MD's address

2011 Annual General Meeting

Good morning ladies and gentlemen and thank you to the Chairman for his introduction and to Ram for covering off the year in review.

Firstly, could I say how thrilled I am to be here at BOQ, and Brisbane. The first five and a half weeks have flown by and I will talk a little later about my first thoughts.

As both Ram and the Chairman have indicated, 2011 has been an interesting and challenging year. And as we edge closer to 2012, it looks like economic conditions will remain challenging both globally and here at home in Australia.

While the European situation, and equity markets, change on an almost daily basis, it is important to understand not only what is happening there now and how it could impact the rest of the world, but also how they came to be in the situation they now face. And the more you understand the more you can see that these issues have been around for a long time and are not ones that have "just arisen".
To take a step back to the beginning; two of the criteria for joining the European Monetary Union, or the EMU, are that Government deficit to GDP must not exceed 3%, and government debt to GDP must not exceed 60%.

Let's take a quick look at where they stand at the moment.

The real problem child through this whole episode has been Greece (notwithstanding the impacts we have seen on Iceland, Ireland, Portugal, Spain and most recently Italy).

European Commission reports have revealed Greece's budget hasn't been within the 3 percent limit a single year since its admittance.

In fact, the government of Costas Karamanlis (the then Prime Minister of Greece) disclosed in 2004 that its socialist predecessor had cheated on its euro-entry exam in 2000. The country was able to enter the currency bloc after claiming its deficit was less than 1 percent of gross domestic product, well within the bloc's 3 percent threshold.

As the Greek crisis started to unfold and we began to learn more about their tax system, you almost wondered how they've avoided catastrophe for so long. For example, tax evasion is common and is widely accepted.

An estimated two thirds of doctors reported incomes under 12,000 Euro per annum. It seems 12,000 Euro is the zero tax threshold.

In 2009 , 9,000 people remitted 4.9 billion Euro overseas....almost half of these had income less than 20,000 Euro per annum. It is estimated half of Greek taxpayers declare incomes under the12,000 threshold!

And there is little in the way of enforcement...apparently it can take up to 15 years to resolve tax cases through the courts. There is no central land registry so if you get paid in cash and then buy property it is just about untraceable.

So if you're the PM of Greece and having trouble taxing incomes, what do you do? You look at the more tangible and one-would-assume difficult to hide products of wealth - real estate and luxury goods.

A swimming pool tax was introduced and in the upmarket Athens suburb of Kifissia the submissions by residents detailed 324 pools...the Finance Ministry thought they would check this number and did a helicopter census.....16,974 pools!

But it's not just the wealthier Greeks' hatred of paying tax that created this crisis. The Greek Government seemed to understand that keeping Government employees happy would help shore up their popularity – until the whole house of cards collapsed, of course.

Around 30% of employed Greeks are government employees, with wages three times greater than their private counterparts. The national railroad has annual revenues of 100 million Euro against an annual wages bill of 400 million Euro and other expenses of 300 million Euro. Just doesn't stack up, does it?

The retirement age for Greeks in "arduous" professions is 55 for men and 50 for women. More than 600 professions are determined as arduous including hairdressers, waiters, musicians.... And at retirement workers get 96% of their pre-retirement income.

But let's not just focus on the Greeks. The Italian situation is just as intriguing. At the same time Berlusconi agreed to step down, the cost of debt for Italy rose to 7.7%. That might seem an arbitrary number, but that was in fact the level where Portugal and Greece had to put their hands up for a bail-out. The difference with Italy is that it is a well developed nation with intrinsic wealth.

Looking at the political situation, it's clear that the governments of Greece and Italy lost their mandate to rule. Their people simply don't trust them and are furious that their countries have been allowed to fall in to such financial disarray.

With youth unemployment at such a huge level, it is impossible to see how they can avoid mass social unrest, particularly among the young, who are emerging from university into a local economy with no real prospects for growth, a job market without jobs, and a massive national debt hanging over their heads. The options seem limited to leaving their country to sort it out without them while they take their education – and money – elsewhere, or staying behind to try to slog it out.

Some pundits have talked about Saudi Arabia and China as being the panacea to the European woes.

And this raises another interesting idea – that of reputational risk.

You see, if we look back to the US crisis, you may recall that China and the Middle East were among the investors burnt. So why on earth would they do it again? Or, more to the point, what would entice them to do it again?

From where I'm sitting, I can't imagine them jumping in to this pool at all as they cannot afford to loose anymore of their nation's money. Indeed the headline that screamed "China's reserves are not for spending" says it all.

China really doesn't have any need to "rescue" Europe. Its exports to Europe are less than 5% of its GDP of which is mainly internalised. A downturn in European growth is a given but the countries most affected will be countries such as Japan and Taiwan.

Most investors are looking for a return of their capital, not just a return on their capital.

The International Monetary Fund has estimated global growth will slow in 2012, so a global downturn is a real risk; however the Asian region is still expected to experience strong growth.

And while Australian domestic conditions are much better than overseas, consumers are acting with caution which is evident with higher rates of savings, which have been of benefit to the banking sector, but detrimental to the retail and property markets. However, credit formation has slowed to a trickle and with the tougher economic environment our proactive moves on interest rates are designed to support our customers as they have supported us over the years. We are in this for the long term, like our customers, and as we support them they will hopefully support us with more of their business as well as referrals of their friends and colleagues to us. The best customers always provide us with the best referrals.

