appropriate. For 2020 we've implemented a six-point plan, modified accountability for our top team, changed governance processes all the way up to the Board, enhanced the metrics we use to monitor results and we've increased pace. We meet more briefly but more often and we make more timely decisions.

As I said, we're focused on the six levers that we think will have the biggest impact: running the business well, maintaining discipline within Institutional, resolving our challenges in New Zealand, investing to prepare Australia for growth, driving further simplification and building the team's resilience and capability.

It's easy to get distracted, but running the business well is our top priority. It's particularly true in Australia where we have acknowledged our challenges. We've responded appropriately, we've changed the leadership team and the organisational structure. We're refining credit policies and investing to reduce processing times and increased capacity. We're delegating more decisions to the frontline and monitoring operational metrics daily.

We launched an incredibly successful campaign to provide confidence for our channels and our customers and while the resulting in uplift in applications is good, the real benefit was the preparation work that we did to improve operational capacity and reduce approval turnarounds. These actions position us well as we head into 2020. However, while the housing market shows some signs of improvement, system growth remains hard to predict. Low interest rates are also putting pressure on margins and managing that trade-off is complex, but we're focused on managing risk-adjusted margin more than simple market share growth.

Running the business well also requires progress on remediation, because it's the right thing to do, but also because the sooner we finish, the sooner we can apply learnings and refocus on responsible growth. For a range of reasons, ANZ started a little earlier than our peers and from what we can see, we're a little further ahead. We're investing everything required to complete known remediations and identify any new issues. I can't tell you when we will be finished, but we are working as hard as we can to get it done.

Finally, running the business well means strengthening the Bank, operationally, culturally and financially. The work done over four years to simplify and de-risk the Bank has seen our expected loss rates fall again.

We are not complacent and we do expect to return to more normal credit conditions at some point, but our book is inherently lower risk than before. We have not changed our risk appetite, although we have reduced our assumptions around cost of capital, which will have an impact on the business rating strategy, particularly in Institutional.

Institutional provides diversification to shareholders and unique value to customers. Its returns are now above our cost of capital and as industry returns for the Australian banking peers fall, our Institutional business is increasing in relative value. But we're not done. Our plan for Institutional is simple: keep disciplined.

There is no change in strategy, there is no change in target market, we will continue to do more with the customers we know and trust. We will do more on cost and simplification, while strengthening the franchise and we will stay disciplined on credit and focused on the risk-adjusted returns.

In New Zealand, the Reserve Bank has two major changes on the table: BS11 and the proposed new capital regime. Preparation for BS11 is well advanced but it comes at a cost, which we estimate at around $350 million over three years. We've already invested $42 million in FY19, which explains the increase in New Zealand operating expense. BS11 investment is not called out as a large and notable item. Now Michelle will talk through the proposed capital changes, but I've expressed my concerns about them, but we're not sitting by hoping for the best.

We're taking the proposals as a catalyst to do better, to be leaner and more focused. We meet weekly and we're actively working on a range of initiatives which will lead to a portfolio of actions. We intend to remain the largest and most successful bank for New Zealanders, but how we go about delivering that will change.

Those priorities are about running the place well, but we also need to invest for the future, particularly in Australia. Australian retail and commercial banking is a good business, generating decent returns, but it's getting tougher. We've strengthened our balance sheet, we've reduced operating risk and we've materially improved productivity and that gives us the capacity to invest without calling on shareholders. Over the past decade we've invested about $1.2 billion each year in new technology and systems across the Group. In 2019, we invested a record amount of $1.4 billion and we will invest even more in 2020.

Other than BS11, that increase is focused on Australia, but we didn't do this on a buy-now-pay-later scheme; 70% of the investment is expensed during the year. As a result, software assets on our balance sheet continue to decline and remain the lowest amongst our peers, reflecting our more conservative approach to paying up front for investment and holding ourselves to account to deliver outcomes. The investments we're making in Australia will reshape ANZ for the coming decade and my team is deeply involved in the detail.

Simpler and better has become the industry mantra. We started early, but it is getting harder. Looking through the noise, our cost base today is around $8.6 billion and getting to this point hasn't been easy. I will remind you that it's the lowest cost base in six years and we've absorbed a lot of change over that time. Revenue is also $450 million higher today than six years ago, despite selling 23 businesses.

We are now focused on simplifying key customer and support function processes that represent around 70% of that cost base. The work is coordinated with other priorities, particularly the investment in Australia and while some is already underway, the major execution will start in the new year.

We will not jeopardise the franchise to meet an arbitrary target, but we remain confident that staying true to our strategy and improving customer outcomes will reduce the cost of running the bank to $8 billion. This work is incredibly important and I am personally leading it.

It is hackneyed but our ultimate competitive advantage is our culture and that means our people. We're asking more of our team than ever before, particularly in terms of change and accountability. I don't see that environment getting any easier and so we're investing to build capability and resilience and there are signs that this is having an impact. Our culture audits show that our people believe in the strategy, are committed to doing the right thing and want ANZ to succeed. We recently recorded the highest employee engagement score in our history at 77% and we saw an 82% increase in applicants for graduate roles. I don’t take the engagement of our people for granted and we will continue to invest in their capability, providing them with better tools and supporting them through a challenging environment.

