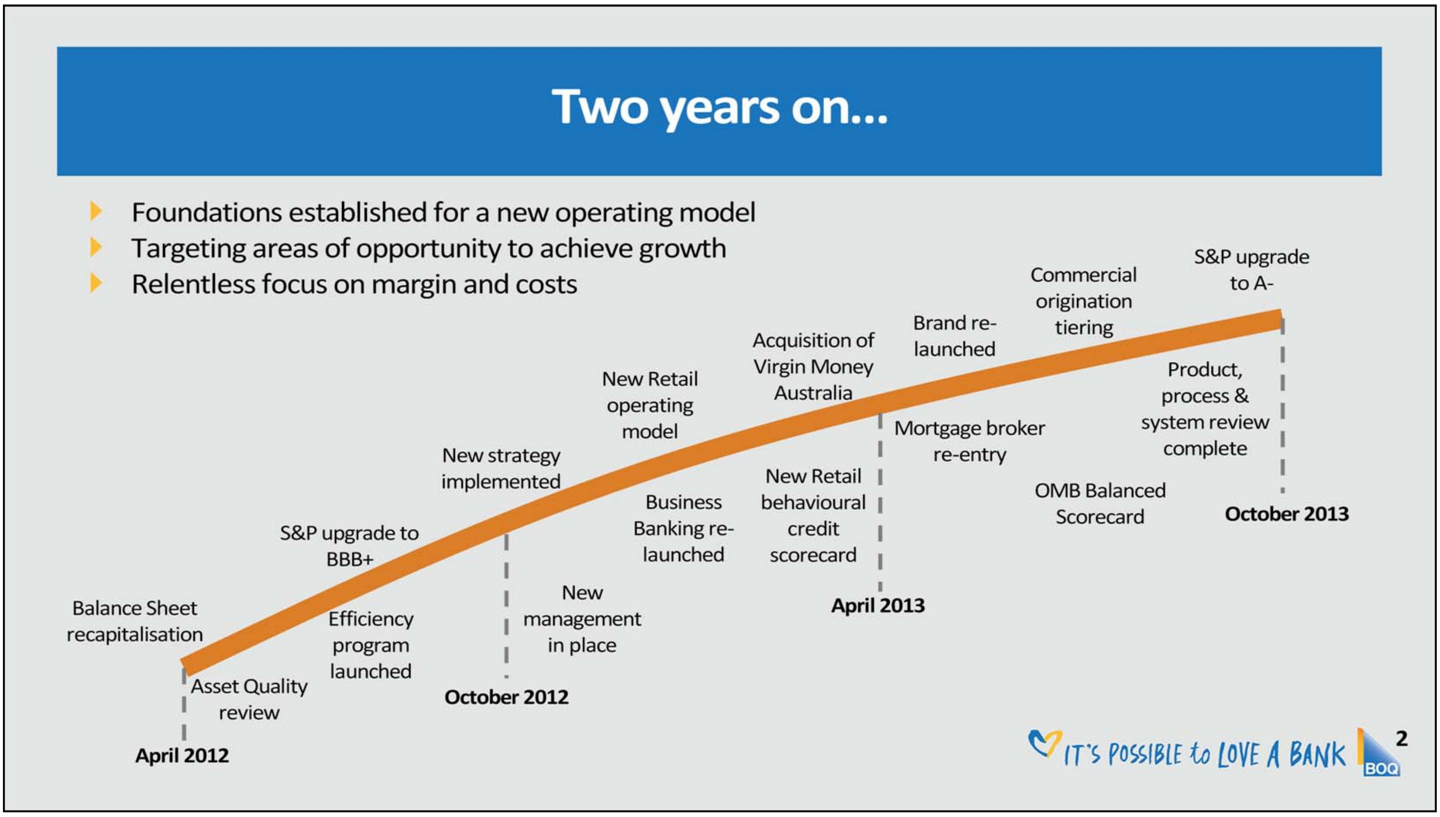
Managing Director's update

Stuart Grimshaw
Managing Director & CEO

Annual General Meeting
27 November 2013

IT'S POSSIBLE to LOVE A BANK



Thank you Roger and good morning ladies and gentlemen.

It is a little over two years since I started at BOQ and, in that time, the organisation has made significant progress in responding to the issues it faced as well as establishing the foundations that will underpin future growth.

