Bank of Queensland / BOQ.AX
Financial Services / Regional Banking
Queensland-Based Multi-Brand Bank
Current Price: $6.70 | Target: $7.89

BOQ: Transformation at Inflection Point with Branch Conversion Catalyst

1H25 Interim Results

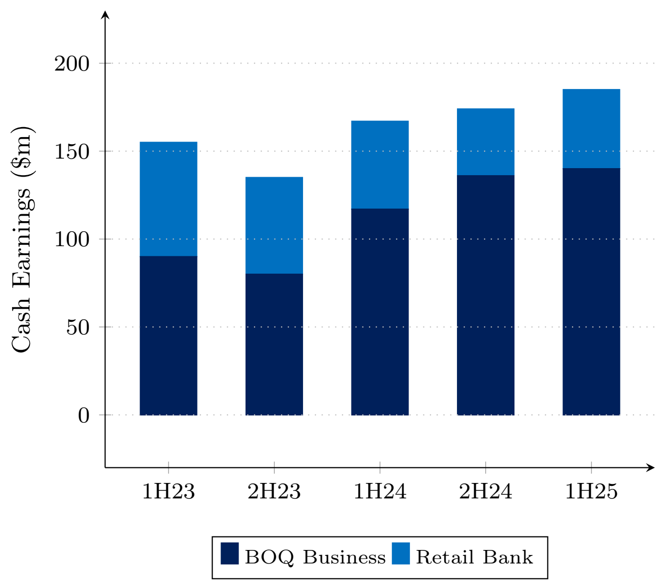
Executive Summary

Bank of Queensland (BOQ) is at a critical inflection point in its transformation journey to become a "simpler, specialist bank." Cash earnings improved 6% to $183 million in 1H25, with net interest margin resilient at 1.57% (+2bps YoY) and the cost-to-income ratio at 65.6% (-30bps YoY). ROE increased to 6.2% (+40bps), though still below management's 8% target for FY26.

The bank has successfully delivered on several strategic milestones, including the recent conversion of all 114 Owner Managed branches to a corporate model in March 2025 (expected to deliver a 12bps NIM improvement), migration of over 140,000 ME Bank customers to its digital platform, and completion of the foundational build of its digital bank. These achievements, combined with disciplined portfolio rebalancing toward higher-margin business segments (commercial lending +9% YoY vs. housing lending -3% YoY), position BOQ for improved returns as transformation benefits materialize.

BOQ's strategy responds pragmatically to the structural challenges regional banks face in Australia's competitive banking landscape. The deliberate prioritization of returns over volume in housing while accelerating growth in specialized business segments where BOQ can demonstrate competitive advantages presents a differentiated approach. With a strong capital position (CET1 ratio of 10.87%) and tangible near-term catalysts, particularly the expected 12bps NIM improvement from branch conversion, BOQ offers an attractive opportunity for investors seeking exposure to a bank with transformation upside.

Segment Cash Earnings Trend ($m)



Outlook

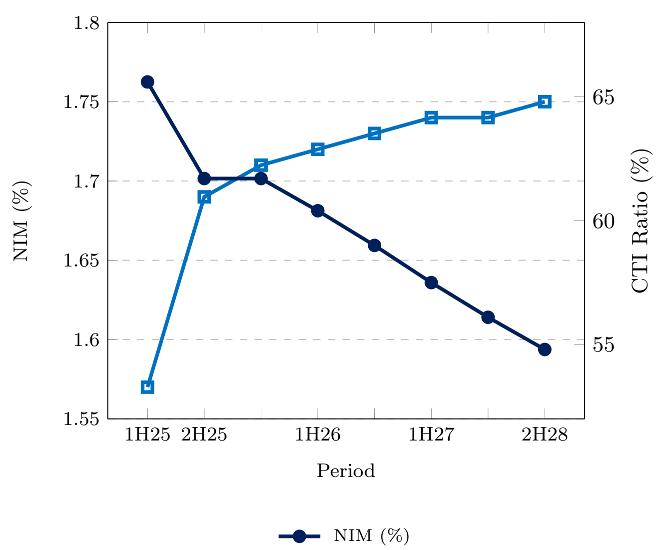
BOQ's outlook is characterized by a strategic pivot toward higher-returning business segments and digital transformation, with near-term financial benefits expected from the recently completed branch conversion. Management has provided clear guidance on both near-term improvements and medium-term targets.

