

managing director's report

I am pleased that the Bank was able to announce a record increase in normalised cash net profit after tax of \$197.1m for the full year 2010, a 5% increase from 2009, despite expected peak bad debt losses. A strong balance sheet and focus on expense discipline, along with system-beating growth in lending and deposits, all contributed to securing such a strong result.

We have continued to deliver on our commitments to the market in that we are a more efficient and productive organisation, reflected in our normalised cost-to-income ratio reducing by 4.1% to 45.8%.

We outperformed our competitors in both lending and deposit growth (1.5x and 2.5x system respectively) in the 2010 financial year, and have also increased our full year Net Interest Margin, despite funding costs putting pressure on margins.

As per our guidance, we believe bad debt losses peaked in the full year 2010, and investments in collection processes and resources are expected to improve specific portfolio performance going forward.

We have come through the GFC with a much higher capital level and stronger liquidity base. Our Tier 1 capital ratio at the end of FY10 of 8.7% remains well above APRA and internal benchmarks. In August 2010, the Bank completed the nation's biggest sale of Retail Mortgage Backed Securitisation (RMBS) since 2007*, providing room for further growth and bolt-on acquisitions.

DELIVERING ON OUR GROWTH STRATEGY

As part of our growth strategy, this year we purchased an insurance business and a vendor finance business to assist us in diversifying our income sources and reducing the capital intensity of our model.

In March 2010, BOQ signed an agreement with Commonwealth Bank to purchase St Andrew's Insurance (Australia) Pty Ltd and St Andrew's Life Insurance Pty Ltd

(collectively "St Andrew's") for \$45 million, subject to post-completion adjustments. St Andrew's is a leading Australian manufacturer of consumer credit insurance products with a solid history of partnering with financial institutions to deliver insurance solutions, including the Bank over the past 6 years. The majority of St Andrew's premiums are in credit protection products, addressing a significant customer need that has been growing in light of the GFC.

This acquisition fits within the BOQ growth strategy, including income diversification through businesses with complementary products to our core mortgage distribution. We are operating the St Andrew's business as a stand-alone entity and we are targeting best in class cross selling with BOQ's customer value proposition enhanced.

In July 2010 we also completed the purchase of CIT Group (Australia) Limited and CIT Group (New Zealand) Limited (CIT Australia and New Zealand), paying a combined total for purchase consideration and refinance of debt of \$475 million. This vendor finance business works with manufacturers, dealers and resellers to provide leasing and financing packages to consumers, businesses, government agencies and education providers.

We have created a new division, BOQ National Finance, which incorporates our new vendor finance business, as well as our existing equipment finance and debtor finance businesses. We see real synergies across these businesses with further leverage opportunities within our Owner-Managed Branch network.

OWNER-MANAGERS ENSURE PERSONAL SERVICE

In terms of our core retail banking business, which includes our branch network, our business bankers and direct banking, the Owner-Managed Branch (OMB) model remains central to the Bank's distribution strategy. We have had continuing success with the conversion of corporate branches to OMBs throughout the year, and this will continue. Our focus does however remain on sourcing only quality Owner-Managers and we intend to take the necessary time and care to ensure only the best bankers, and business people, become BOQ Owner-Managers.

We have such great confidence in this business model and our Owner-Managers, that in early 2010 we launched a new brand campaign in which our Owner-Managers were featured. We wanted to highlight the personal service that our Owner-Managers provide and fittingly, 'It's personal' was adopted as the guiding philosophy of all BOQ staff.

Going forward, the Bank's operating model will be based on three business lines – the core bank, BOQ National Finance, and St Andrew's insurance. It is the start of our diversification into becoming a wider financial services group, giving us momentum to achieve our goal of becoming the real alternative in Australian financial services.

**NORMALISED CASH
COST-TO-INCOME
RATIO DOWN 4.1%**



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EXECUTIVE TEAM ENHANCEMENTS

Over the past year we have reorganised our Group Executive structure to help us to better realise the strategic opportunities available to the Bank.

Our new Chief Financial Officer, Ewan Cameron is charged with ensuring we remain an efficient organisation that delivers on our promises to the market. The previous incumbent of this role, Ram Kangatharan was appointed to a newly created position of Chief Operating Officer in March 2010 to oversee the day-to-day operations of the Bank, including all three business lines.

Darryl Newton was appointed as the Bank's Chief Risk Officer and he will drive the Bank's significant operational and credit risk initiatives and ensure continual enhancements to our risk management function.

Keith Rodwell, previously the Managing Director of CIT Vendor Finance, Asia Pacific, was appointed to the position of Group Executive, BOQ National Finance with responsibility for vendor finance, equipment finance and debtor finance.

Renato Mazza, the Chief Executive Officer of St Andrew's Australia also joined the Group Executive team following the acquisition of St Andrew's and continues to operate the St Andrew's business.

Jim Stabback, who joined the Bank in 2008, remains in the role of Group Executive, IT & Operations, overseeing the strategic focus of the Bank's IT platform and its service delivery, along with the Bank's important outsourcing relationships with HP and Fiserv.

I am delighted to have this Executive team now in place and have every confidence that we have the necessary skills and experience to grow and enhance our Bank.

OUTLOOK

Many of the issues the Bank faced in 2010 will continue in to 2011, specifically the sustained high funding costs the industry is bearing, and the subsequent squeeze on margins. We also have a significant pipeline of regulatory changes and projects underway. Despite this, the Bank is optimistic about FY11 and has issued the following guidance for investors.

We are aiming to continue to grow 1.5 to 2 times faster than our competitors and our focus will remain on well secured housing and SME lending as we anticipate more growth opportunities in these areas in the near term.

We will be looking to continue to convert corporate branches to OMBs and open new OMBs in high growth areas over the next couple of years. Further bolt-on acquisition opportunities are also emerging.

We will be growing and diversifying the St Andrew's business by improving sales productivity of existing corporate partners and we also intend to acquire new corporate partner relationships. With these changes we are aspiring to double the size of this business line within three to four years.

We see significant growth in the vendor finance market and the CIT acquisition and creation of BOQ National Finance provides an ideal growth platform for BOQ. We are planning to create a best in class finance company and to further develop our offering in the profitable motor vehicle finance sector.

We will be enhancing our product suite over the coming year to help us attract new customers and lower our cost of funding. This will include a new SME Business Privileges Package, a Self Managed Super Fund high interest bearing investment account and a new transaction account. We will also be offering a unique new 'Save To Win' account which will enable deposit-holders with a minimum balance to be automatically entered into a monthly cash prize draw.

In 2011 we will also be launching an online share trading service in partnership with CMC Markets Stockbroking, BOQ Trading, further enhancing customer and shareholder value.

Next year we anticipate that we will reach a profit of between \$220 million to \$250 million. We will also be looking to increase dividends to ensure we remain a rewarding investment for our shareholders.



DAVID LIDDY
Managing Director &
Chief Executive Officer