I am the first to admit that my first 12 months here were particularly challenging.

The Bank was weighed down by a combination of internal legacy issues and its exposure to the Queensland property market which had been devastated by a series of natural disasters including the 2011 floods which affected much of the State.

We had to make very difficult decisions regarding the Bank's capital position, risk frameworks and organisational structure which affected our shareholders, customers and staff. The performance of our business since then has shown that those decisions were the right ones.

In the last 12 months, we implemented and made significant progress with our new four pillars strategy:

- a new executive team has had the first year together and has performed strongly over the course of the year;
- we opened up new ways for our customers to do business with us including through the extremely important mortgage broker channel which accounts for about 50 per cent of home lending in Australia;
- we acquired Virgin Money Australia, giving us access to an entirely new set of customers and platform for distributing BOQ products;
- we re-launched our brand; and
- we made changes to our branch network which we believe will help both corporate and owner-managed branches better reach their potential.

We have continued to work hard on our risk settings to ensure we are receiving an appropriate return for the business we take on; we have targeted areas of opportunity to achieve growth, rather than chase growth for growth's sake; we have reviewed our products, processes and systems and are addressing legacy issues we uncovered; and, while achieving all of this, we have maintained a relentless focus on margin and costs.

Our hard work is evidenced by the sound profit performance of the past 12 months.

We announced record financial results for the 2013 financial year and higher returns to shareholders through increased dividends. We are in the process of building a stronger and more sustainable business, which will position us well for the future.

Our focused strategy, financial strength and strong business performance has been validated by the decision of ratings agency Standard and Poor's to upgrade our long-term credit rating twice in the last eighteen months – we believe that we're the only bank in a post-GFC world that has received two upgrades in such a short space of time. We now have an 'A-' credit rating, which is the highest credit rating the Bank has ever held and which should increase the range of funding opportunities available to us and, over time, help lower our cost of lending.

While we are conscious of never resting on our laurels, we do believe the work we have done over the last two years puts us in a sound position from which to grow.

FY13 highlights - back in the black

	FY13	FY12	Change FY13 v FY12
Underlying profit before tax (Cash)[1]	$477.4m	$443.5m	▲ 8%
Cash earnings (loss) after tax	$250.9m	$30.6m	▲ Large
Statutory net profit (loss) after tax	$185.8m	($17.1m)	▲ N/A
Ordinary dividend	58¢	52¢	▲ 12%
Net interest margin (Cash)	1.69%	1.67%	▲ 2bps
Cost-to-income ratio (Cash)	44.3%	45.7%	▼ 3%

(1) Profit before loan impairment expense

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BOQ 3

As mentioned, the work we have done is driving stronger financial returns.

Underlying profit was up 8% year on year, a direct result of our disciplined approach to growth, margin and expense management.

Our capital position remained strong with common equity tier 1 and the total capital adequacy ratio remaining at market-leading levels of 8.63% and 12.24% respectively.

Our strong financial performance and the Board's confidence in BOQ's future prospects resulted in the full year dividend increasing by 6 cents – or 12% - to 58 cents per share.

These results demonstrate that through strong execution, we've established a platform of lower risk, lower volatility and sustainable returns for shareholders.

Financial performance comparison

Metrics[1]	BOQ	Major 1	Major 2	Major 3	Major 4
Revenue growth (%)	5	3	7	2	4
Expense growth (%)	2	-3	4	4	5
Pre-provision profit growth (%)	8	9	9	-1	4
Margin change (bps)	+2	-9	+4	-9	-2
Cost to Income (%)	44.3	44.8	44.7	44.0	40.9
BDD Charges to Total Loans (bps)	32	26	19	37	16
Total Shareholder Return (%)	86	43	36	53	40

(1) Source: UBS & IRESS. Total Shareholder Return is 1 year return as at 26 November 2013.

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As we break down the performance a little more, this chart shows our performance for the financial year compared favourably with that of the major banks.

We were more than competitive on all key measures including:

- total shareholder return, which at 86% was better than any of the majors for the 12 months to yesterday; and
- underlying profit, where our growth of 8% was at the top end of the scale.

Our revenue and expense growth stood up favourably compared to the majors. We also protected our margins, our cost to income ratio continued to come down and bad and doubtful debt charges to total loans fell significantly.