For FY25, the bank expects continued divergence in segment trajectories, with Business Banking maintaining strong momentum (cash earnings +20% YoY in 1H25) while Retail Banking undergoes further restructuring. Housing lending contraction will likely persist through FY25, which management has identified as the "peak contraction" period, before stabilizing and returning to growth as the digital mortgage platform (scheduled for market launch in 2H25) scales. Business lending is projected to continue its robust growth trajectory in specialized segments like healthcare and agriculture.

The most significant near-term financial catalyst is the expected 12 bps net interest margin improvement from the March 2025 branch conversion, which should materially enhance 2H25 results. This improvement, combined with ongoing portfolio mix optimization toward higher-margin business lending, is expected to drive NIM expansion from 1.57% currently toward 1.75% by FY28. Cost efficiency remains a critical focus, with management targeting an improvement in the cost-to-income ratio from 65.6% currently to 56% by FY26 through the $250 million productivity initiative.

Looking toward FY26, management's performance targets include 8% ROE and 56% cost-to-income ratio. While the 1H25 results (ROE of 6.2%, CTI of 65.6%) indicate significant improvement is still required, the expected benefits from branch conversion, digital mortgage platform, and continued business banking growth provide a credible pathway to these targets.

Projected NIM & CTI Ratio Path



Valuations

Our primary valuation approach for BOQ utilizes a modified Dividend Discount Model (DDM) tailored specifically for banking institutions, complemented by Return on Equity (ROE) analysis and Price-to-Earnings (P/E) multiple approaches. This blended methodology appropriately captures BOQ's distinctive characteristics as a regional bank undergoing strategic transformation.

Methodology	Implied Price Per Share
DCF - Base Case	$7.89
DCF - Bull Case	$9.61
DCF - Bear Case	$5.37
P/E Multiple - NTM	$7.80
ROE-based	$7.70
Precedent Transactions	$8.05
Implied Valuation Range	**$7.40 - $8.25**
Current Share Price	**$6.70**
Up/Downside to Base Case	**+17.8%**

Our base case DCF valuation of $7.89 per share represents 17.8% upside to the current price, supporting a BUY recommendation. This valuation is derived using a weighted average of three complementary methodologies: 50% weight to the DDM yielding $8.03, 30% weight to the ROE-based approach yielding $7.70, and 20% to the P/E multiple method yielding $7.80.

Key explicit assumptions in our base case include an initial dividend of 18 cents per half-year growing progressively to 25 cents by 2H28, NIM expansion from 1.57% to 1.75% by FY28 (driven by the 12bps uplift from branch conversion and continued portfolio mix optimization), cost-to-income ratio improvement from 65.6% to 54.8% by 2H28, and loan impairment expense normalization from 1bp to 10bps by 2H27.

For discounting purposes, we utilize a cost of equity of 13.0% based on a risk-free rate of 4.1%, equity risk premium of 6.0%, levered beta of 1.15, size premium of 0.8%, and company-specific premium of 1.2% accounting for transformation execution risk. The terminal value uses a 2.5% perpetual growth rate, yielding a terminal P/B multiple of 0.95x and terminal P/E of 11.0x.

Sensitivity Factor	Change	Share Price Impact
Terminal ROE	±100bps	±$0.92
Cost of Equity	±100bps	±$0.85
CTI Ratio	±200bps	±$0.73
NIM Expansion	±5bps	±$0.48
LIE/GLA	±5bps	±$0.37

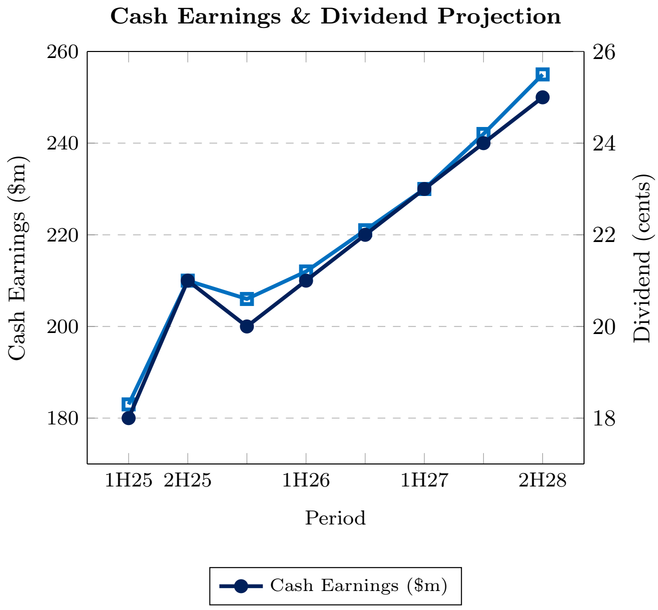
Our scenario analysis highlights significant valuation sensitivity to key execution variables. In the bull case ($9.61 per share, 43.4% upside), accelerated transformation benefits drive NIM expansion to 1.80%, cost-to-income ratio improvement to 53%, and ROE exceeding 9.5% by FY26. Conversely, the bear case ($5.37 per share, 19.9% downside) assumes transformation execution challenges leading to limited NIM improvement (1.55%), stubbornly high cost-to-income ratio (63%), and ROE stalling at 5.5%.

