Bank of Queensland

Managing Director, David Liddy
Bourse Talk 13 October 2006

bank different®

Bank of Queensland

Speech Notes

David Liddy

Bourse Talk

Friday, October 13, 2006

Brisbane Hilton

Thank you.

Remember the days when bankers stood before you and talked about numbers and money.

Those were simple days, the salad days for bankers and financiers.

Business was bottom line, product innovation and marketing.

If a banker spoke of culture he spoke of Dame Nellie Melba, Blue Poles or the Archibald prize, if at all.

If a banker spoke of service it would most likely be in regard to Patrick Rafter's game.

If a banker spoke of relationships it would undoubtedly be of Nicole and Tom, or maybe Christopher and Pixie.

The salad days indeed.

Today, everyone who stands before you talks about customer service.

Not just banks, everyone.

After years, decades even of being left in the PR wilderness, the marketing black hole, service is back, and now we're all on board.

Customer service, service with a smile, relationships, personal, one-on-one, face-to-face….they go on and on. Marketing budgets are on fire with the word, the underlying belief, that service is everything.

Service… what was old is new again.

Products are cookie cutter clones of each other, marketing budgets blur into one another, space on TV, on the internet, on ipods, billboards, T-shirts or skywriting - it doesn't matter because it is all just noise.

We need to return to the good ol' days.

Service is the new black, the hot buzzword, the key to the future.

The fact is, of course, that service never went away. Sure, corporate Australia stopped talking about it, stopped delivering it some would say, but service was never at the bottom of the customer's list.

Customers never stopped wanting good service, they just stopped expecting it.

So why now, why has service made such a comeback to the lexicons of corporate leaders, spin doctors and advertising executives?

Why has the service bandwagon been hitched back on to the modern corporate horse and dragged back into the ring?

Competition, that's why. Fading market shares, that's why.

In the finance sector there has never been a more competitive environment in Australia than now.

Overseas players, non-bank lenders, mortgage brokers, regional banks, building societies, credit unions, the big four, or the big six depending on who you are talking to…they are all in there fighting for the customer.

Times have never been so good if you are looking for finance, whether you are an individual, a small business or a corporate player, the world is awash with money.

Online savings accounts are now standard, internet banking is now a basic tool, business banking is the new battleground, small and medium enterprises the new prize client.

Margins have never been tighter.

You know that when the Reserve Bank says the real reason interest rate increases haven't bitten into the consumer psyche the way they should have is because of competition amongst lenders that we have hit a new level of marketplace competitiveness.

Lenders are swallowing rate increases to remain competitive. Who'd have thought that would happen a few years ago.

The world has been turned on its axis. Where once banks treated customers with indifference, believing they controlled the relationship, they now woo and court customers with all sorts of goodies and claims of cuddly benevolence.

The customer is king again.

If you don't believe me, just look at the facts. In the last month the media has run stories about one of the Big Four trialling a new customer-focused approach in some of its Queensland branches while another of the Big Four is trialling a new "retail experiment" focused on customer service in a bayside branch.

Still others in the Big Four are launching franchised mobile lenders or incentive schemes for regions to retain customers.

Bank advertising campaigns which were once robustly masculine and sometimes overtly aggressive are now friendly, inviting and focused on you, the customer.

Your bank is once again your friend for life, guiding and assisting you through the ups and downs of life's journey as you progress from children's savings account to car loan, mortgage, insurance, superannuation and death.

We've got you covered.

Well, at least that is what the message is. That's what the spin will tell you. Everything's changed, it's all about you.

Of course, PR and marketing is only effective if there is some truth to the message.

Now, before you think I am taking a shot at my industry unfairly here, I want to point out that wanting to change is a great start, for anyone.

However, saying that customer service is central to your reason for being, and making it true, are actually quite different things.

I can tell you now that it is not easy to change a culture, to retrain, re-educate, refocus an organisation which has been locked into a different direction.

The Titanic comes to mind, or the task of the Queensland Coalition in unseating Peter Beattie, Carlton winning a premiership or Akermanis staying out of the media.

