Managing Director's address

2012 Annual General Meeting

Thanks Neil and good morning ladies and gentleman.

First of all I'd like to thank you all for coming along today – I'm still a little new to this but I look forward to chatting with you after the formalities.

It's been a busy 12 months since I last stood before you for the first time last year. Today I'd like to start by giving you my view on the broader environment we're operating in, including how that will affect BOQ. I'll also provide a recap on the year that was, before outlining the way forward for the business and why I'm confident about the future.

Macro environment

- Starting with the macro environment, there are a number of changes that have had an impact on us over the past 12 months, and will continue to have an influence on us in the year ahead. We're seeing moderate economic growth in Australia, supported by lower interest rates and assisted by demand for our natural resources and growth in Asia, but offset by continued uncertainty and fears about what's happening in Europe and the US.
- Firstly, China appears to be stabilising and improving on its growth outlook after a slowdown.
- However, continued uncertainty over fiscal cliff scenarios in the US has combined with ongoing concerns over the debt burden of some EU nations, austerity measures and economic contraction. Notwithstanding the long lead times in achieving progress, I am hopeful that the relevant authorities will find a way to series of longer term solutions to the crisis.
- In Australia this uncertainty, which has been compounded by the unstable domestic political environment, has meant businesses and consumers have been paying down debt faster than in the past and are showing less appetite for credit. This means asset growth in the banking sector has been subdued and we're also seeing competition for deposits increase as all banks seek to adjust their funding mix towards retail term deposits, which are viewed as a more stable source of funding by credit ratings agencies and regulators. This competition is putting pressure on margins and net interest income, which in the past have been influenced more by the loan side of the balance sheet but in this environment it's deposits that are creating the shrinkage. With the shift towards fee free transaction accounts we're also seeing pressure on non-interest income.
- Looking closer at the QLD economy, and we've seen significant decreases in property values in parts of South-East QLD in particular, as unemployment has increased and businesses and consumers are deleveraging. We've seen the effect of this directly in our loan portfolio, and I'll talk about the actions we've taken to address this shortly.

- The other key macro trend I'd like to highlight today is the shift in consumer preferences for how they deal with banks and bank products. On the one hand, we're seeing a technology driven shift towards online, mobile, social media and other direct service channels for simple products and transactions, whilst on the other hand we are seeing continued movement towards brokers for more complex product purchases such as home loans. These are important trends because they influence how customers learn about, search for and apply for financial products. It also impacts the way they choose to interact with us for transactions and enquiries. I'll talk you through how we're adapting to these trends shortly, but first I'll provide a recap on the 2012 financial year.

2012 recap

- The past year has been about getting the fundamentals of the bank right. We completed a capital raising earlier in the year and increased provisions to provide a sounder foundation for growth in the current environment, strengthened our risk management framework and refreshed our leadership with a new and highly capable team.
- While these factors meant we reported a loss for the full year, which I know has created a lot of headlines, it was a reflection of the prudent provisions we've taken to protect the bank from what has been a severe downturn in property prices in some areas of Qld.
- It was necessary to strengthen the fundamentals of the bank and we have now achieved that.
- However, what shouldn't be forgotten is that, as the Chairman has outlined, through this transformation the underlying performance of the bank remained healthy.
- Our normalised underlying profit – the reflection of our underlying business performance – was largely in line with the result of the prior year with a profit of $443.5m. This fact provided the Board with the confidence to pay dividends totalling 52c for the year, a signal of the confidence they have in the underlying business.
- Our loan growth was subdued, in line with the broader market and the general economic conditions I've just spoken about , and as a result of the forced run-off of a number of non-performing assets
- By comparison, our retail deposit growth was solid at 10%, bringing our retail funding mix to 59% and on track for our longer term target of 63%.
- We also managed to improve our net interest margin to 1.67%, compared to 1.65% in 2011, which is quite an achievement considering most of our competitors have been going backwards on this metric.
- Importantly, we've also demonstrated a return to profitability in the second half of the year with a normalised cash profit of $103m for the second half, showing that the business is back on track after the impact of increasing provisions in the first half.