Recent regional bank transactions provide useful valuation benchmarks, including ANZ's acquisition of Suncorp Bank (2022-2023) at 1.3x P/B, NAB's acquisition of Citigroup's Australian Consumer Business (2021) at 1.1x P/B, and BOQ's own acquisition of ME Bank (2021) at 1.05x P/B. These transactions suggest our terminal P/B multiple of 0.95x is conservative, with potential upside if BOQ successfully executes its transformation strategy.

Free Cash Flow Transformation

BOQ's free cash flow profile reflects its status as a bank undergoing strategic transformation. Unlike standard corporate DCF approaches, the bank's cash flow assessment must consider regulatory capital requirements that constrain dividend distributions, with the CET1 ratio maintained within BOQ's target range of 10.25-10.75%.

In 1H25, BOQ generated $183 million in cash earnings after tax, up 6.4% from 1H24. This translated to a dividend payout of 18.0 cents per share, representing a payout ratio of 65.1% of cash earnings, within the bank's target range of 60-75%.



The cash flow trajectory is projected to improve significantly over the medium term as transformation benefits materialize. Key inflection points include:

1. **Branch Conversion Benefits (2H25)**: Expected to deliver a 12bps improvement in NIM, translating to approximately $32-35 million in incremental annualized net interest income—a significant near-term catalyst with minimal additional capital investment required.

2. **Digital Mortgage Platform Launch (2H25-1H26)**: Expected to drive gradual recovery in housing lending from FY26 onwards, delivering both volume growth and cost efficiencies.

3. **Productivity Initiative ($250 million by FY26)**: Will progressively enhance cash flow through operating model simplification, technology rationalization, and process automation—critical to achieving the targeted cost-to-income ratio improvement.

4. **ME Bank Migration Completion (FY26)**: Will unlock significant synergies and platform efficiencies, enhancing the cost-to-income ratio and improving free cash flow generation.

These initiatives collectively drive our forecast of cash earnings growth from $183 million in 1H25 to $255 million by 2H28, representing a CAGR of 9.2%. This earnings expansion, combined with disciplined capital management, supports projected dividend growth from 18.0 cents per half-year currently to 25.0 cents by 2H28.

From a capital perspective, BOQ maintains a strong position with a CET1 ratio of 10.87% as of 1H25, slightly above the management target range. The bank's funding profile is expected to improve with the deposit-to-loan ratio increasing from 83.3% currently to 86.0% by FY28, enhancing funding stability and potentially reducing wholesale funding costs.

About the Company

Bank of Queensland Limited (BOQ) is an Australian Authorized Deposit-taking Institution with a 150-year Queensland heritage. Operating under multiple brands including BOQ, ME Bank, and Virgin Money Australia, the Group serves approximately 1.5 million customers across Australia. Listed on the ASX with a market capitalization of approximately $4.4 billion, BOQ positions itself as a challenger bank, differentiating through its multi-brand strategy targeting niche segments and specialized business banking capabilities.

BOQ generates revenue primarily through net interest income and non-interest income (fees, commissions, trading). The Group operates through two main divisions: Retail Bank (serving personal customers through branches, digital platforms, and intermediaries) and BOQ Business (providing tailored solutions including commercial lending, equipment finance, and transaction services).

The customer base comprises approximately 1.3 million retail customers and 160k business clients. The distribution network includes 120 branches (all converted to corporate model as of March 2025), a broker network of over 12,000, and growing digital platforms.

