

Note: analysis to 2005 has been prepared on the basis of AGAAP. 2006 analysis has been prepared on the basis of AIFRS.

Wealth Creators Report 2006

Bank of Queensland

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The Wealth Creators Report attempts to answer the most fundamental questions in business



- How much wealth has this business created or destroyed for investors over the past 12 months?
- What returns does the business generate on capital?
- How much growth is built into the company's current valuation?

Agenda

- Refresher on the Stern Stewart Value Management Framework
- Bank of Queensland's 2006 MVA and EVA performance
- Details of the EVA calculation

Wealth creation is a function of cashflows and appreciation in the value of the company

BOQ

Wealth creation 12 months to 31 August 2006

	<u>2006</u> \$'000	<u>2006</u> \$'000
<i>Free Cash Flow</i>		
Dividends paid	\$42,000	
Capital raised*	(\$55,900)	(\$13,900)
<hr/>		
<i>Growth in value of company</i>		
31 August 2006 Market cap	\$1,627,913	
31 August 2005 Market cap	\$1,177,817	\$450,096
<hr/>		
Wealth created		<u>\$436,196</u>
Total Return to Investors (TRI)**		<u>37%</u>

* Includes dividend reinvestment plan

** TRI is calculated as wealth created as a percentage of opening market capitalisation. It is analogous to Total Shareholder Return (TSR)

Of course thought should also be given to how much wealth should have been created

BOQ

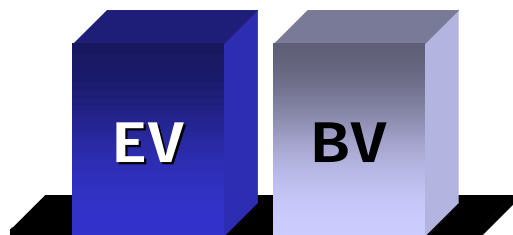
Wealth added 12 months to 31 August 2006

	<u>2006</u> \$'000	<u>2006</u> \$'000
<i>Wealth created</i>		
Free cash flow	(\$13,900)	
Growth in value of company	\$450,096	\$436,196
<hr/>		
<i>Expected return</i>		
31 August 2005 Market cap	\$1,177,817	
Expected return	11.2%	(\$132,151)
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Wealth added		<u>\$304,045</u>
Wealth added as % of opening market cap*		<u>25.8%</u>

*this is analogous to excess return

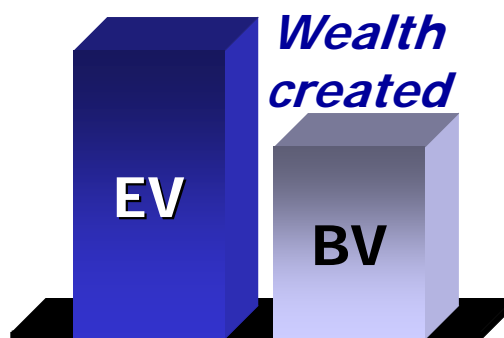
Wealth is created when funds are invested for good returns

Generate returns equal to those required for risk...



...trade at book value

Generate returns above those required for risk...



...trade above book value

Generate returns below those required for risk...



...trade below book value

Leaving the question of price aside, the best business to own is one that over an extended period can employ large amounts of incremental capital at very high rates of return. The worst business to own is one that must, or *will*, do the opposite – that is, consistently employ ever-greater amounts of capital at very low rates of return.