I'll now hand over to Michelle to walk through the results in more detail.

Michelle Jablko: Thanks Shayne and good morning. This year we had three things to balance: fixing issues of the past, running our business well and building for the future. Right now, like many in the industry, we're more heavily weighted towards fixing past issues. But we've also been investing more to further simplify the business and build for the future. Against this backdrop we had a solid result.

Continuing cash profit was flat at $6.5 billion. EPS was up 2% and ROE was stable. Revenue in our Australian retail and commercial business was down $590 million, reflecting margin and fee pressures and some execution challenges.

We saw the benefits of disciplined growth in Institutional, with cash profit up 11% and ROE almost 100 basis points higher. Costs of the Group were well managed and even with higher investment, they were down 1.6% FX adjusted. Credit losses remained low, benefiting from significant work in recent years to de-risk the business. Our work on customer remediation continued and we took $682 million in post-tax remediation charges. So while the broader operating environment was challenging, we maintained cash profit and increased EPS.

We also maintained the dividend at $0.80 per share, but it will be franked at 70%. I'll spend some time at the end taking you through this once we've discussed the result.

Balance sheet strength has been the key plank of our strategy. Our CET1 ratio is 11.4%, around $3.5 billion above unquestionably strong. Organic capital generation remained high at 165 basis points for the full year. We returned capital to our shareholders, completing $1.1 billion in share buybacks this year. We neutralised the DRP for the sixth consecutive half and absorbed 60 basis points of new regulatory imposts during the year.

So while there are clearly some regulatory uncertainties, we face them from a position of strength. We're engaging with our regulators on a number of possible capital changes. Most of these remain in consultation. While in the past the primary focus has been on Level 2 Group capital, these potential changes put an increased focus on Level 1.

This slide shows the difference between Level 1 and Level 2 capital generation this year. The difference stems largely from our New Zealand Board already retaining around $1.5 billion of the possible higher capital that might be required in New Zealand over the next few years. We expect the RBNZ's final position in December.

APRA has also released a consultation paper on investment in subsidiaries. While the paper implies an impact of $2.5 billion, there are measures that could materially offset this. In short, while there are still many moving parts, our capital position means that these proposals are more about capital efficiency than quantum. Once we have more clarity, we will consider future capital management and capital allocation opportunities.

There are six key things that really shaped the result this year: lower revenue in Australia, disciplined growth in Institutional, margin pressures across the Group, good outcomes on cost and credit quality, and further customer remediation charges. Australia revenues were down $590 million for the year, but stabilised in the second half. $530 million of the reduction was due to lower margins and fees. $60 million was due to lower volume, largely because of the slower housing market and some execution issues in home loans, as well as lower credit card and personal loan volumes, in line with market trends, subdued lending volumes in small business but good deposit growth and the continued runoff of our consumer asset finance business.

Our mortgage portfolio is down $7 billion for the full year, almost all in interest only loans. In the second half of the year, we significantly improved our home loan assessment times, with better clarity and consistency on policy and risk settings for the front line. This has seen the overall rate of decline in the portfolio progressively slow over the course of the second half. We also ran a major marketing campaign to attract new customers and restore confidence across our distribution channels. As a result, application volumes increased, with average levels in the second half more than 30% higher than the first. Importantly, our improved momentum has continued, with application volumes now not far below the campaign average and slightly below 2018 levels.

This improved momentum takes time to flow through to the balance sheet and needs to be balanced against higher amortisation, with 82% of customers paying principal and interest and many customers now getting ahead on their repayments, given lower interest rates.

Institutional continues to deliver the benefits of a simpler and more disciplined business. On a year-on-year basis, revenue, profit and ROE all increased. This was driven by another record year in payments and cash management, where revenue was up 10%. Loans also performed well, up 7%. Markets were flat year on year at around $1.8 billion, with the second half impacted by a flattening yield curve and low volatility. Market sales were up and were actually more than half of market's revenues for the year.

Lower interest rates and competitive pressures continue to impact margins. Underlying NIM was down five basis points. Asset and funding mix had a two basis point impact. With rate cuts globally, deposit margins were down four basis points, mostly in Australia. Lower rates also impacted earnings on capital and our replicating portfolios by a further two basis points. There was some benefit from lower wholesale funding costs and some asset repricing, but these weren't enough to offset the significant impact of lower rates and competitive pressures across all businesses.

These headwinds on margins are likely to remain in the near term. Competition and mix impacts are continuing. There will be a further negative impact in the first half of 2020 from rate cuts that have already happened, including the RBA rate cut earlier this month and the Fed cut overnight. This is around three basis points and net of recent repricing decisions.

Any additional rate cuts would have further impacts. We know that around $110 billion of our deposits globally are already at or near zero rates, so any further cuts would impact deposit margins as well as our earnings on invested capital.