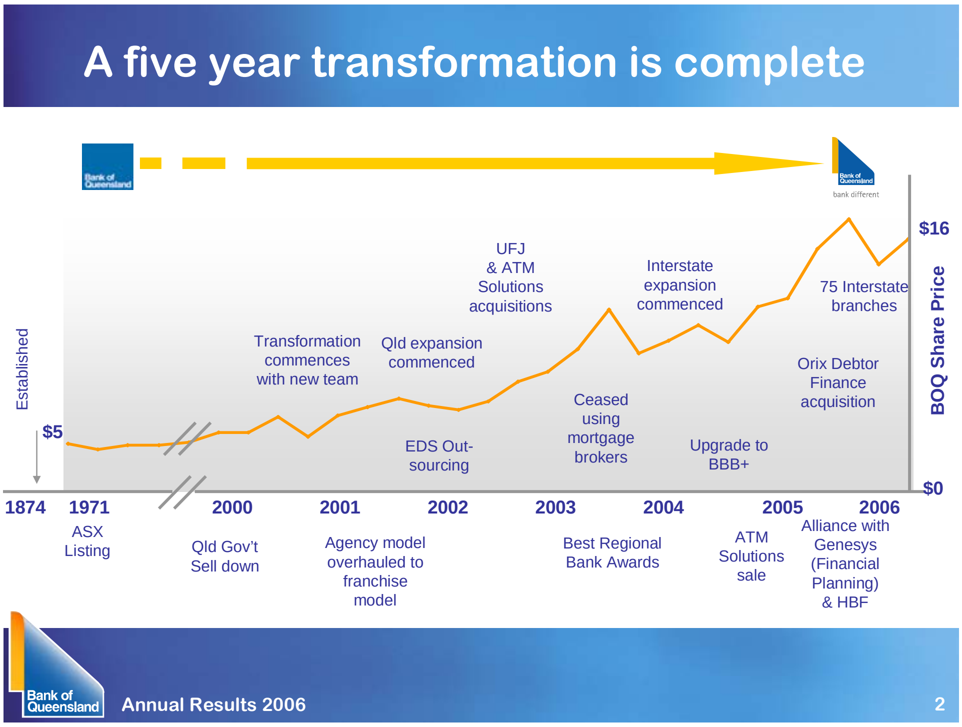
Nobody says these things can't happen, but we all know it might take some time and there is a lot of work to do before it becomes a reality.

Which brings me, as you knew it eventually would, to Bank of Queensland.

For the more than five years since I joined BOQ, we have focused on one key tenet – customer service.

And the reason is simple, we had to.

Slide One



As you can see from this slide, in 2001 Bank of Queensland was chugging along. It had a great brand, but had seen little growth above $5 a share for 30 years.

Every step we have made since then has been designed to support our strategy of attaining more customers, of keeping them, and of growing their commitment to the Bank.

This growth strategy has seen a corresponding growth in the Bank as a whole, as our results yesterday indicated.

In 2001 BOQ had 93 branches, only in Queensland while its competitors had around 130 in this State.

And today we have 215 branches, including 75 outside of Queensland.

In 2001 our statutory net profit after tax was $24 million, while in 2006 it is $92.7million.

In 2001 our cost-to-income ratio was 72.9 cents in every dollar, compared to 64.5 in 2006.

In 2001 our cash earnings per share was 38.2 cents, and in 2006 it is 76.4 cents.

In 2001 our loan approvals amounted to $2.8 billion whereas in 2006 they have reached $10.0 billion.

Our assets under management have more than trebled over the same period, from $5.2 billion to $16.9 billion.

And the share market has rewarded us for the growth. Our market capitalisation five years ago was $400 million and now it is around $1.6 billion.

It’s a good growth story, and one which is far from over. I’ll speak more of our results later.

But growth alone is not the strategy. Growth without customer retention is little more than rowing a boat in circles. To my way of thinking and in terms of growing shareholder value, customer attrition risk is a bigger risk than credit risk.

Retention comes through customer service. Attraction of new customers more often now comes through good service and word of mouth. Growth in the commitment of the customer to the Bank comes through over-servicing and building relationships.