6 out of 7 key management targets met

Metrics[1]		FY13 Actual	FY13 Target	FY15+ Target[4]
BOQ asset growth				
-Retail	✗	0.6x system	1.0x system	1.2x system
-Business[2]	✓	3.6x system	1.0x system	1.5x system
Net Interest Margin	✓	169bps	Low-Mid 160s	Low-Mid 160s
Expense growth	✓	2%	< Inflation	< Inflation
Cost to Income	✓	44.3%	45%	Low 40s
Bad & Doubtful Debts to GLA	✓	32bps	28-34bps	~20bps
Return on Tangible Equity[3]	✓	11.9%	~10%	13%+

These are internal management targets and are not forecasts or projections

(1) Cash earnings basis
(2) Excluding the impact of impaired asset run-off; includes Commercial and BOQ Finance
(3) Excluding goodwill and other intangibles
(4) Excludes Virgin Money Australia

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Further evidence of our progress was provided by the fact that we met six out the seven key management targets we had set ourselves.

I've touched on most of these areas already but I wanted to talk briefly about the management target we didn't meet – retail lending growth – before giving you a sense of our progress against the four pillars that make up our strategy.

Part of our mortgage lending portfolio has been a home equity line of credit which, over the years, has developed a higher risk profile than our more traditional home lending portfolio. The LOC portfolio is now approximately 16% of the total home loan exposure which is down from 23% a few years ago. This deliberate run down in this portfolio has meant that we have ceded market share – excluding the LOC run-off, our home lending growth would have been 1.1x system. As we have always said we will not chase market share at the expense of weakening our risk parameters.

Competition in the mortgage market has intensified significantly in recent months, with the majors offering heavy discounts, cash back offers, 10 year interest only terms and broker incentives to keep their engines running.

We did participate with some cash-back offers of our own in the first half but in recent months the incentives have risen to levels where we haven't seen for some time.

We are focusing on attracting profitable customers – particularly by pursuing growth through our Business Banking expansion where we achieve higher margin, higher return commercial lending to quality business & agribusiness customers.

Turning to our strategy, we have made good progress on each of the four pillars.

Multi-channel distribution

Although our owner-manager and branch network has always been, and will continue to be, an essential part of our distribution network, it is important we give customers more choice in how they want to interact with us.

We established a successful mortgage broker program and improved our digital and online banking offerings.

We also acquired Virgin Money Australia, giving us access to an incredibly powerful brand, digital expertise and a further platform to offer banking products to different customers.

Risk/Return balance

Underlying improvement in the credit quality of our portfolio was evidenced by improvement across all key metrics.

To achieve the right balance of return for risks taken, we diversified our balance sheet by pursuing higher margin and higher return on equity segments in business banking and agribusiness.

We also introduced a new balanced scorecard for owner-managed branches that balances lending, deposits, cross sales and compliance components and closely aligns the interests of owner-managers and BOQ.

Operational excellence

Operational improvements mean we are now a far fitter organisation. During 2013, we continued to consolidate back-office operations and remove administrative tasks from branches.

There is still more work to do in this area as August's announcement regarding legacy product issues showed.

As we improve the way we do things by introducing new products and initiatives such as simplified lending processes, these types of issues will be minimised. Our new Clear Path lending product is a good example of this improvement.