Adjusted for FX costs across the Group were down 1.6% this year, despite the impact of higher regulatory and compliance costs and inflation. Costs in institutional were down for the seventh half in a row, costs in Australia were flat.

This year we generated $260 million of savings across the Group after absorbing inflation of $160 million. For example, we have reduced FTE through automation and process improvements. We replaced higher cost managed services with internal resources and technology. We continued to reduce our property spend through consolidation of our international footprint as well as optimisation of our branch network.

This outcome has not been at the expense of investment. In fact investment spend is up $185 million over the year. Quite a bit of the increase has been for regulatory and compliance spend, such as meeting our BS11 requirements in New Zealand and a number of compliance projects in Australia. Other investment has been skewed to Australian retail and commercial, along with digital data and payments initiatives.

Whilst some might categorise regulatory and compliance spend as an extra burden, this spend also improves the business through enhanced data quality, better customer origination processes, and lower operational risk.

Importantly 70% of our investment spend is recognised upfront as OpEx, given our $20 million capitalisation threshold. Driving our capitalised software balance to a new low of $1.3 billion.

Our disciplined approach to credit quality has continued to deliver with a loss rate of only 13 basis points for the year. Credit impairment charges were higher in absolute terms but off a low base and largely due to release of collective provisions in the prior year.

Institutional remained well managed with zero net IP charges and a 40% reduction in impaired assets. This wasn't because of write-backs and recoveries, which were down $100 million in the division.

Our collective provision remains strong at $3.4 billion. Adjusting for regulatory capital in costs our coverage ratio remains stable.

Gross and new impaired assets were both down 5% year-on-year. Australian mortgage 90 days past due were 116 basis points at the end of September and stabilised in the fourth quarter. The absolute number of loans past due and losses both remain small. Across our book 76% of customers are ahead on their repayments, and 82% are now paying principal and interest.

We have continued to make substantial progress on remediation this year. On 8 October we announced additional remediation charges of $559 million, bringing our full year charge to $682 million. Total remediation charges over the past three years are around $1.6 billion. Our balance sheet provision now stands at around $1.1 billion.

Our costs of remediation have increased as we have expanded the number of staff supporting our efforts to just over 1000. Around 70% of the current year charge relates to banking product and service remediation as we accelerated our proactive discovery reviews. These product reviews are ongoing. We have provided for what we know and we are working hard to put customers right as soon as possible.

Turning to the dividend. The Board has proposed to maintain a final dividend of $0.80 per share, franked at 70%, and to neutralise the DRP. In making its dividend decision the Board considered a range of options and the interests of all shareholders, including retail. The Board landed on $0.80 per share supported by our strong capital position.

On franking, you know that our position has been tight for a while. This half was franked at 70%. While there are some subtleties around timing of tax payments, statutory profit in our Australian geography is the key driver here. These earnings have declined over the past couple of years with lower underlying revenue, remediation costs, the bank levy and the divestment of wealth.

This year Australian geographic earnings were 55% of our total, compared to a dividend payout ratio of 76%.

Given the current operating environment I thought it might be useful to provide some context for the first half of 2020. On Australian housing lead indicators for ANZ suggest momentum is improving. While we expect this to lead to improvement in new volumes, this needs to be balanced with faster amortisation of our existing book in a low rate environment.

On margins a combination of competitive pressures, mix impacts and low rates across all of our geographies will continue to have an impact.

In the past we have said that we manage markets as a $2 billion business in terms of capital and resource allocation. However in a world of lower global growth and rates revenues are likely to be closer to current full year levels in the near term, and we're changing out settings accordingly.

On expenses we are committed to absolute cost reduction. But as we have said, the paths may not always be linear. With this in mind we expect underlying expenses in the first half of 2020 to be around $150 million to $200 million higher than the second half of '19. We will have a new accounting standard on leases and higher investment, including BS11.

In the medium-term lowering costs remains an intense focus so that we can fund investment in our business and meet our $8 billion cost ambition. The first half is also likely to bring clarity on regulatory capital. Once we have this we can determine our business response and any future capital management opportunities.

Overall while the operating environment is tough our efforts to create a simpler, stronger and more productive ANZ place us in a good position. With that I'll hand back to Shayne.

Shayne Elliott: About four years ago we identified the need for bold action to reposition ANZ for long-term success. We recognised that while banking would remain attractive a step-change in the operating environment meant that strategies of the past would no longer be successful. We have work to do but have prepared well by strengthening our balance sheet, reducing financial and non-financial risk, simplifying the bank, enhancing management capability and improving productivity.

There is no change in our strategy and we are fully focused on execution. Low interest rates and the weaker global economy mean that growing revenue will be difficult. Remediation requires ongoing effort, and we do need to invest for future growth.

Credit conditions are benign but they will turn at some point. But our balance sheet is strong, our revenue sources diverse and we have a clear plan with a focus on simplification, productivity and capital efficiency. Our people are more engaged than ever.

I do not underestimate the challenge. But remaining true to our purpose, values and our strategy will unlock opportunity to the benefit of our customers and shareholders alike.