Warren Buffett, letter to shareholders, 1992



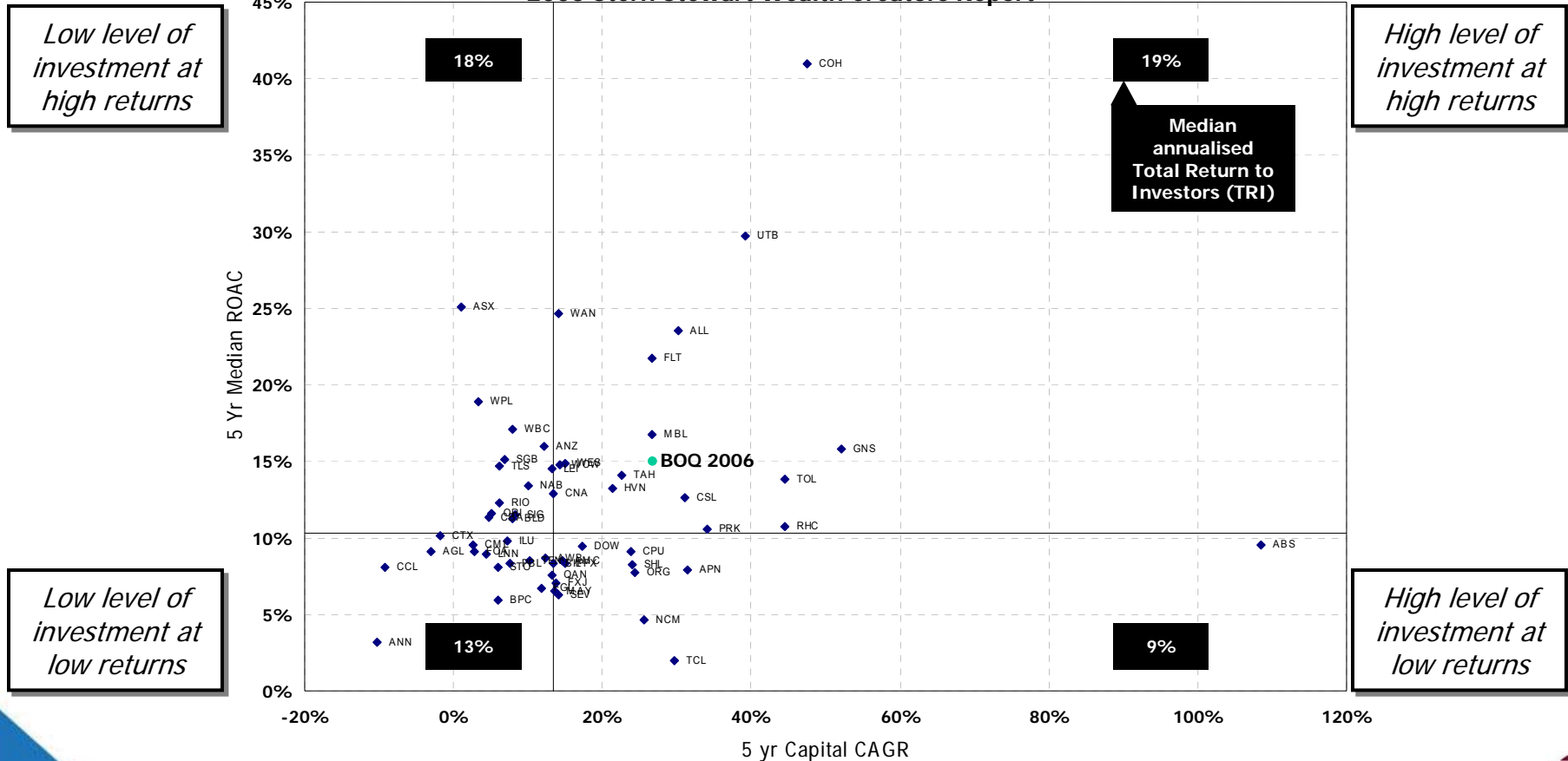
EV = enterprise value
BV = book value

Buffett's insights play out in practice among Australia's largest companies

5 year Total Return to Investors by Return on Funds Invested and Growth in Funds Invested

