



CHAIRMAN'S SPEECH
Annual General Meeting, 22 October 2014

Good afternoon and welcome to the 2014 Annual General Meeting.
Thank you for your attendance today.

At Heritage Bank, we are justly proud of our mutual status and our core mission of delivering great value and service to our customers, whether they be borrowers or depositors. Unlike the big banks, we are not about making the biggest profit possible.

However, that's not to say we don't have to be profitable. We need to be successful to meet the capital requirements of the regulators and to be able to invest in making our business even better for our customers.

In 2013/14, we have continued to strike the right balance between these goals.

Our profit result was strong, given the fierce competition in the marketplace.

Our pre-tax profit was down 5.5% on the previous year. However, as the prior year contained the proceeds from the sale of our Visa shares, our underlying pre-tax profit was actually up 0.1% from the previous year to \$50.04 million.

Our loan approvals were up 7.5% to \$1.440 billion, a great result in a competitive environment. Significantly, our loan approvals in the second half of the financial were up 19% on the first half, which was a very a satisfying trend.

I mentioned balance just before, and while we reported another strong profit in 2013/14, we also delivered great value for our customers.

In fact, independent research by analysts Canstar found that in 2013/14 our customers were more than \$48 million better off by banking with Heritage rather than the big four banks.

In other words, our customers had an extra \$48 million in their pockets because we give them a better deals on fees and interest rates, both on loans and deposits.

How does this happen? The foundations of our success are no secret. We have created a *People first* culture here at Heritage that underpins everything we do. The Board and leadership team actively nurture that culture by providing the right environment for it to thrive. Our staff respond by living the culture every day and championing the values that our customers prize so much. That's not an accident or a recent invention. It's the way we have acted throughout our 139-year history and it's the way we will continue to act in future. We show integrity, professionalism and a customer focus at all times.

I'm happy to say that this approach is reflected in a number of different measures of our customer satisfaction. In the latest Roy Morgan monthly customer satisfaction ratings, our score was 90% - one of the best in Queensland. We also score highly in the Roy Morgan customer advocacy ratings – which measures the likelihood of your customers recommending us to their friends or family. In the 2013/14 year, our average monthly score was positive 25, while three of the big four banks were in the negatives. These results give us a great deal of pleasure, not for their own sake, but because they are a measure of how well we live up to our *People first* mantra.

We do deliver for our customers, but we cannot rest on our laurels and think that we can continue to succeed by doing things the same way. Times are changing in this industry, and changing fast. We're in the middle of a digital transformation that is fundamentally changing the way people interact with their financial institutions. People increasingly want to do their banking at any time of the day or night, wherever they might be, while using their mobile device of choice. That shift is completely changing the role of our physical branches, and affecting where we need to invest to provide customers with the services they want.

Heritage is meeting this challenge with a five-year Digital Blueprint that outlines how we will transform the business to meet the new demands of the digital age. This includes a program of significant investments in upgrading our online and mobile banking services; in upgrading our data systems; and in simplifying our processes. We will start making substantial investments from the 2014/15 financial year. Future years will incorporate the amortised cost of this investment. However, the

magnitude of this investment is significant and is likely to have an impact on our costs in coming years. To offset this impact, we will be targeting increased loan volumes and cost efficiencies. This investment in transforming our business for the digital age is non-negotiable – we must make these changes to stay relevant to our customers.

All this is happening at a time when we are still feeling the legacy impacts of the GFC. Demand for credit remains low, as people continue to save money and be frugal with their borrowings. Interest rates are at record lows, which is great for borrowers as they can pay off their loans quicker. But this does impact not just our interest revenue but also the returns we can provide to investors. Competition is also extremely fierce, with other financial institutions big and small all jostling for a share of the market.

It's against that backdrop that the Federal Government launched the Financial Systems Inquiry (FSI) review of the current banking system. This was a positive step by the government in looking to tackle the structural issues that are needed to ensure a thriving and competitive financial sector in future.

The Federal Government must use the FSI to act now and curb the unfair advantages that Australia's big banks enjoy, if it is serious about making banking more competitive.

Millions of Australians are effectively being shut out of a better deal on their banking because the big banks can sidestep the hurdles that customer-owned competitors have to jump over.

Governments have talked up the benefits of competition for years. Now is the time to deliver real reform. The Financial System Inquiry is the perfect opportunity to tackle the inequities.

The big banks enjoy a huge advantage because they are authorised to use the internal ratings-based (IRB) approach to measuring the riskiness of their assets, which significantly reduces the amount of regulatory capital they have to hold.

They also enjoy “too big to fail” status, with the implicit guarantee that the Federal Government would bail them out if any of the big four banks got into trouble.

Those factors give the big banks huge funding advantages that tilt the playing field against smaller customer-owned competitors such as Heritage.

Australia’s big banks make up four of the eight most profitable banks in the world. Together the four majors made almost \$30 billion in combined profits in the 2013/14 financial year.

That’s a good result for investors but not so good for bank customers. Those profits effectively come out of their pockets.

Mutual organisations such as Heritage don't pursue profits as strongly, so they can offer their customers a better deal. Mutuals drive competition on customer benefits and service, but are constantly battling the unfair advantages the big banks enjoy. At times, it seems that some of the Regulators don't understand the basic model of Mutuals, and don't appreciate the special needs that Mutuals have. By imposing higher capital requirements than many of our competitors on similar categories of lending products, especially when our arrears are so much better, they are certainly making it harder for Mutuals to compete.

We need stability in the banking system with common sense regulation and supervision. But the system also needs the competition that the mutual sector provides. We are hopeful that the FSI outcomes will stress the importance of competition and allow the mutual sector to continue providing customer-focussed services to the people of Australia.

In closing I would like to acknowledge the outstanding contributions made by my fellow Directors, John and the senior management team, and all the staff at Heritage. I am privileged as Chairman that I have the opportunity to work with such a talented and professional team, whose efforts have enabled Heritage to continue to deliver such strong financial performance and meaningful value for customers.

As I announced earlier, Professor Peter Swannell is stepping down from the Board at the conclusion of today's meeting. He joined Heritage as a Director in July 2003 and his contribution over that time has been most professional and invaluable. On behalf of Heritage, I thank him and

congratulate him for his service. At this stage we are not replacing Peter's position as Director on the Board.

In conclusion, I especially thank all our loyal customers who have helped make Heritage such an iconic organisation, and we look forward to another successful year in a changing environment.

Kerry Betros

Chairman of Directors