Can you see the trend?

The fundamental understanding which has driven this growth by Bank of Queensland is that we must match our competitors on product range, accessibility and innovation while out-performing them on personal service.

After all, we see our competitors as the Big Six, and even the smallest of the Big Six is more than ten times our size when it comes to market capitalisation.

We can’t outspend them on TV advertising.

We do not have a huge residual pool of customers who are finding it too difficult to switch banks.

We don't even have funky European cars with our brand all over them, although we are working on that!

What we do have is a culture which is completely different from the traditional banks.

What we do have is an entrepreneurial network of branch managers and business bankers who are the best in their field.

What we do have is a nimbleness, flexibility and speed to market.

But most of all, what we do have is a team behind the BOQ brand which actually does care about customer service.

And the team is, in turn, supported by a model which infuses the staff with a service culture.

It is interesting to note that when we changed the old agency model over to the Owner Managed Branch model in 2001 we believed we were creating a new culture in our branches.

What we did not anticipate was how that culture would push back into the other areas of the bank, driving change by its sheer dynamism, its need for a support structure which matched its own enthusiasm and drive.

Because the Owner Managers, as franchisees with skin in the game, would not, and will not, settle for service from the back end which fails to match their own high levels out the front.

They would not be let down by systems and processes which stymied instead of supported their own service culture.

They demanded better, and we at head office have had to come up with the goods to provide them with better.

If you ask them , they will say this is still a work in progress. After all we have had a lot of catching up to do.

And despite all this, and our internal surveys, it still irritates me no end when I hear we are number two when it comes to customer satisfaction in banks, and number two (behind a different bank) when it comes to customer satisfaction for business banking customers.

It irritates my team even more, I am sure, as we continue to drive them to reach the number one spot for both retail and business customers when it comes to customer satisfaction.

Still, we have put everything in place to achieve the number one spot.

As the timeline above shows, we have replaced our core banking system, opened 122 new branches, rebranded and repositioned the bank, refocused and relaunched business banking, and selectively acquired where we believed we had weaknesses, all in the past three years.

This was supported in the equipment finance and debtor finance areas through the acquisitions of UFJ and the Orix debtor finance business.

It included the purchase of a small Melbourne based company called ATM Solutions which we doubled in size from 900 ATMs to 2200 ATMs, allowing us to have the second largest bank-owned and branded ATM fleet in the country.

Now, they weren't on high street. In fact, you are more likely to find them in the local corner store or service station, but the fact remains they gave us an instant, national ATM fleet to support our national expansion.

We then sold ATM Solutions to Macquarie Bank for an after-tax profit of $15.5 million, but maintained our agreement for branding and customer ATM usage for Bank of Queensland.

In 2004, with a national ATM and business banking support network already in place, we started our interstate expansion. We took little old Bank of Queensland into the heartland of our opponents. As Sun Tzu says, we attacked in undefended places.

We went back to the CBD, inner-city suburbs, strip malls and shopping centres and provided a new alternative for customers in New South Wales and Victoria.

We also formed strong partnerships with key insurance groups like CGU and St Andrews to provide insurance products for our customers. Since then we have also formed alliances with Macquarie to provide a market leading margin lending product and Genesys to provide a strong and successful wealth management alliance.

At around the same time we made one of our more momentous decisions. We decided to stop using mortgage brokers to sell BOQ loans.

Now many have taken this decision and used it to say that BOQ doesn't like mortgage brokers.

Not true. The fact is many mortgage brokers have done a very good job of filling the hole left by banks who failed to provide genuine one-on-one service for their customers.

Many banks have, I believe, abrogated their responsibility for productive and effective distribution and customer service to mortgage brokers.

When 40 to 50 per cent of your loan book is being sold by third parties, I don't see how you can claim to have the primary relationship with that customer.

To me it is an admission of defeat. It says that we can not sell enough home loans to maintain market share on our own. It screams that we have forgotten how to sell home loans, and to provide a service culture which makes customers actually want to deal with us rather than a mortgage broker.