n = 58

2005 Stern Stewart Wealth Creators Report

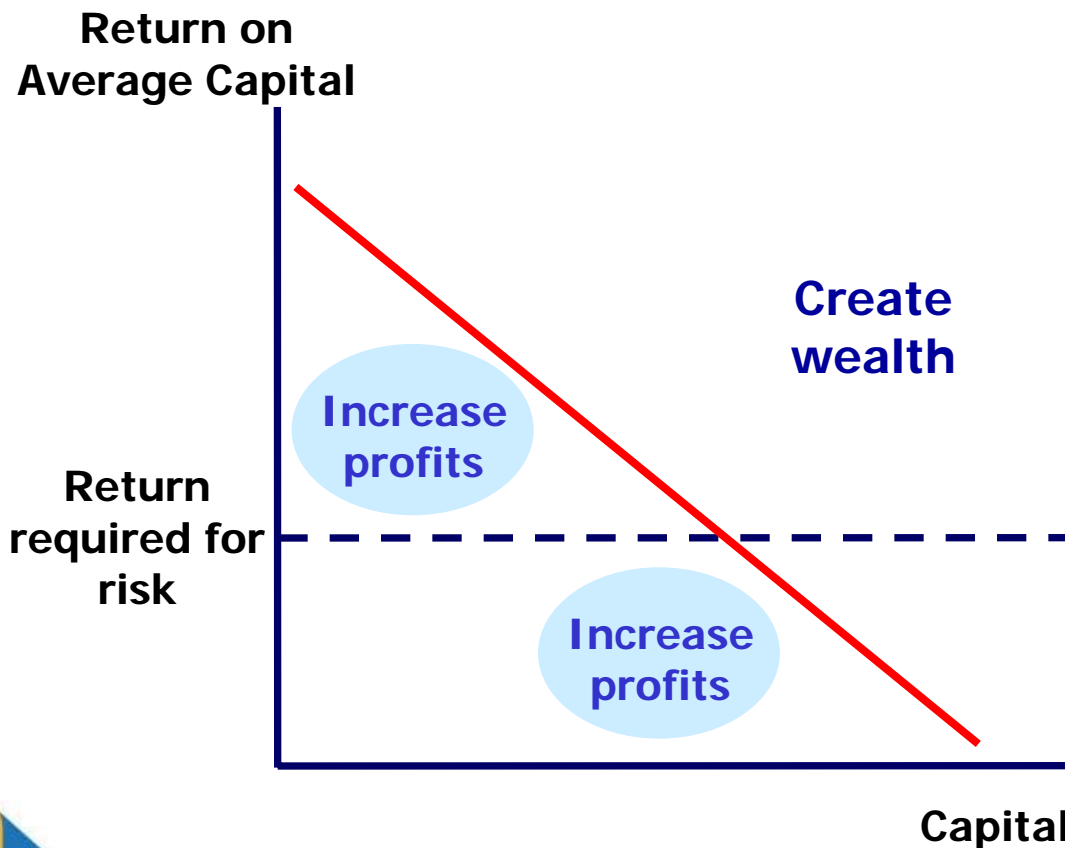


But the accounting framework most businesses follow includes a major trap

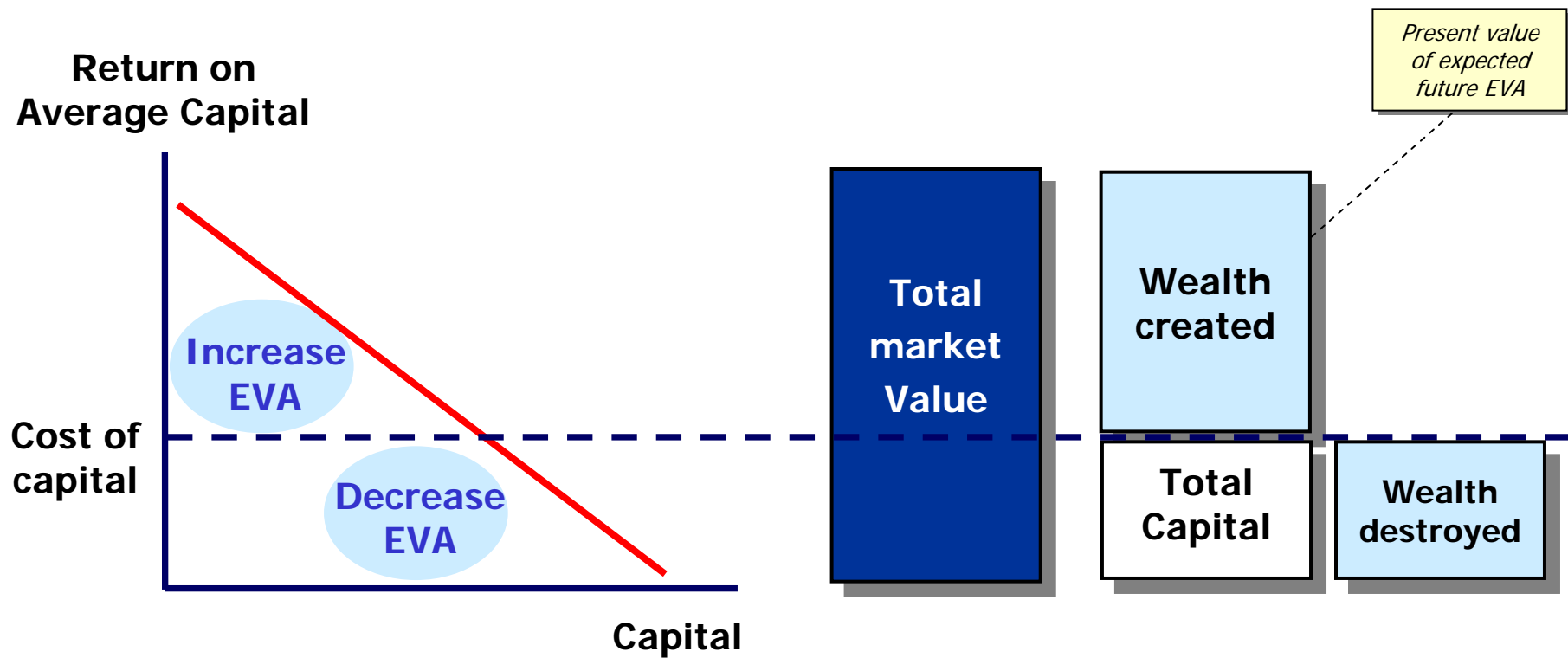
Accounting framework of valuation

Value = Earnings x P/E multiple

Assumes the P/E multiple remains constant



To rectify, we developed EVA[®]



Take on all positive NPV investments, or...

