Chairman's address

2010 Annual General Meeting

Ladies & Gentlemen,

This past 12 months has been an interesting, yet challenging, year in the Australian financial services sector.

Legacies of the global financial crisis have taken the form of continued funding pressure, soon to be exacerbated by expensive regulatory changes designed to lessen the likelihood of a similar event occurring in the future. Financial institutions are also still generally cautious on credit and therefore credit growth has slowed since earlier this year.

Despite these challenges, your bank recorded a full year normalised profit after tax of $197.1 million for the full year 2010, a 5% increase from 2009. BOQ enjoyed strong growth, with the Bank growing loans 2.5 times higher and deposits 1.5 times higher than system growth (that is the combined growth of the sector) for the 2010 full financial year.

A strong balance sheet, cost disciplines and the productivity of our Owner-Managed branch model assisted to achieve this strong result in what has continued to be challenging economic times.

The Bank's lending focus has remained on retail mortgages and secured lending to small and medium enterprises, usually referred to as SMEs, resulting in a relatively low risk profile. SMEs are, however, feeling the delayed effects of the macroeconomic slowdown and this has been reflected in the increase in bad debts. The majority of our lending is in Queensland which has traditionally always lagged the rest of Australia in recovering from a slowdown.

As a consequence management is cautious about predicting the level of bad debts but are confident that the Bank will see an improvement in the second half of the current financial year.

I can assure shareholders that every effort is being made to predict the consequences of an adverse economic downturn.

It is fair to say that most industry sectors in Queensland with the exception of mining and gas and their associated industries are suffering financially particularly the retailing and property development sectors.

One of the challenges management undertook during the year was to lower the Bank's cost base. The normalised cash cost-to-income base was reduced from 49.9% to 45.8%. This was a significant challenge and now is close to the major four banks – something many commentators believed was unachievable.

Some time ago your Board decided to look for other opportunities to diversify the Bank's income streams so as to support its long term sustainability as a sound investment.

As a consequence our acquisitions in July this year, namely, St Andrew's Insurance (Australia) Pty Ltd, St Andrew's Life Insurance Pty Ltd, CIT Group (Australia) Limited and CIT Group (New Zealand) Limited, have been good investments and these are performing to expectation. The Managing Director will talk more about these businesses in his address.

Complementary acquisitions such as those mentioned are important to our Bank for another reason. It enhances our scale and improves, but certainly doesn't guarantee, our prospects of receiving a ratings upgrade. While we know that our approach to lending is conservative and this is attractive to ratings agencies, an upgrade from our current BBB+ rating would be difficult without scale and diversification.

Why is a rating upgrade important? This has been dramatically demonstrated over the last two years where the major four banks have taken advantage of their AA ratings to use the Federal Government's guarantee to borrow funds from the wholesale market at a substantial cost advantage over BOQ. Whilst the opportunity to access funding using the Federal Government's guarantee ceased in March this year the elevated cost of the guarantee will continue until 2015 when the Bank's borrowing facilities expire.

To put this into perspective, BOQ is paying approximately 1.2% more for its borrowings using that guarantee than the four major banks plus a credit spread. This is well above the borrowing cost margin between the major banks and the regional banks prior to the credit crisis. Not surprisingly their overall net interest margin is around 2.4% while ours is currently 1.6%.

Despite that disadvantage, BOQ has a service offering that allows us to compete very effectively due to our Owner-Managed branch model, however all regional banks would be much better placed to compete with the four major banks if there was equality on the guarantee charge and a clear path to capital relief for regional banks.

The access to Residential Mortgage Backed Securitisation funding is the key issue for regional banks in terms of competition in the banking sector. This securitisation is the process banks use of bundling up mortgage loans to on-sell to institutional investors. This provides banks, like BOQ, with a fundamental source of funding for their operations.

Some significant Government investment has, however, come via the Australian Office of Financial Management participating in the purchase of securitised assets and the Bank would welcome continued support of this nature. The Bank has recently lodged its submission to the Senate Inquiry into Competition within the Australian Banking Sector and the Managing Director has certainly been relentless in his call for equality in funding opportunities.

It is speculated that the Federal Treasurer will announce in the coming days some reforms into banking competition. We will await this announcement and respond accordingly.