It smells of surrender.

It would be like McDonalds deciding it couldn't sell enough burgers on its own so getting the corner fish and chip shop to sell them on their behalf.

To me it's throwing out the baby, the bathwater and then the bath.

We did not want that for Bank of Queensland. Instead, we wanted to build our own direct relationships with our customers. We basically gave up a billion dollars in lending per year on the premise that our branch expansion would replace it within 12 months. It didn't, it replaced it in 11 months.

All of those new customers now have a relationship with Bank of Queensland, a primary relationship as their bank. I believe this will be particularly important in the next couple of years as housing continues to soften under the weight of inflation pressures and interest rate increases.

This is when we will see those brokers, who already prefer to churn customers out of a home loan and into another after every two years or so, forced to do this even more to continue their own growth.

This will make it even more difficult for the lenders to retain customers which they do not have a direct relationship with, forcing them into a fight on rates and fees to retain the ones they have, further diminishing their margins.

And before some broker magazine screams that I am bashing mortgage brokers, I am not. I don't blame the brokers at all. Their business model is not the same as the model of the major banks. They have their own businesses to worry about.

Mortgage Choice, for example, created a very sound and successful niche in the market.

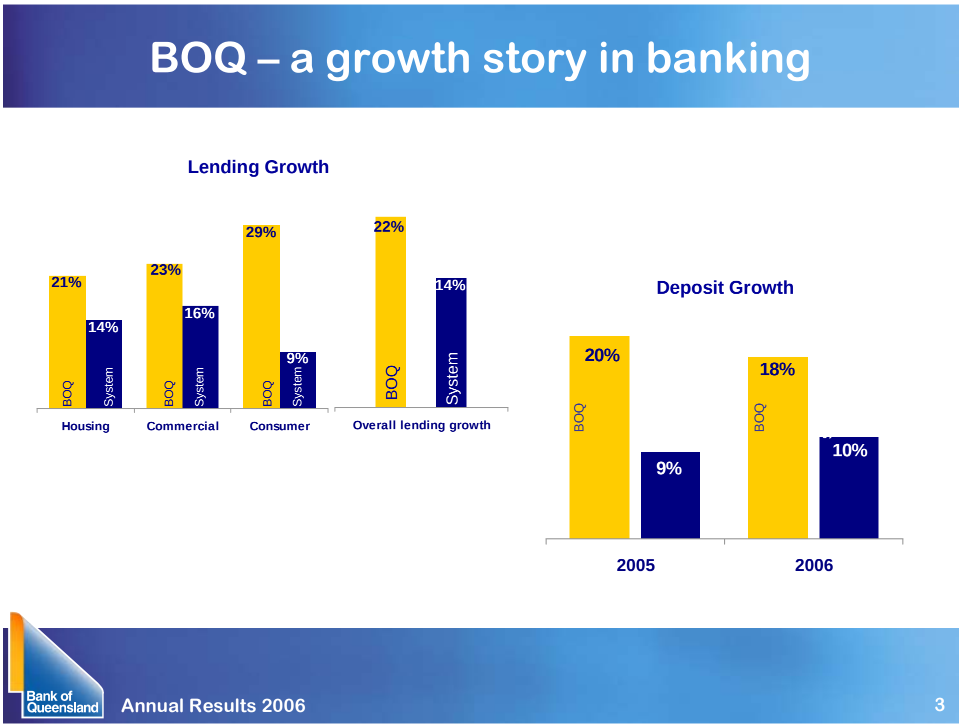
No, it is those banks that have passed over responsibility for selling home loans to the brokers who must live with the medium to long term impact of that decision.

Personally, I am happy to be out of it. While we must compete in an increasingly competitive market, I know that I have every opportunity to impress our customers with what BOQ can offer. I am not relying on someone outside of the business for my lending growth, and for that I sleep a little easier.

As yesterday's 2006 financial year results for Bank of Queensland indicated, we are well placed to continue our growth in national market share in lending and deposits over the next 12 months.

Importantly, we are also experiencing strong growth in areas like business banking, particularly in the SME market, and credit cards and consumer lending.