Maximise EVA

For BOQ, EVA was positive during the most recent financial year

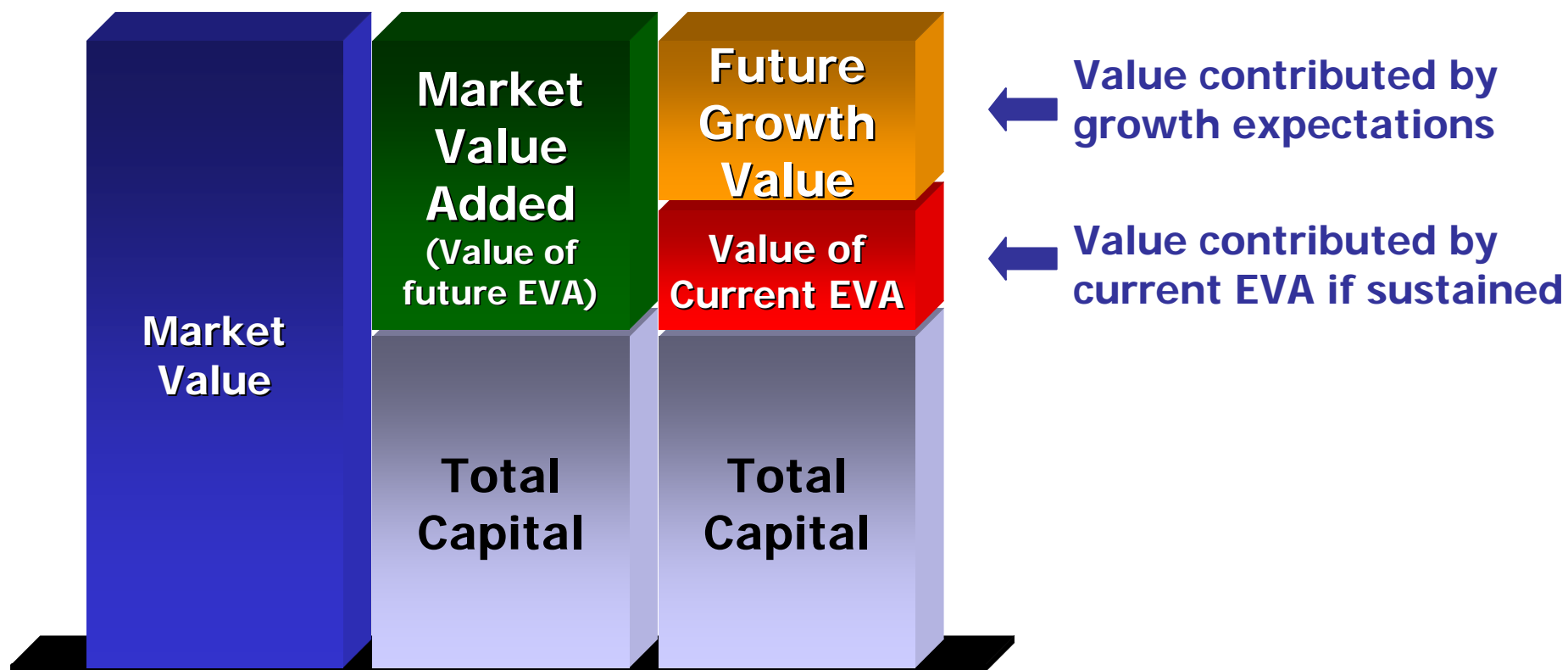
BOQ

Economic Value Added (EVA) Most recent financial year to 31 August 2006

	<u>2006</u>
	\$'000
NOPAT	\$98,800
Average Capital invested	\$640,254
Return on capital	15.4%
Expected return (Cost of equity)	10.1%
EVA spread	5.4%
Average Capital invested	\$640,254
Economic Value Added (EVA)	<u>\$34,455</u>