What does this all mean?

- As I mentioned, we now have stronger foundations in place with capital levels and provisioning coverage at or near the highest in the industry, which provides credit ratings agencies and regulators with confidence that we are managing the business prudently. We've also completed a detailed review of our loan book and enhanced our risk management framework, which has included the following components:

- Substantial risk appetite and credit policy changes across a range of areas including Loan to Valuation ratios, valuation practice and property finance lending criteria;
- New retail scorecards and underwriting standards to improve retail portfolio quality and lower bad and doubtful debt expense in future years;
- A substantially expanded Asset Management Group to more effectively manage the weak and impaired commercial portfolio exposures; and
- Extensive commercial loan portfolio follow-up reviews have been undertaken, focusing on exposures greater than $1m.

- This provides us with confidence that we understand the existing loan book and know that the quality of business we are writing going forward is acceptable.
- We have introduced a new management team, which we've brought on progressively over the past 12 months. These talented individuals will help deliver our strategic objectives over the coming year.
- Each of the executives we've recruited have left promising careers at other organisations to join BOQ because like me, they see the potential in this business and are confident that we can make a difference and take it to new heights.
- I've spent a lot of time personally on key leadership positions, and have actually worked with a number of the individuals in the past. I know that they bring with them a high degree of skills and expertise, but also the personal traits of integrity, passion and work ethic, which are key to our sustainable success going forward.
- BOQ is in a unique position – because of our size, culture and operating model, we really do have the opportunity to take up the fight to the major banks by providing customers with a proposition that they can't get elsewhere, but there is some work to do to ensure we reach our potential.

The way forward

That is a summary of where we have come from in the last 12 months. I now want to turn to the future.

- Through our refreshed strategy we are focusing on 4 key areas
- Number 1 is Multi-channel optimisation, which is a mouthful but essentially means serving our customers in the way they wish to do business with us - be it face-to-face in-branch or through a broker, over the phone, online or via social media. As customers' preferences change, we need to make sure we keep up with them, otherwise we won't attract any new customers and we risk losing our existing ones. Choice is the key.
- To give you an idea of the ground we have to make up in this space, the average household footings, or total loans and deposits, per branch are around $150m, compared to $300m for the major banks and $450m for the best performing competitor. The reason for this is that they use online channels and brokers to complement their branch networks, which increases the options for attracting new customers.
- This is something we have been missing out on due to our predominantly branch focused distribution which provides approximately 90% of our new business. By opening up new broker and online channels, we significantly increase the opportunity to attract and retain customers.
- That's number 1 of our new four step strategy.

- Number 2 is Risk-Return balance, which means we are focused on targeting and attracting more profitable relationships, by making sure we cover all of our customers product needs and ensure we get the right reward for the risks we take.
- We have not always done this as well as we should but your new management team is focused on making this one of the bank's strengths.
- In a lower credit growth environment, where higher margin returns and fee income will become increasingly important, it is a critical factor in our future success.
- We've built up our capability in the Business Banking space, moving selectively into the Agribusiness sector and we are introducing financial market products that allow our customers to better manage their interest rate and exchange rate exposures.
- We want great and supportive customers, and we want to service them for the long-term.
- Our third area of focus is operational excellence. What I've found since I've come into the business is that our internal structures and processes have not been anywhere near as efficient as they need to be in a low revenue growth cycle.
- As a result, we've taken action to reduce the layers of management in the organisation and consolidated functions and processes that have been duplicated in different parts of the business. We're also taking a hard look at our retail and commercial lending processes, and are looking at smarter ways to make things simpler for our staff and customers.
- To give you an example, what we call the average 'time to yes' for our home lending process currently sits at around 84hrs, whereas the best in market is down to about 1hr – this is to do with our processes which we are focused on improving.
- Customers increasingly expect quick decisions. We need to provide that level of service if we want to compete.
- We're also exploring a different approach to technology, partnering with providers who can give us access to global scale for a fraction of the cost that our larger competitors are incurring to overhaul their own systems. This is an area where we can use our smaller size to our advantage, but we need to be smart about the way we do things and make sure our processes are as simple and efficient as possible. We still have some work to do in this space.
- The fourth and final area of focus is making sure we have the talent, capability and culture to deliver on the other 3 objectives I've just discussed. I've talked about the strong leadership team we now have in place, but we're also looking to make sure we're effectively utilising our people, and to do this it's critical that all of us are working towards the same goal, so we're refreshing our internal culture and we are looking at the external representation of this – our brand – to ensure all is aligned and heading in the same direction.