Dividends

In an effort to conserve our capital reserves during these challenging times, the Directors approved a fully franked final dividend of 26 cents per share, taking the full year dividend to 52 cents per share, matching that paid in 2009.

The Board, in making its decision on the amount of dividends, is very mindful of the need to reward our shareholders. The diluted earnings per share in 2009 was 74.4 cents; this year it was 76.1 cents. The Board decided on a fully franked dividend payment of 52 cents per share which represents a 68.33% payout ratio to profit for the year. This is close to the Board's traditional guide of 75%.

This payout represented a yield of 5.29% on the share price at the 2010 balance date. This compares with 4.46% last year and 4.60% when we paid the record dividend of 73 cents in 2008.

Because of the events occurring in the banking sector around the world and the changes to capital requirements being foreshadowed by the regulator the Board had decided to take a conservative view and increase the level of retained profits. These accumulated funds are retained as part of the equity of the Bank and as such are available for future dividend distributions.

I am well aware that some shareholders are not happy with the reduced dividends but I'm sure all shareholders will agree that having increased reserves during these times when banks in other countries are failing is prudent and responsible. It certainly has been well received in the Australian market as the correct approach to take.

The Board believes however that as the economy improves dividend payments to shareholders should be at a higher payout ratio and have therefore provided guidance to the market for increasing dividends by between 10% to 20% for the full year in 2011.

Capital Management

The Bank's capital management strategy aims to ensure that the Bank maintains adequate capital to act as a buffer against risks associated with activities whilst maximising returns to shareholders. The Bank's capital is measured and managed in line with prudential standards issued by the Australian Prudential Regulatory Authority (APRA). This regulatory capital differs from the statutory capital in that certain liabilities such as preference shares are considered capital from a regulatory perspective and certain assets including goodwill and other intangibles are considered a deduction from regulatory capital.

During the year under review the Bank issued 15,895,481 shares. These were allocated through the Dividend Reinvestment Plan and under an Institutional Placement and Entitlements offer.

As a result the Bank at balance date was well capitalised with our tier 1 capital at 8.7% and our overall capital adequacy ratio at 11.7%. This is well above the prescribed regulatory minimum levels and at the upper end of the range set for Australian banks.

Shareholders need to appreciate that the Bank is required to hold a level of capital as directed by APRA. Every time the Bank raises capital, shareholdings are diluted depending on the discount, and secondly, earnings per share is affected unless the Board and management can effectively employ that capital to increase the earnings per share. In the past twelve months the Bank has had to raise capital when the capital markets provided the opportunity and consequently the benefits of employing that capital effectively has not necessarily been maximised during the year.

With the acquisition of the St Andrew's Insurance Group and CIT Group in July this year the benefits were only recognised in the last two months of our reporting year. The Board is very confident the capital raised is now effectively working in the shareholders' interest.

Board matters

During the year under review two directors retired from the Board. Mr Anthony Howarth, who joined us following the acquisition of Home Building Society retired in July and Mr David Graham who has been a director for the past four years, retired in October. I would like to thank both these gentlemen for their contributions to the Bank and wish them all the very best for the future.

Mr David Willis, who stands for election today, was appointed as a non-executive independent director in February of this year. Mr Willis has already made an outstanding contribution in his short time serving on the BOQ Board and we will discuss his qualifications and suitability later in the meeting when he stands for election.

During the year under review your Board has undertaken a full review of all corporate governance policies as part of our process of continual improvement. The Bank is committed to providing an environment in which all employees are treated fairly and equitably and as part of this annual review, has set objectives to:

- maintain a workforce that reflects the diversity of the Australian population;
- continue to grow the number of women in senior roles;
- ensure gender is not a factor in remuneration; and
- increase the representation of women on our Board.

All our corporate governance statements are on our web site.

With regard to the number of females working in the Bank, the percentage of females to all staff employed is 61%. There are currently no females at Group Executive level despite a concerted effort to find the right people. In the past there have been several females at that level and management is attempting to correct that imbalance. There are certainly many females at other senior levels in the Bank.

As for the Board, the next appointment will be a female. Such an appointment would bring the Board numbers back towards a full complement following recent retirements.

