Westpac Banking Corporation

2009 Annual General Meeting

Melbourne, Australia

16 December 2009

Chairman's Address

Mr Ted Evans
Chairman
Westpac Banking Corporation

Let me begin by acknowledging the continued support of our shareholders through what has been a difficult year.

I know that for many of you the past year has not been easy. Falling markets and weak economic conditions have reduced both wealth and incomes, and the Board is acutely aware of the stresses that this placed on many of you.

Given those difficulties, we are grateful for your support, and your confidence in the Board and management.

In these remarks, I shall focus on the outcome for shareholders, now and looking ahead, and the factors that are shaping those results, including the recent increases in mortgage rates.

Our CEO will then speak to the extraordinarily complex set of challenges which management has been addressing with, in the Board's opinion, outstanding success.

The Results

The past year has been the first in over a decade that Westpac has reported a fall in earnings and dividends.

But the past year has also been marked by bank failures around the world and, of those that survived, many have not reported profits at all.

Hence, seen in context, Westpac has delivered a sound financial result, as well as successfully completing the historic merger with St.George.

In the chart on the screen, cash earnings are presented on a 'pro forma' basis; that is, prepared as if the merger with St.George were completed on 1 October 2007.

On that basis, cash earnings for 2009 were $4,627 million, down 8 per cent on the previous year.

Reported profit was also lower, down 11 per cent.

Within this performance, however, were some important positives.

As is clear from the chart, revenue growth was strong, up 13 per cent, reflecting good markets income and increased share in key lending and deposit products.

Expense growth was held to 5 per cent. This, combined with the strong revenue growth, resulted in further improvements in efficiency: our expense to income ratio fell to just 40.2 per cent, a record low both for us and for the Australian banking sector.

Offsetting that excellent performance was a material rise in impairment charges, or bad debts, which increased by over $2 billion.

I would like to discuss this a little further because I know it is an area of concern to many shareholders.

Around one fifth of the increase in impairment charges was directly linked to the Global Financial Crisis in that it emerged from a small number of large companies whose business models did not stand up under the pressures of the circumstances.

But those cases were limited in number.

The majority of our losses over the year can be traced back to the deterioration in economic conditions in both Australia and New Zealand – two segments of note were mid-sized Commercial customers, and property development.

Importantly, the consumer sector has continued to perform very well.

While the losses were disappointing, they were a small fraction of those that occurred in the early 1990s – not to mention what occurred this time around the world.

Managing risk

In brief, our risk management practices have improved immeasurably over the past decade or so.

But they are not perfect – and the Board and management have sought to ensure that the lessons learned from this cycle become embedded across the organisation.

Moreover, in ensuring the Group is well positioned, we placed a high priority on strengthening our balance sheet.

This included raising over $3.8 billion of core equity, improving our funding profile and boosting our liquid assets.

These initiatives have seen Westpac further lift its Tier 1 capital ratio to over 8 per cent, well above our target range.

Importantly, right through the global crisis we have maintained our 'AA' credit rating, and are now one of just 10 banks globally with a rating of 'AA' or higher.

Shareholder returns

But such initiatives are not costless.

Given the lower cash earnings and the additional capital raised over the year, earnings per share declined by 18 per cent.

The final dividend of 60 cents brought the total dividends for the year to $1.16 per share, down 18 per cent on the prior year, consistent with the decline in earnings per share.

This level of dividends saw the Group pay-out 73 per cent of earnings for the year.

In considering the dividend, the Board weighed up a number of factors. In the first half of the year, with conditions still highly uncertain, the Board's focus was on strengthening the balance sheet and preserving capital.

At final dividend time, the Board recognised the improving conditions and that impairment charges were at a cyclical high. These factors, combined with the Group's strong capital position, underpinned our decision to lift the dividend in the second half, a positive sign for future dividends.

People and leadership

The exemplary performance of the Group this year reflects the outstanding leadership of our CEO, her hard-working Executive team, and the more than 37,000 employees – outstanding performance, not just this year, but over many years.

I would also like to acknowledge the support and dedication of my Board colleagues.

The Board composition has not changed since last year's AGM, and there has been a very heavy workload on the team.

Looking forward

Let's turn to the outlook which, again, will be heavily shaped by governments.

The Australian economy has weathered the Global Financial Crisis well.

To a significant extent, that reflects the prompt stimulatory action by the Australian government.

It also reflects the fact that the Australian financial system was in excellent shape, not least because Australian banks had pursued sound risk management practices.

Having now witnessed the result of poor risk management in banks abroad, and the pain still being endured by the citizens of those countries, we should think very carefully before seeking to change the way in which the Australian financial system operates.

How Australia approaches changes in regulation will be important in that regard.

It will be equally important that banks be allowed to exercise their commercial judgement in properly pricing risk.

The recent increases in mortgage interest rates are a case in point.

At Westpac, we have been facing increased funding costs since the crisis began, as prices jumped in international markets. Those costs have been extended by our desire to be open for business throughout the crisis and hence to continue to serve customers by growing our loan book. Not all our competitors were as active.

For a time, those forces were partly offset as our Reserve Bank cut cash rates at home; and we absorbed some of the external cost increases, rather than pass them on to borrowers – at the expense, of course, of shareholders.

With interest rates now clearly on the rise again, both at home and abroad, there are limits to how long we could continue to absorb these costs without weakening our bank, the Australian financial system and, hence, the Australian economy.

Of course we are aware that increases in mortgage interest rates will cause pain to borrowers; and we stand ready, as we have throughout the crisis, to assist those who become over-extended.

But we would do no favours to anyone by offering mortgages at rates that we know to be unsustainable.

Nor is it fair to other borrowers, such as small business owners, or even large project developers, to have their interest rates increased so that mortgage rates can be subsidised.

Nor is it fair to those who save to have deposit rates held down so that mortgage borrowers can be subsidised.

A properly functioning financial system, with strong banks that can stand on their own feet, requires that banks adjust interest rates in line with market pressures. That is what Westpac did on 1 December.

Competition in the markets will ensure that power is not abused; and as has been demonstrated again in recent weeks, such competition is alive and well in Australia.

If these facts are acknowledged, the prospects for the future can be bright.

The Westpac Group starts the new year well positioned and with strong business momentum. As a result, we look forward to the period ahead and the continued delivery of solid returns for shareholders.