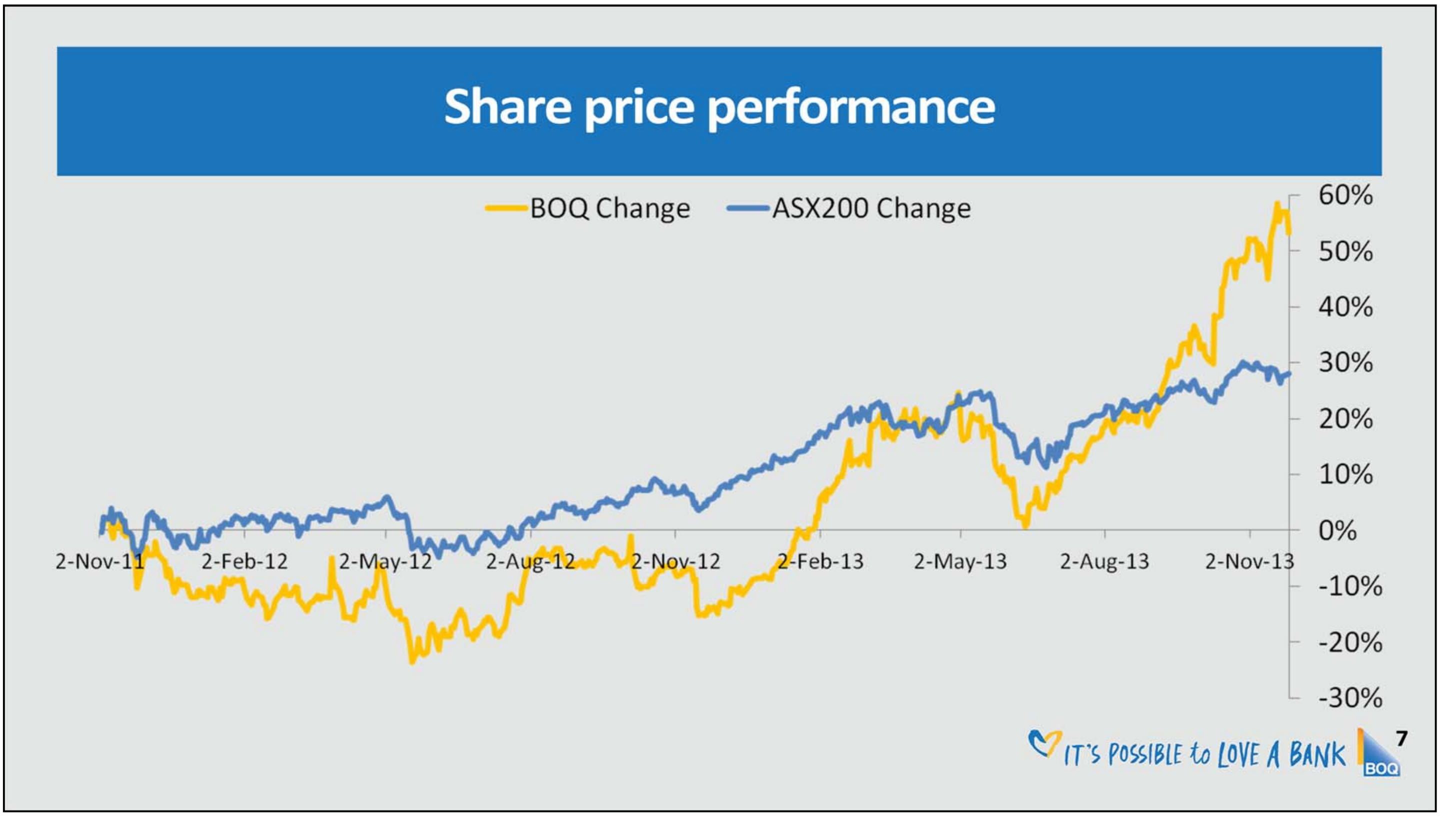
Talent, capability and culture

In a relatively generic financial services market, our organisation's talent, capability and culture continue to differentiate us from competitors and reinforce our challenger model.

Our ongoing focus on customer service, together with the fact that we are one of the few remaining independent banking options in the local market, increasingly provides us with opportunities to successfully compete in attractive market segments.

The essence of this positioning strategy is captured by our new branding position, "It's possible to love a bank".

Our ability to deliver this brand position clearly depends on the ability of our people to build long-lasting customer relationships and to go the extra mile for customers wherever possible. Because of our size, culture and operating model, we believe we are the best positioned of all the Australian banks to consistently achieve this goal.



Over the last two years, we've spent a lot of time in front of the market explaining what we've changed about our business and the difference that these changes will make in the future. In that time, we have delivered steady improvements with each reporting period and have been able to demonstrate the progress we are making.

I think it is fair to say that the market has greater confidence in our organisation, our strategy and our ability to deliver what we say we will deliver. This confidence is represented in BOQ's recent share price performance.