In practice, valuations look at future returns

Stern Stewart Value Management Framework

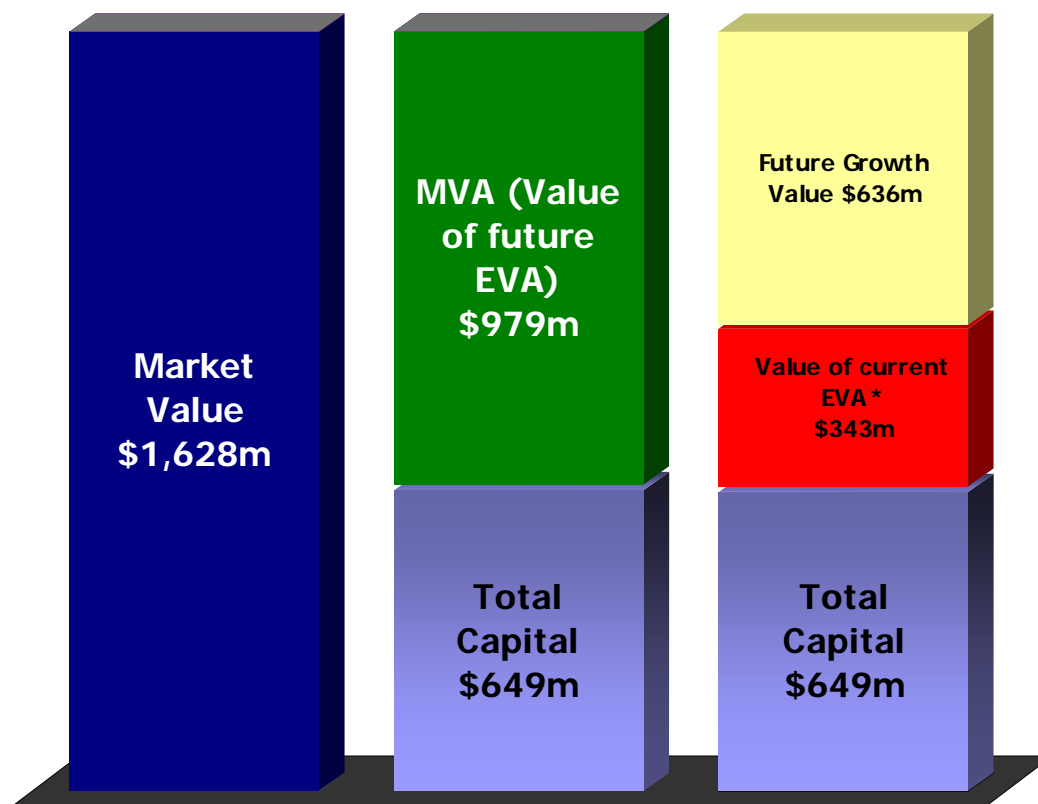


Investors are expecting BOQ's current EVA to grow strongly

BOQ

Based on 31 Aug 2006
share price of \$15.29

Value Management Framework As at 31 August 2006



* Current EVA of \$34m divided by cost of equity of 10.1%

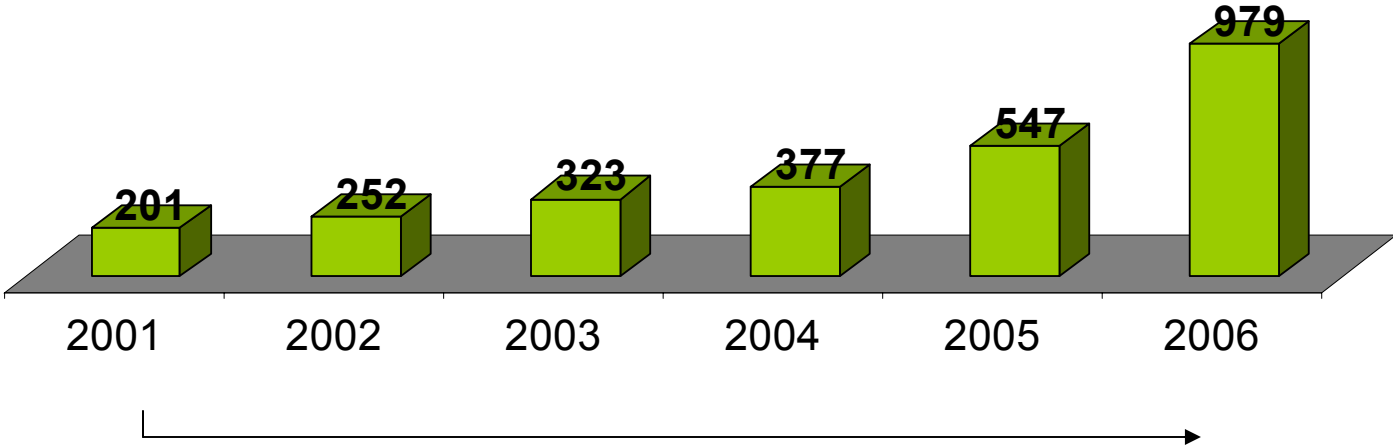
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Bank of Queensland has an impressive history of MVA growth