Recent announcement

I would like to provide shareholders with an update on Storm Financial.

Shareholders would be aware that ASIC released a statement recently stating that it will commence proceedings against a number of banks, including BOQ, arising out of the collapse of Storm Financial and the Bank responded to that announcement with a release to the Australian Securities Exchange.

This ASX release highlighted that:

- BOQ has cooperated with ASIC's investigation for almost 18 months;
- The Bank has engaged in a great deal of work and received extensive legal advice in forming its position;
- BOQ has engaged in good faith in the commercial resolution discussion process; and
- The Bank has endeavoured to work with its affected customers one-on one, particularly those in financial hardship.

Approximately 368 BOQ customers in total were affected by the collapse of Storm Financial and while we have every sympathy for these customers, the Bank's Board is entrusted to uphold the interests of all BOQ stakeholders, including the interests of our 85,000 shareholders, while acting in a responsible, ethical and legal manner.

The Bank is confident of the approach that has been taken to date and we will continue to work with each affected customer who is experiencing financial difficulty to fairly determine an appropriate response to each individual case.

As ASIC has now stated it intends to commence proceedings unless a commercial resolution can be reached before 17 December, the Bank is not in a position to provide a further update at this meeting today, however we will of course update the market in due course.

As such I cannot take any questions today from this meeting regarding Storm.

Shareholders feedback forms

In the Notice of Meeting that went to shareholders I included a form that could be used to ask questions of the Chairman. I'm pleased to say the Bank received over 100 such questions and I hope in the course of these proceedings either Mr Liddy or I can address the majority of these questions.

Future outlook

Before I ask Mr Liddy to address you, I will share some of my views on the economic outlook that we are facing and the Bank's strategy for the future.

There has been a lot said recently that the banking sector had withdrawn lending support for small business. Whilst other banks had curtailed their lending to SMEs, BOQ continued to lend cautiously throughout the past three years as evidenced by our lending growth compared to the sector as a whole.

As regards our vision for the Bank post Project Pathways the Board and management continue to believe that your Bank will play an active role in shaping the regional bank landscape in Australia. We see BOQ continuing to be an independent, fast growing bank with a national focus and a business model that emphasises entrepreneurship with a high service culture through a franchised network, that is, through owner managers.

Your Directors and management have set a deliberate strategic plan to grow the Bank but as mentioned earlier, to diversify into other income streams. There are many opportunities that are presented to us and all are carefully evaluated to ensure they provide a fit to our strategic direction. Strategic acquisitions properly integrated will only benefit shareholders in the periods ahead. Mr Liddy will talk more about this in his address to you.

The Owner-Managed Branch model has been tested during the last three years and has proven to be resilient and extremely productive. This Bank continues to be the only bank in Australia to operate through this model. We are unique from that perspective.

BOQ is a strong, dynamic regional bank and cannot be compared to a building society or one of the major banks. As such the Federal Government needs to recognise the unique characteristics of the regional banks in determining the role they can play in a competitive banking sector.

The Bank is ideally positioned in two growth economies – being Queensland and Western Australia. Over 71% of our business is in those states. Whilst growth in Queensland (outside the mining sector) is badly lagging behind the rest of Australia at the present time, the Board is very confident this will reverse in the near future.

The Bank is very mindful of its social responsibilities and supports a range of charitable and community based organisations. We will continue to do this is a measured way.

The global outlook is improving, although at slower rate for developed nations, than for emerging countries, but Government stimulus in the US and countries of the European Union are expected to have a positive effect. Already there are positive signs that the largest economy in the world (the US) is showing stronger growth than previously thought.

A somewhat cautious view is taken domestically, with higher interest rates and rising costs of living expected to dampen consumer spending and the housing market activity, but overall, I believe the outlook in Australia is positive.

As such, the Bank believes it will be able to increase our normalised cash net profit after tax for the year to 31 August 2011 to between $210 million to $230 million. In striving to achieve this profit target range, the Bank will continue to look after its staff, excel in customer service, invest in the community and reward our shareholders.

On behalf of the Board, I thank all shareholders for their loyalty over the past year. I will now hand over to Mr Liddy to provide his address to you.

Neil Summerson
Chairman
9 December 2010