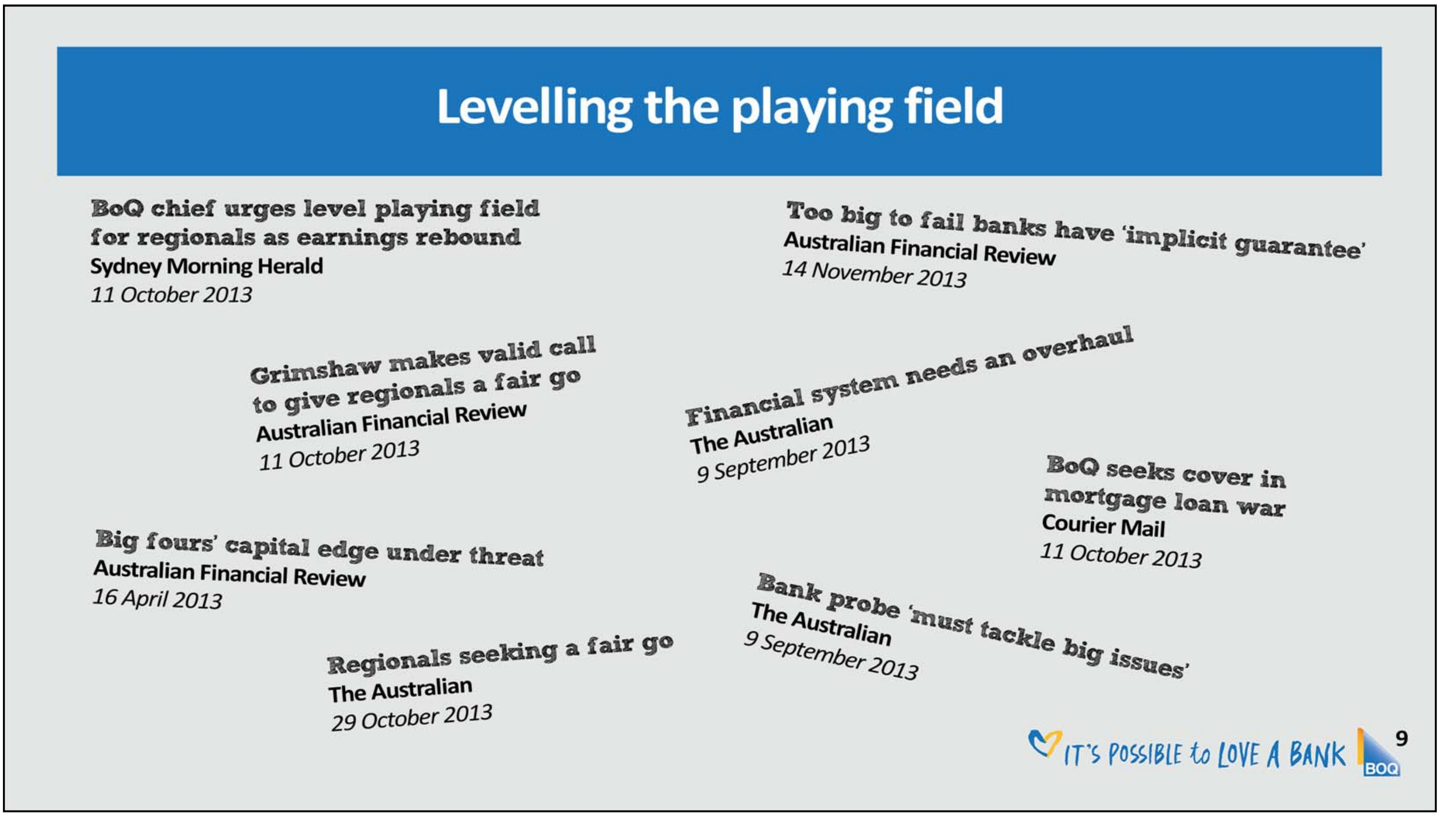
Since the upgrade to 'A-' in September and the announcement of our full year result in October, we have seen BOQ's share price start to outperform.

That being said, we know that our job isn't done yet and we need to keep delivering in fairly challenging market conditions if we are to reach our full potential.

Looking forward, as it has been for the past two years, it's all about execution.

We're largely implementing strategies that others have successfully implemented – it's basic banking done well.

Our ability to build great relationships with our customers sets us apart from our competitors – we will continue to use this advantage to build our business.



Before finishing up, I want to spend some time talking about some of the challenges our market and regulators – and those around the world – are grappling with and the challenges and opportunities that the Government's upcoming Financial System Inquiry provides.

Roger has already talked about the domestic economy and the headwinds that we're facing in a low credit growth economy.

Suffice to say, it's not easy out there at the moment especially in sectors such as small business. Hopefully, the New Year will bring renewed confidence that translates into investment decisions and results in economic growth. A fall in the value of the Australian dollar would also provide some stimulus for the tourism, retail and service sectors, particularly in our home state of Queensland.