5 year MVA performance \$m

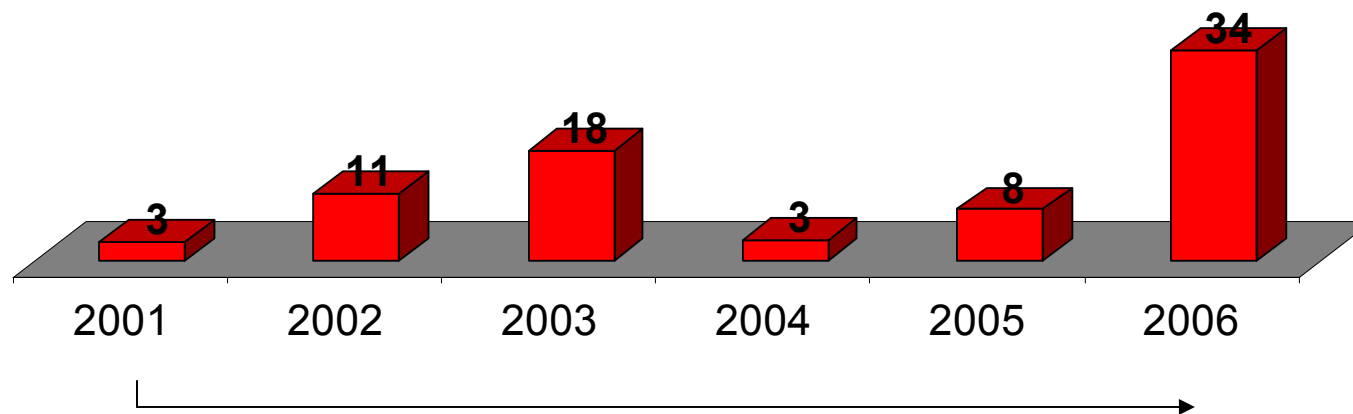


37.2% CAGR
Top 23% of 2005 WCR 100



...driven in part by EVA growth...

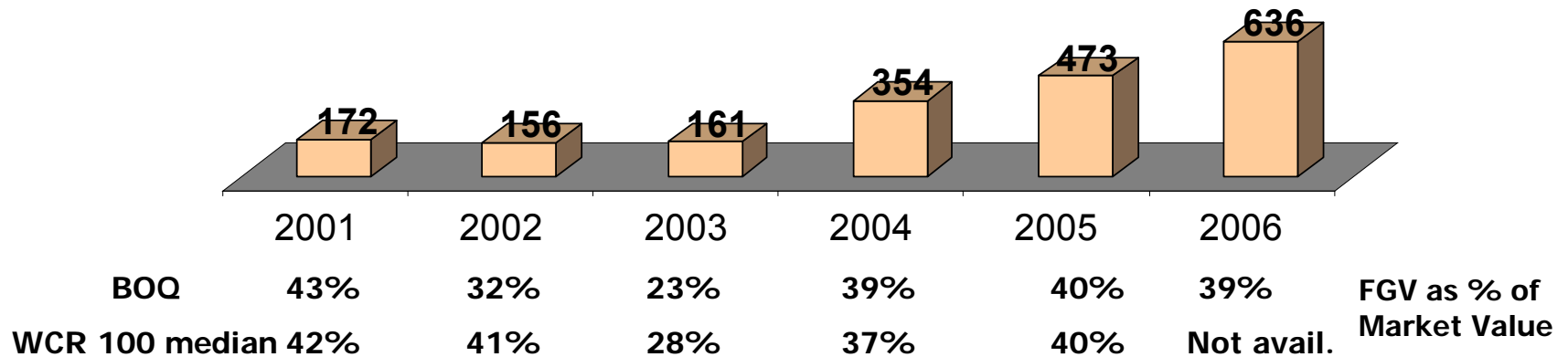
5 year EVA performance \$m



62% CAGR
Top 5% of 2005 WCR 100

...but more aggressively by expectations of future EVA growth

5 year FGV performance \$m



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The underlying numbers reveal strong growth in profits and capital employed

Economic Value Added

Bank of Queensland

Dollars in Thousands

August	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>5 Year CAGR/ Median</u>
<u>Performance Summary</u>							
NOPAT	24,207	35,683	50,889	63,399	73,500	98,800	32.5%
Avg Capital	201,436	219,332	301,906	448,989	581,504	640,254	26.0%
NOPAT/Avg Capital	12.0%	16.3%	16.9%	14.1%	12.6%	15.4%	14.8%
Cost of Capital (C*)	10.5%	11.3%	11.0%	13.4%	11.2%	10.1%	11.1%
<u>Spread Method</u>							
Profit Spread R-C*	1.5%	4.9%	5.9%	0.7%	1.4%	5.4%	3.2%
x Avg Capital	201,436	219,332	301,906	448,989	581,504	640,254	26.0%
EVA = (R-C*) x Average Capital	3,063	10,833	17,800	3,100	8,255	34,455	62.3%
<u>Residual Income Method</u>							
NOPAT	24,207	35,683	50,889	63,399	73,500	98,800	32.5%
Cost of Capital (C*)	10.5%	11.3%	11.0%	13.4%	11.2%	10.1%	11.1%
x Avg Capital	201,436	219,332	301,906	448,989	581,504	640,254	26.0%
Capital Charge	21,144	24,850	33,089	60,299	65,245	64,346	24.9%
EVA = NOPAT-Capital Charge	3,063	10,833	17,800	3,100	8,255	34,455	62.3%
Increase in EVA	(3,489)	7,770	6,967	(14,700)	5,155	26,199	