Competitive advantage

- That's our strategy. We are committed to it because we believe it will work. It will make us more competitive and provide us with a solid foundation for sustainable growth.
- Looking at multi-channel optimisation – we already have unique relationship with our core customers through our owner managed branch network, but by complementing this with broker and online channels

to serve customers where and how they want, and with a renewed focus on corporate branches, we are in a much better position to further enhance these relationships.

- Online and broker channels also gives us the opportunity to gain geographic diversity, by attracting customers in areas where we don't necessarily have a branch. That may be in Queensland or it may be interstate where millions of potential new customers live.
- The OMB model has been our key competitive advantage in the past and will continue to be in the future. We will look to enhance it by providing customers with better access through multiple channels.
- We'll initially be piloting the use of brokers in Western Australia early next year – now you may ask why WA? Well WA continues to demonstrate strong economic growth and it represents a significant opportunity for us to improve our market share to match a solid branch footprint. Customers in WA are also more inclined to use brokers, so we need a multi-channel approach to increase our share in that market. We've already taken steps to improve our performance in WA with a reinvigorated leadership team and retention program to reduce run-off. As a result, positive signs in our asset growth trend are already evident. We'll continue looking to expand our use of brokers in areas where we don't have a strong branch presence and where it makes sense to do so.
- Looking at Risk-Return balance, the capability to target more profitable customer relationships instead of a one product focus means we are enhancing our return profile, and more stringent lending practices mean our bad and doubtful debts will trend down.
- In terms of operational excellence, there is plenty of low-hanging fruit to improve our processes which will keep our costs below inflation and enhance our branch productivity so we can focus on attracting and better serving our customers.
- And building capacity to innovate quicker than our competitors means we can be a step ahead and react quicker to keep up with the pace of change in the area of technology in particular.
- When it comes to our people, having a leadership team capable of delivering on these objectives, combined with a culture that can't be matched is a critical success factor. During the year we announced a relocation of our Brisbane head office to a site at Newstead in 2014, which will enable us to take our cultural advantage to another level in a purpose built environment that will be more conducive to collaboration, flexible working conditions and improved productivity.
- So as you can see, we have a lot of advantages which enable us to compete with vigour and provide real benefits to our customers.

Current trading position

- As evidence that the strategies we embarked upon around 12 months ago are starting to gain traction, underlying earnings after 2 flat years have now resumed a positive trajectory. Further, as the chart behind me shows, we are on track to meet the internal management targets that we disclosed in October of this year.
- Asset growth is in line with system, our margin is within the target range, Expense growth is contained and with regard to Bad & Doubtful Debts, new problems and write-offs are in line with internal estimates.

Summary

- To sum up then, it has been a challenging year, but we've taken the steps required to get the fundamentals of the business right and provide a more stable platform for growth.
- We've been through the loan book and made sure it is well provided for. Your bank is much stronger for it.
- We have a new strategy in place which will enhance our competitive advantage.
- These factors combined mean I am confident about the future of BOQ, while still being mindful of the macro risks that are affecting all banks.
- Thank you again for joining us today and I hope you're as excited about the future of BOQ as I am.

Stuart Grimshaw
Managing Director and CEO
13 December 2012