Last week, the Federal Government announced the draft terms of reference and proposed timetable for their Financial System Inquiry. The Inquiry provides an important opportunity for Australia to review the effectiveness of its banking system, including the role that regional banks such as BOQ have to play.

We think it is vital that the Government doesn't miss this opportunity to remove barriers that currently prevent regional banks from competing on a level playing field.

The simple fact of the matter is that the pace and volume of regulatory reform in recent years has increased. As a result the costs of compliance are increasing and this cost is falling increasingly heavily on the smaller businesses where the ability to ameliorate the cost over a small expense base is difficult. It is a common proposition that. as regulatory compliance increases. the cost burden falls disproportionately on the smaller players.

A related issue that is increasingly occupying the minds of regulators here in Australia and overseas is that the Inquiry must address the issue of banks being ‘too big to fail’. This occurs where there is potential for the failure of large, complex financial institutions to severely disrupt the financial system and economy, requiring government intervention to prevent the failure.

The International Monetary Fund raised the issue of the Big 4 banks being ‘too big to fail’ in its Financial System Stability Assessment of Australia last year and, as I mentioned, it is increasingly an issue being raised by regulators in other markets such as the US.

Indeed, ratings agency S&P recently said it boosts the credit ratings of the Big 4 on the assumption that they would receive extraordinary government support in the event of financial difficulty.

At a recent Global Economic Policy Forum in New York, the CEO of the Federal Reserve Bank of New York William Dudley outlined the considerable economic risks of having banks that are considered ‘too big to fail’.

As he points out, banks considered too big to fail gain an implicit guarantee at the taxpayers’ expense that they don’t have to pay for. This creates an uneven playing field between large and small financial firms, with larger firms gaining credit rating, and therefore funding, advantages. We estimate this funding benefit saves the major banks over a billion dollars collectively each year.

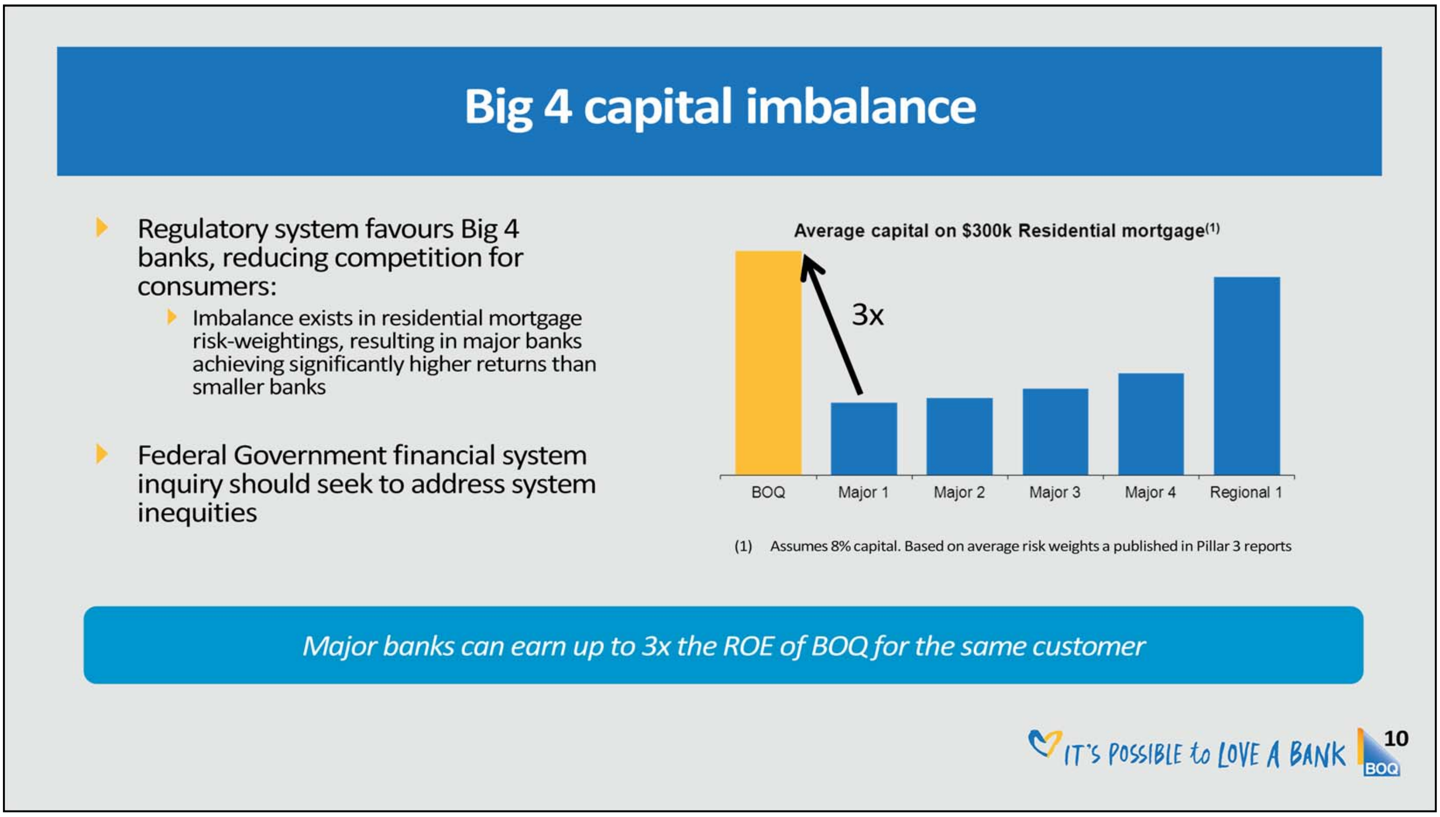
In many jurisdictions around the world, additional capital requirements have been introduced to reduce the risk of systemically important bank failures, which if introduced in Australia could require the major banks combined to increase their capital by up to 14 billion dollars according to a recent Morgan Stanley report – this would go part of the way to reducing their Returns on Equity and therefore help to level the playing field.