Slide 2



This has seen a record result for the Bank again this year. Yesterday we announced our results for the year and we have again received a positive response from analysts and the media.

That's encouraging, because it is a good news story.

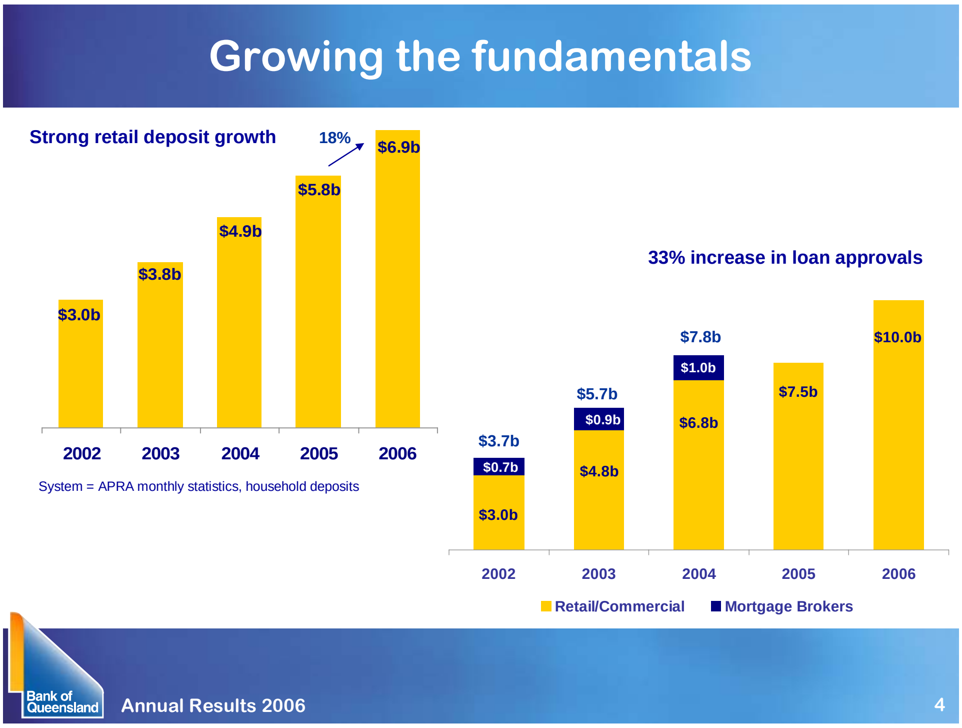
As the slide above shows, we have continued our strong growth in lending, and deposits well ahead of our competitors in the banking sector and overall system growth.

Secondly we have seen retail deposits grow 18 per cent to $6.9 billion. This is in a market which has never been more competitive and where international players, the big guys and the specialist online providers are all offering strong deposit products.

Our deposit products, which have won two Cannex Five Star ratings in the last six months, are either the equal or better than any on the market, and that, combined with our service offering, is why we have continued to grow so strongly.

Importantly for me, as I mentioned earlier, we have seen significant growth in two key areas against the rest of the banking system.

Slide 3



Loan Approvals have grown from $7.5 billion to $10 billion in the last 12 months, growth of 33 per cent in a very competitive market. This is without us utilising mortgage brokers or diving headlong into the low doc end of the market. We do have low doc loans, but they make up a small percentage of our overall book.

Our interest margin has remained steady at 1.83, again impressive with such competitive pressure in the product space, while asset quality has also remained high with impaired assets as a percentage of non-securitised loans at 0.07% in 2005/06.

This has obviously fed through to our overall net profit after tax available for distribution to ordinary shareholders of $82 million, an increase of 21 per cent on a like-for-like (ie AIFRS) basis compared to last year.

So, a very strong result for Bank of Queensland in a market which is slowing, and which is gaining new competitors and more focus from the big guys as they try and claw back market share.

These results reinforce the recent report on Bank of Queensland issued by Credit Suisse in which they increased their target price for the Bank to $16.25 a share over the next 12 months.