The cost of equity capital has fallen during the year reflecting a fall in the Group's beta

Cost of Equity Capital Bank of Queensland

as at 31 August	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Risk Free Rate (R_f)	5.82%	5.87%	5.32%	5.69%	5.34%	5.49%
Market Risk Premium (MRP)	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
Equity Beta - Bank of Queensland (β)	0.78	0.91	0.94	1.29	0.98	0.76
Bank of Queensland Risk Premium	4.68%	5.46%	5.64%	7.74%	5.88%	4.56%
Cost of Equity Capital (K_e)	10.50%	11.33%	10.96%	13.43%	11.22%	10.05%
NOPAT/Average Capital (R)	12.02%	16.27%	16.86%	14.12%	12.64%	15.43%

Cost of Equity = Risk Free Rate + (Beta × Market Risk Premium)

Note: Beta data is from the AGSM Centre for Research in Finance.

We need to make adjustments to accounting numbers to determine an economic picture of Bank of Queensland's performance

Accounting Framework

Income Statement

Balance Sheet

Cash Flow

Adjustments



For example, should the changes in the General Provision be included in profit or should we wait until losses are actually incurred?

EVA Framework

NOPAT

Capital Employed

EVA

The key difference between accounting profit and economic NOPAT is the treatment of significant items

2006 NOPAT Calculation Bank of Queensland 2006-Base Dollars in Thousands

<u>Operating Profit</u>		<u>NOPAT</u>
1,017,000	Interest revenue	1,017,000
747,200	- Interest expense	747,200
269,800	Adjusted Net Operating Profit	269,800
115,200	+ Non-interest income	115,200
(12,300)	+ Provision for bad and doubtful debts	(12,300)
(239,814)	+ Other Income	(239,814)
(9,286)	+ Significant items	
	- (Incr) in Doubtful debt reserve	(1,500)
123,600	Adjusted Income Before Tax	134,386
30,900	- Taxes / Cash Operating Taxes	35,586
92,700	Net Income / NOPAT	98,800

There are a number of differences between accounting and Economic Capital

Capital - Financing Approach

Bank of Queensland 2006-Base

Dollars in Thousands

August	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Common Equity	171,295	200,495	320,300	482,100	594,400	689,800
Revaluation Reserve	(1,036)	(1,036)	(200)	(200)	0	0
Deferred Taxation Asset	(9,671)	(11,444)	(15,000)	(33,300)	(36,400)	(81,000)
Deferred Taxation	10,330	11,137	14,200	21,600	23,700	27,100
Net Deferred Income Taxes	659	(307)	(800)	(11,700)	(12,700)	(53,900)
Cumulative significant items AT	5,638	10,074	10,074	7,204	(8,296)	(1,796)
Doubtful debt reserve	24,371	28,511	36,700	53,000	56,200	13,800
Accum Goodwill Amortization	0	0	0	1,500	1,500	1,500
Other Adjustments	30,009	38,585	46,774	61,704	49,404	13,504
Adjusted Common Equity	200,927	237,737	366,074	531,904	631,104	649,404
Capital	200,927	237,737	366,074	531,904	631,104	649,404

Cash operating taxes rose in 2006

Analysis of Cash Taxes Bank of Queensland 2006-Base Dollars in Thousands

August	<u>2005</u>	<u>2006</u>
Tax paid as per the cashflow statement	34,500	32,800
Less Taxes on:		
Significant items	8,100	(2,786)
Cash Operating Taxes	26,400	35,586

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