In Australia, the reality is that the funding advantage the big banks currently enjoy creates incentives to become bigger and more complex.

As the banking system becomes more concentrated and complex, that further increases the financial stability risks making the ‘too big to fail’ problem even more acute.

With a combined share of around 85% of the market, the Big 4’s market share is as concentrated as it has ever been. The reality is that they do provide the cornerstones of one of the safest financial systems in the world. And, quite frankly, it is their sheer size and transactional nature that provides opportunities for banks like us to offer customers far superior service and tailored product offerings.

What we’ll be pushing as part of the Financial System Inquiry will be the removal of some of these inequities that prevent regional banks from competing on a more equal footing than they are currently able to. This should provide consumers with more banking choices and, in time, go some way towards reducing the market concentration risk that currently sits with the Big 4.



An example of how the current regulatory system favours the majors is the issue of the residential mortgage risk weightings.

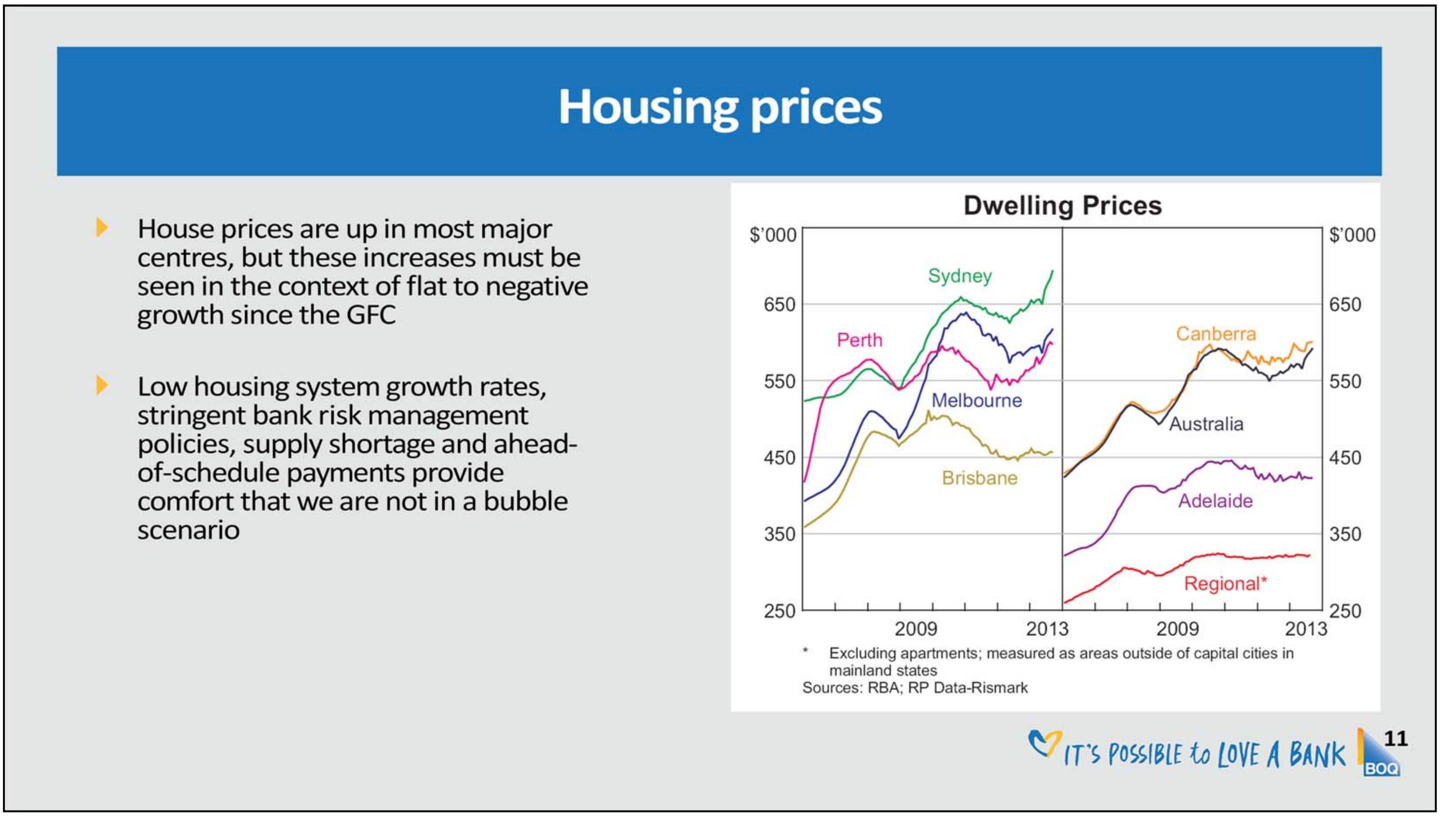
What this effectively means is that if any customer were to walk into one of the major banks for a home loan, the major bank would hold as little as one third of the capital against that customers mortgage as we would if the loan was with us.

This means that the majors can be earning as much as 3 times the return on the exact same customer. While some may argue that the major banks have more sophisticated risk modeling, I don't think it's unreasonable to question whether such a stark differential is really warranted.

We think the Financial System Inquiry should seek to address such inequities and give the regional banks and smaller financial institutions a fair go.