The reason for the increase is what they called the “branch rollout bow-wave”.

I love that phrase, “bow-wave”, because it sums up exactly what is going on with Bank of Queensland.

In their report on BOQ Credit Suisse states, and I quote:

“BOQ is our preferred pick amongst the smaller capitalisation regional banks as a reasonably priced (although under-estimated) medium-term growth story.”

They also state that our “transformational branch rollout strategy hits a maturation sweet spot from 2008 financial year as the greatest proportion of BOQ’s branch network enters the two-to-five-year old branch profit uplift phase” and that “profit growth is most pronounced for a two-to-five year old branch.”

Hence the bow-wave.

The problem we have faced in some circles is that we have probably performed above expectations through the new branch channel.

Our belief was that the branches would take six to twelve months to get going, and become profitable in two years. This is still the case, but we have also seen many of our branches become profitable much faster.

In fact, some of the owner-managers we have brought on board have proved to be unbelievably pro-active, signing many clients before they have even opened their doors.

We also see a lag when we compare lending to deposits, with lending being the branch staple for the first 12 months and then deposits following as the branch deepens its relationship with the customers.

The real upside of our branch bow wave is that much of the growth through our expanding branch network is ahead of us, and that’s great news for our investors and our customers.

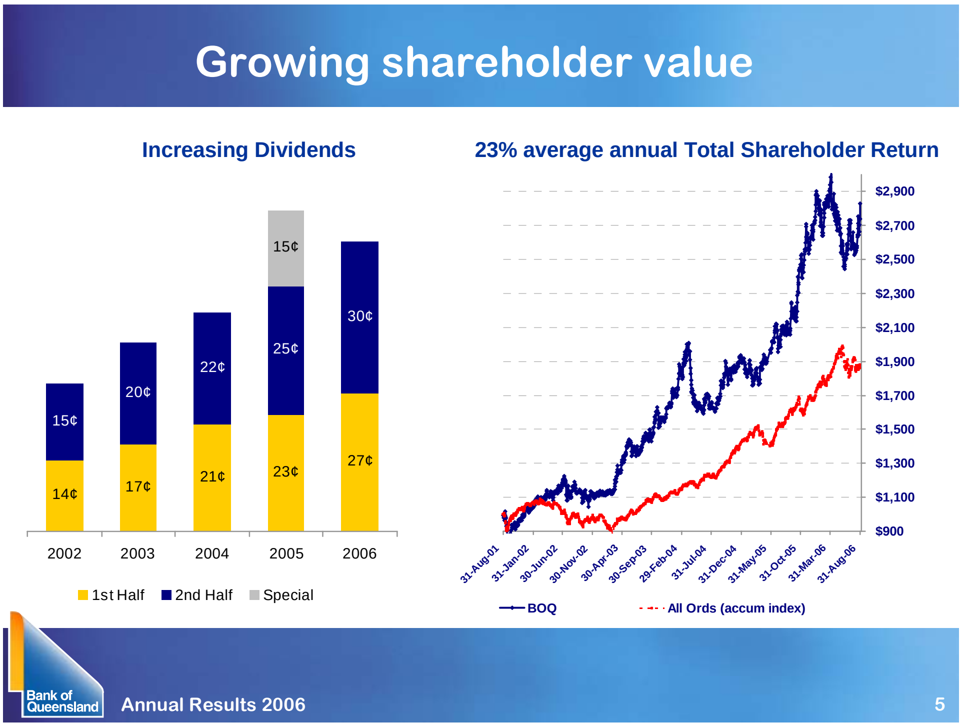
It promises to be an exciting year ahead for the Bank. Our proposal to merge with Pioneer Permanent Building Society and bring its 40,000 customers into the BOQ fold is an exciting one, and one we believe is in the best interests of all Pioneer shareholders, staff and customers.

There has been much local speculation about Pioneer, with claims of bidding wars and the like, but we believe our friendly merger is the only one which offers a genuinely positive result for the Society.

Also this year we see the roll-out of our relationship with HBF, Western Australia's biggest health fund with 900,000 members. HBF will be selling white-labelled home loans and deposit products manufactured and supported by Bank of Queensland.