We are in a two speed economy and the mining/resources sector will continue to flourish as Asia continues to grow – albeit at a slightly reduced rate. The conundrum that we are dealing with is a sluggish consumer and business environment that is diametrically opposed to the bullish resources sector.

Consequently, it means that Australian credit growth will remain subdued so a low/slow growth environment will result, impacting more heavily on the major banks who have responded with a focus on cost cutting. In addition I would expect to see greater focus from the majors on either adjacencies to the industry (viz CBA acquisition of Count) or the increased focus on the growth region of Asia.

From a balance sheet perspective, uncertainty in global capital markets will not help credit spreads of the major banks. While we remain relatively well rated globally a looming issue could well arise if the Euro Sovereigns guarantee European bank paper given the lack of confidence in investing directly into a European bank. Access to funding will remain a critical strategic issue for all banks – aside from Asia who fixed their system back in 1997! We rely on the international capital markets for only 1.5% of our total funding and while we have disappointingly been downgraded by S&P to BBB flat (from BBB+) there will not be any material earnings impact upon us.

The main issues S&P have flagged as a negative are around our inability to compete with the major Australian Banks – might I say here that we do not have aspirations to be a major Australian Bank, we do not want to be lead by them, we want to be an institution that is always seen as doing the right thing by its customers and staff -, lack of geographic diversification (more on this later), the level of bad debts, and our overall relevance to the financial services sector.

Notwithstanding the downgrade (and this is only one of the rating agencies), our funding book is well under control. As the Chairman mentioned, we don't have to pursue unsecured debt funding issues this financial year, but will of course look at any opportunities that arise at the right term and price. We will continue to look at the securitised market which we have traditionally used and we are seeing other banks pursuing this route also – initially through the covered bond market, although this has now closed.

And while we face funding pressures as our peers, BOQ's expansion in to capital-lite businesses, such as St Andrew's Insurance, while also seeking higher margin business, in our expanding vendor finance, equipment finance and debtor finance business line, mean that we are doing well in these uncertain times.

Having been here only a short time it is abundantly clear to me that we have a competitive advantage in our unique Owner-Managed branch model, where Branch Managers actually own the branch and are directly responsible for their own profitability. It is a compelling force to providing superior customer service and we continue to attract large numbers of customers who recognise this. Our objective is to become an intensely focused customer service organisation. This can only be achieved through having great people who are passionate about our customers – and from what I have seen in my early days I can confirm that we do have a great and committed team…now, however, we need to do it consistently. We are now giving our staff the tools to succeed through attractive pricing, great products as well as enhanced technology.

In addition, the OMB model gives us a real competitive advantage in the one marketplace in which I know we can really outperform – small business.

Because our Owner-Managers are small business owners themselves, they are uniquely positioned to understand the threats and challenges specific to small business customers.

And because they own the branch, they are committed to staying around for the long-haul. According to every small business survey I've ever read, one of the biggest gripes of small business customers is the ever-changing nature of relationship management at Australia's big banks. And it's true – if you are a high performing manager at any of Australia's banks, you will be promoted. That sounds like a positive, right? But not so to the small business owner who has spent six months explaining his or her business model and strategy to their bank manager, developing that relationship and trust, only to have this Manager moved in to a new role.

Well, not so at BOQ. Not only do we offer an Owner-Manager who understands small business, our SME clients know they won't have to explain their story to a new Owner-Manager in six months time. The Owner-Manager owns the branch. They're not going to be rotated out any time!

So if you know any small business owners looking to bank with a great institution that takes its customers seriously, who offers Owner-Managers who understand small business and who are here for the long haul, please come and see me at the end of the meeting. I have spent the past month or so getting to know our people and the BOQ business, and I can assure you there are already dozens of BOQ Owner-Managers I have met first hand and would be happy to recommend to you or your small business associates.

And it's not just our Owner-Managers who are setting the bar high. Our corporate branch managers play an extremely valuable role in delivering exceptional service to our customers and they should not be forgotten.

In addition to the competitive advantage we hold with our business model we have a comparative advantage in Queensland. While S&P are telling us we need to be more diversified I do not believe that should be the case. Last time I looked, Queensland was larger than most European nations and I don't see S&P telling them to diversify geographically – in fact the exact opposite. We will continue to expand in Queensland, and also out of state, but our comparative advantage is that this is our home state and this is where we need to be much stronger. We will continue to expand our branch network and our customer focus into areas such as Small Business, which unfortunately we were more prevalent in some years ago.

BOQ has a great team, and one that I'm thrilled to be a part of. Every BOQ person, from our Customer Service Officers, Owner-Managers and Corporate Managers on the frontline, through to the dedicated Call Centre operators who help solve customer problems and answer questions over the phone, and of course the people working in our Support Centres who provide the back engine of the Bank, are all working towards one goal – to make BOQ your own personal bank.

I prefer to look at these times as exciting with plenty of opportunity. While we do still have some housekeeping to get right the long term focus on our customers and an unwavering desire to be the best will provide long term benefits to shareholders.

This is not lip service – we genuinely believe that's what we can offer. And after just over a month in the job, I know we can do it and I will be working very hard to achieve this.

Thank you for your time.

Stuart Grimshaw
Managing Director and CEO
8 December 2011