Another benefit of freeing up some of the additional capital that regional banks are having to hold is that this can then be reinvested into those sectors, such as small business, that we traditionally invest in. As a bank of small business owners through our unique Owner-Manager franchise model, the needs of the small business sector are particularly important to us.

All of these are important issues for us, the regional banking sector and the wider Australian economy and we will be focusing heavily on them over the next 12 months as we engage with the Government and regulators around the Inquiry.



Finally, the inevitable question that has been front and centre at all recent Bank AGMs is whether there's a housing bubble developing and are we at risk?

Real Estate prices are up with capital city dwelling prices for the 8 National City index up 1.6% month on month, 3.7% quarter on quarter and 7.9% year on year. These are strong increases but must been seen in the context of the flat to negative growth we have seen in the intervening period since the global financial crisis with the result that today capital city dwelling prices across all major cities are only 2% higher than the previous October 2010 peak. Brisbane prices are down 8.45% from the peak, Melbourne down 0.8% from peak and only Sydney is up 9% from the prior cycle peak.

When you combine these trends with the low housing system growth rates of sub 5% and the substantially improved risk management policies, affordability cushion and loan to valuation policies employed by all Banks then, absent a large leap in unemployment, we are relatively sanguine, but ever vigilant, about any housing bubble arguments. As, I may add, is the RBA.

In closing, I would like to express my appreciation to the Board, my colleagues and all BOQ people for their efforts over the past year – your hard work was crucial to the company's improved performance over the last 12 months.

I would also like to thank shareholders for your ongoing support.

I'll now hand back to the Chairman to continue the meeting.