BOQ is led by Patrick Allaway (since March 2023) and chaired by Warwick Negus. The company's strategic priorities focus on four pillars: strengthening risk culture, simplifying operations, digitizing platforms, and optimizing for higher-returning segments.

Tailwinds

Business Banking Momentum: The BOQ Business segment has demonstrated strong performance with cash earnings growth of 20% year-over-year in 1H25, driven by 9% growth in commercial lending focused on specialized sectors. This momentum provides a solid foundation for continued growth, with proven success in healthcare, agriculture, and owner-occupied commercial property sectors.

Branch Conversion Benefits: The March 2025 completion of the conversion of all 114 Owner Managed branches to the corporate model represents a significant tailwind, with management projecting a 12 bps positive impact to NIM. This structural change eliminates potential conflicts inherent in the franchise model while providing greater control over customer experience and operational execution.

Digital Transformation Progress: BOQ has successfully completed the foundational build of its digital banking platform with 41% of retail deposit customers now onboarded. The first phase of ME Bank migration has been completed with over 140,000 customers transferred to the platform, representing $9.1 billion in deposits. The digital mortgage platform is ready for market launch in 2H25 following successful piloting.

Economic Recovery and Rate Cycle: The Australian economy has improved with rising household disposable income and a resilient labor market. BOQ's central case is for further strengthening as businesses and consumers gain confidence and cash rates decline. The anticipated easing cycle should improve loan affordability while potentially stimulating credit demand.

Headwinds

Transformation Execution Risk: BOQ is undertaking a complex multi-year transformation with significant milestones still ahead. The bank must successfully launch its digital mortgage platform, complete ME migration, and deliver $250 million in productivity benefits by FY26. Failure to execute effectively would jeopardize anticipated benefits, including the 12bps NIM improvement from branch conversion and the pathway to 8% ROE and 56% CTI targets.

Competitive Pressure Risk: BOQ operates in an intensely competitive banking environment dominated by major banks with significant scale advantages and rapidly evolving digital capabilities. This competitive pressure is evident in home lending performance (BOQ brand -13.53% YTD vs. system growth of 5.41%) and creates ongoing challenges through higher funding costs and limited pricing power in mass market segments.

Retail Banking Underperformance: The Retail Bank segment continues to underperform with cash earnings declining 10% year-over-year in 1H25 and an extremely high cost-to-income ratio of 82.7%. This inefficiency reflects the structural scale disadvantages BOQ faces against major banks in mass-market retail banking, creating a substantial drag on group returns that may take longer than expected to address.

Credit Quality Normalization: While BOQ's current credit quality metrics are exceptionally strong (loan impairment expense at 1bp of GLA, impaired assets down 18%), this represents a historically low point in the credit cycle that management acknowledges is unsustainable. The bank's deliberate shift toward business lending introduces different risk characteristics that could manifest during economic stress.

Competitors

BOQ faces a competitive landscape dominated by the four major banks, which collectively hold approximately 75% of housing lending and 80% of business lending. As a regional bank with 2.50% share in housing and 1.38% in business, BOQ has adopted a differentiated strategy focusing on specialized segments.

Competitor	Competitive Positioning
Major Banks	15-25bps lower funding costs; CTI ratios 45-50% vs. BOQ's 65.6%; ROEs 11-13% vs. BOQ's 6.2%; Superior technology investment capacity
Macquarie Bank	Digital-first approach; 17.32% housing growth YTD (vs. system 5.41%); Focus on affluent customers; Diversified earnings streams
Regional Banks	Similar scale challenges; Comparable valuation multiples (0.7-0.9x P/B); Suncorp Bank acquired by ANZ; Community banking focus (Bendigo)
International Banks	Selective Australian operations; Focus on specific segments; Global platform leverage

Within the competitive landscape, BOQ's strategic positioning emphasizes its multi-brand approach targeting different customer segments and specialized business banking capabilities in sectors like healthcare and agriculture. While lacking scale advantages of major banks, the transformation strategy acknowledges these limitations and focuses on segments where BOQ can deliver differentiated value.

Interestingly, ME Bank (within BOQ Group) is outperforming system growth in housing lending (5.49% YTD vs. 5.41% system), highlighting the effectiveness of the multi-brand strategy in targeting different customer segments.

Results Summary

Bank of Queensland delivered a solid financial performance in 1H25 with cash earnings after tax of $183 million, representing 6% growth compared to the prior corresponding period. This improvement was achieved despite a challenging operating environment characterized by intense competition in both lending and deposit markets.