On top of this we have our branch expansion, which is now in Western Australia and the Northern Territory along with the ACT, NSW and Victoria, and this year will expand to take in Tasmania and South Australia.

Slide 4



The end result has been a good return for Bank of Queensland's shareholders over the last five years with total shareholder return of 23% per annum against the all ords of 14% per annum.

As this slide shows, on whatever barometer you wish to measure it, we have shown strong returns for our investors. In fact, in the last 12 months our TSR was 36% against an all ordinaries accumulated index of 20%.

So, there is my plug for Bank of Queensland and its results for 2006.

I hope you think it was a good plug, without being too over the top.

Slide 5

There is much more I would like to talk to you about, but we probably don't have the time.

After all, I have been quite vocal in the past about the past-its-use-by-date Four Pillars policy which will ensure that none of our major banks will be big enough to compete on the international stage in the next decade. This, I believe almost guarantees them all to be eventually snapped up in the future by those American, Asian and European banks which have grown through mergers and international acquisitions.

I could talk about that.

I could talk more about the over-regulation facing banks these days which ensures, like the Freedom of Information Act, that the customer receives so much information they are guaranteed to read none of it.

How does it protect someone from making an incorrect decision on a banking product to give them documentation the size and weight of Brisbane's Yellow Pages? They are not going to read it, it adds massively to the cost of banks doing business, and it kills a lot of trees unnecessarily.

Yep, I could definitely speak more about that.

Or I could talk about the opposite situation, where non-bank lenders have the flipside. Instead of over-regulation, sections of the finance community are under-regulated or slip through the regulatory cracks completely. The end result is something like the Westpoint disaster which sees investors lose funds.

But I won't talk about that today.

I have spoken today about the journey, and how I believe Bank of Queensland is only just getting started. I have spoken of what the future holds.

The future for banking is being written now. The big banks have figured out that they went too far and are scrambling to return to being a service-focused industry.

Products will continue to evolve at an unbelievable rate to meet the growing demand for instant access to credit, faster loan approvals, flexible and high-return deposit products and channels which offer 24-hour-a-day, seven-days-a-week access to finance.

This is what the customer demands, and it is what the customer is getting.

I do expect the future to also hold more rationalisation in the finance sector. What we have seen with the credit unions, and our merger with Pioneer, will continue and, I believe grow, at least at that end of the market.

I also believe a tightening mortgage market will see rationalisation in the mortgage broker and mortgage originator markets.

We will also see more regulation in the financial planning and advice industries as more and more funds are poured into superannuation which has finally become attractive to investors.

And we will see more off-shoring of jobs by Australia's finance sector, and across the corporate spectrum.

Part of me hopes they do keep sending their call centres to India or Asia, although I am sorry if Australians are losing jobs through this shift.

The fact is though, off-shoring is great for Bank of Queensland, it is the perfect policy for Bank of Queensland, because we are not going to do it.

I have no intention of off-shoring our call centres, and I believe it will add yet another reason for customers to come to Bank of Queensland. Whether it is security concerns, concerns over employment or just the desire to speak to someone who might know where Paddington or Moonee Ponds is, Bank of Queensland intends to remain firmly fixed in Australia when it comes to call centres and other such sectors of our business.

I call it on-shoring, and it is part of the BOQ future as well.

As I have stated today, we have spent five years laying down the foundations, building the platform, for the true growth and expansion to occur.

This platform puts Bank of Queensland in the perfect space to meet the challenges the future offers.

We are now geared for that growth after our five year transformation.

I won’t go on further with it now. Instead let me close by posing you all a question.

Are you happy with your bank? No, come on, really happy?

Because if not, I want you to give us a go.

I know it can be painful to change, but think of the ongoing pain you will save yourself.

Despite our strong position here, and our growing position in the business banking market, it is still a sad fact that most Queenslanders still don’t bank with us.

It must end.

Jump on board. Surf the bow wave that is Bank of Queensland. As our advertising campaign states, we want customers, we want you, and we want you now.

Thank you for listening.