Key Metrics ($m)	1H25	1H24	YoY
Cash earnings after tax	183	172	+6%
Net interest income	725	725	0%
Non-interest income	68	70	-3%
Total income	793	795	0%
Operating expenses	520	524	-1%
Loan impairment expense	3	15	-80%
Cash NIM	1.57%	1.55%	+2bps
Cash CTI ratio	65.6%	65.9%	-30bps
Cash ROE	6.2%	5.8%	+40bps

Total income remained stable at $793 million (0% YoY), with net interest income of $725 million (0% YoY) and non-interest income of $68 million (-3% YoY). This flat top-line performance masks significant shifts in the underlying portfolio composition, with deliberate contraction in lower-returning housing lending (-3% YoY) offset by growth in higher-margin business lending (+9% YoY). This strategic rebalancing supported a modest improvement in net interest margin to 1.57% (+2bps YoY) despite competitive pressures.

Operating expenses decreased by 1% to $520 million, demonstrating early benefits from simplification initiatives offsetting inflationary pressures. Loan impairment expense decreased substantially to $3 million (1bp of gross loans and advances) from $15 million in the prior period, reflecting exceptionally benign credit conditions.

The interim dividend was increased by 6% to 18 cents per share, representing a payout ratio of 65.1% within the target range of 60-75%.

Performance by Segment

BOQ's segment performance reveals stark divergence between the Business and Retail divisions, highlighting the strategic shift toward higher-returning business segments.

Segment	Cash Earnings	YoY Change	Total Income	YoY Change	CTI Ratio	Loans $bn
Retail Bank	$45m	-10%	$433m	-1%	82.7%	53.5
BOQ Business	$140m	+20%	$362m	+3%	44.8%	26.1
Group	$183m	+6%	$793m	0%	65.6%	79.6

The Retail Bank generated cash earnings after tax of $45 million in 1H25, down 10% compared to 1H24 but up 18% on 2H24. This segment faces significant efficiency challenges with a cost-to-income ratio of 82.7%. The high cost structure reflects the structural scale disadvantages BOQ faces in mass-market retail banking. The segment's gross loans and advances contracted 4% to $53.5 billion, reflecting the deliberate strategy to prioritize returns over volume in housing lending.

In contrast, BOQ Business delivered outstanding performance with cash earnings after tax of $140 million, up 20% compared to 1H24. This segment demonstrates superior efficiency with a cost-to-income ratio of 44.8%, improved by 30bps year-over-year and comparable to major bank metrics. The segment's gross loans and advances grew 3% to $26.1 billion, driven by 9% growth in commercial lending.

The segment contribution analysis demonstrates the strategic importance of the Business division, which generated 76.5% of group cash earnings in 1H25 despite representing only 32.8% of total lending. This disproportionate contribution highlights the superior returns available in business banking compared to highly competitive, lower-margin housing lending.

Balance Sheet & Credit Quality

Balance Sheet ($bn)	Feb 25	Feb 24	YoY
Gross loans and advances	79.6	80.7	-1%
- Housing lending	60.3	62.3	-3%
- Commercial lending	12.2	11.2	+9%
- Asset finance	6.9	6.9	0%
Customer deposits	66.3	66.0	+1%
Deposit to loan ratio	83%	82%	+1%
Risk weighted assets	40.2	40.7	-1%
Capital & Liquidity			
CET1 ratio	10.87%	10.76%	+11bps
Total capital ratio	15.11%	15.17%	-6bps
Liquidity Coverage Ratio	134.5%	132.5%	+200bps
Net Stable Funding Ratio	122.7%	122.3%	+40bps
Asset Quality			
Provisions for impairment	310m	332m	-7%
Impaired assets	95m	116m	-18%
Total provision/GLA	39bps	41bps	-2bps

Asset quality metrics remain exceptionally strong with loan impairment expense at just 1bp of gross loans and advances, decreasing from 4bps in the prior period. Total provisions decreased 7% to $310 million (39bps of GLA), while impaired assets declined 18% to $95 million.

Balance sheet metrics demonstrate the strategic portfolio shift with housing lending down 3% and commercial lending up 9%, driving a slight 1% contraction in total gross loans and advances to $79.6 billion. Customer deposits grew 1% to $66.3 billion, improving the deposit-to-loan ratio to 83% (+1 percentage point) and enhancing funding stability.

Capital metrics remain strong with the CET1 ratio increasing 11bps to 10.87%, above the management target range of 10.25-10.75%. This provides flexibility for continued transformation investment while maintaining regulatory buffers.

Key Project Status

BOQ is executing several critical transformation projects that represent key enablers for achieving its strategic and financial targets.

Project & Status	Expected Benefits
Branch Conversion 100% complete (Mar 2025)	• 12bps NIM improvement • Enhanced distribution control • $32-35m annual NII uplift
Digital Foundation ~90% complete	• Platform scalability • 41% of retail deposit customers • $9.1bn deposits on platform
ME Bank Migration First phase complete (FY26)	• Cost synergies • Platform efficiencies • 140,000+ customers migrated
Digital Mortgage Platform Launch in 2H25	• Housing growth revival • Origination efficiency • Improved customer experience

The branch conversion represents the most immediate catalyst, with management projecting a material 12bps improvement in NIM from this initiative alone. The digital foundation buildout enables the ongoing migration of customers to the digital platform, with 41% of retail deposit customers already onboarded. The ME Bank migration and digital mortgage platform launch represent critical upcoming milestones for realizing the full benefits of BOQ's transformation strategy.

Financial Forecasts

Income Statement ($m)	1H25A	2H25E	1H26E	2H26E	FY27E	FY28E
Net Interest Income	725	781	787	795	1,622	1,675
Non-Interest Income	68	70	72	74	156	167
Total Income	793	851	859	869	1,778	1,842
Operating Expenses	(520)	(525)	(530)	(525)	(1,035)	(1,022)
Cost-to-Income Ratio	65.6%	61.7%	61.7%	60.4%	58.2%	55.5%
Underlying Profit	273	326	329	344	743	820
Loan Impairment Expense	(3)	(15)	(25)	(30)	(75)	(85)
LIE/GLA (bps)	1	4	6	7	9	10
Cash Earnings After Tax	183	210	206	212	451	497
Cash Earnings Growth	6.4%	22.8%	12.6%	1.0%	7.9%	10.2%
Balance Sheet ($bn)						
Gross Loans & Advances	79.6	79.3	79.1	79.3	80.9	83.7
- Housing Lending	60.3	59.5	59.0	58.7	58.9	60.0
- Business Lending	12.2	12.7	13.0	13.4	14.8	15.9
Customer Deposits	66.3	66.8	67.3	67.8	69.5	72.0
Deposit to Loan Ratio	83.3%	84.2%	85.1%	85.5%	85.9%	86.0%
Key Metrics						
Net Interest Margin	1.57%	1.69%	1.71%	1.72%	1.74%	1.75%
Cash ROE	6.2%	7.1%	7.0%	7.2%	7.7%	8.3%
CET1 Ratio	10.87%	10.65%	10.58%	10.52%	10.45%	10.50%
Dividend Per Share (¢)	18.0	21.0	20.0	21.0	45.0	49.0

Our financial forecasts reflect BOQ's transformation journey, with near-term improvements driven by the branch conversion benefits and ongoing strategic repositioning. The most significant inflection points include:

1. **2H25 Margin Expansion**: Net interest margin is projected to increase from 1.57% in 1H25 to 1.69% in 2H25, primarily driven by the 12bps benefit from branch conversion. This drives a meaningful step-up in net interest income from $725 million to $781 million (+7.7%).

2. **Progressive CTI Improvement**: The cost-to-income ratio is forecast to improve from 65.6% in 1H25 to 61.7% in 2H25, and then gradually decline to 55.5% by FY28 as productivity initiatives deliver benefits.

3. **Loan Impairment Normalization**: Loan impairment expense is projected to increase progressively from the historically low 1bp in 1H25 to 10bps by FY28, reflecting normalization toward through-the-cycle averages.

4. **Portfolio Rebalancing**: Housing lending contraction continues through 1H26 before stabilizing and returning to modest growth from 2H26 onwards as the digital mortgage platform scales. Business lending maintains strong growth throughout the forecast period.

5. **ROE Progression**: Cash ROE improves from 6.2% in 1H25 to 8.3% by FY28, achieving management's 8% target with a slight delay from the original FY26 timeline.

End of Report

Alpha Insights
www.alphainsights.com.au
ryanl@alphainsights.com.au