Westpac Banking Corporation

2015 Annual General Meeting

Sydney, Australia

Friday, 11 December 2015

Chairman's Address

Lindsay Maxsted

Introduction

The 2015 financial year has been another period of significant change and development for the Westpac Group.

We have welcomed a new CEO, refreshed the Group's strategy, introduced a new organisational structure and proactively responded to a raft of regulatory and industry changes.

At the same time, we have continued to grow the franchise and strengthen the business. This performance has seen us deliver sound earnings and return value to shareholders through increased dividends.

CEO Change

At our last AGM I thanked Gail Kelly for her successful leadership of your company and I would like to again acknowledge her outstanding contribution.

As you know, in February Brian Hartzer commenced as Westpac's 25th Chief Executive Officer. In a little under a year Brian has clearly demonstrated himself to be a seasoned banking executive with the leadership skills to take the bank into its third century.

Brian has sharpened the organisation's service-led strategy while growing customer numbers and building stronger relationships. Brian and his executive team have also continued to manage the business in a disciplined way. This can be seen in the return and margin outcomes for the year, the proactive approach to regulatory developments and the good progress in digitally transforming the business.

You should expect that this service and growth focus will continue as all of our employees work towards our vision to be one of the world's great service companies, helping our customers communities and people to prosper and grow.

Technology

In pursuing our vision there are significant opportunities and challenges. Technology is a common thread, having an all pervasive impact across the organisation; fundamentally changing the way we do business.

In speaking with shareholders over the last year I have often been asked about how the Board is responding to these developments. Given this rapid change, it is difficult to predict the future, but we know it will be quite different from how we operate today.

The Board is devoting more time to technology developments including combatting cyber-crime, dealing with disruption, and evaluating the progress on our technology investments. These are topics we have taken very seriously and have maintained a dedicated Board Technology Committee since 2009 to lead our thinking.

We are also very pleased to have further strengthened our technology management team over the year led by Dave Curran, our Chief Information Officer.

During the year the Board has also approved the Group's new technology strategy which includes plans for the further development of our technology architecture. The strategy is centred on the development of a new customer service hub.

The customer service hub brings together all the information and interactions we have with customers, regardless of how they interact with us. The centralisation of this information better aligns technology with our strategy and will completely change how we support customers.

For the many shareholders that are also Westpac customers, you may have noticed that we completed the rollout of a new online and mobile banking platform this year. The system significantly improves how customers manage their finances online and has contributed to a large fall in customer complaints. We are rolling out a similar initiative in New Zealand called Westpac One. In online and mobile banking we are now recognised on many fronts including by Forrester Research as the industry leader in Australia and a leader globally.

In wealth, our new funds administration platform is up and running with enhanced capability and investments continuing to be added. Called Panorama, we believe this platform will transform the way people manage and protect their wealth and will further build on our comparative advantage in this segment.

Behind the scenes we have made significant progress on our technology infrastructure. This includes consolidating 13 of our data centres into three state-of-the-art facilities that are supported by even stronger security protocols.

Capital

The other major topic that shareholders have often raised is capital.

Movements in capital followed the release of the final report from the Financial System Inquiry (FSI) in late 2014. Among a range of considerations, the FSI report found that Australian banks are generally well capitalised. However, the report went further and recommended that Australian banks needed to be “unquestionably strong” in comparison with global peers. Under that mantra, APRA indicated that Australian banks would need to increase their capital.

We responded, raising capital early in the year and aiming to lift our common equity tier one capital ratio (CET1) to the upper end of our preferred range of between 8.75% and 9.25%.

This saw Westpac raise $2 billion of equity with our 2015 first half result. We also raised a further $0.5 billion from the partial sale of our shareholding in BT Investment Management. These initiatives contributed to increasing our CET1 capital ratio to 9.5% by September 2015 and above our preferred range.

Then in July this year, in responding to FSI report, APRA announced changes to the calculation of risk weighted assets for Australian mortgages for those banks operating with advanced risk methodologies. That change is to apply from 1 July 2016. The change is significant, increasing the capital we need to support our Australian mortgage portfolio by over 50%.

The size of this required increase, and the relatively short implementation timeframe, led us to announce a fully underwritten pro rata entitlement offer to raise $3.5 billion of equity in October of this year.

We decided that an entitlement offer was the fairest alternative because all shareholders were able to either purchase new shares at a discount or receive value for their entitlements that were not exercised.

The offer received very strong support with 95% of eligible institutions taking up their entitlements while 70% of our eligible retail shareholders also exercised their entitlements.

We recognise that shareholder participation is not automatic and so I would like to personally thank you for your endorsement.

Changes in the capital required by the Australian banks is part of a global debate on how much capital banks should hold. In essence, regulators are aiming to avoid a repeat of the Global Financial Crisis, where banks in many other countries were bailed out by taxpayers.

Australia has a very strong banking sector, recognised by many as one of the strongest in the world, but remaining so requires constant vigilance, as the next source of stress is usually different from the last.

We fully support having a robust banking system but at the same time we should acknowledge both the sector’s strong starting point and that efforts to further strengthen banks will ultimately come at a cost.

Requiring banks to hold more capital for example has real costs. It impacts returns, it increases costs to borrowers and it impacts the economy by diverting resources from other productive uses.

To put some dimension to this, over the last 12 months the major Australian banks have lifted capital by around $20 billion with the majority raised from Australian investors. These are big numbers, equal to around $2,000 for every Australian household.

In thinking about the notion of unquestionably strong we also need to look at more than just capital. Strong banks need to have well-managed balance sheets, excellent credit quality, strong profitability and a culture of doing the right thing and focussing on the long term sustainability of the company.

I am pleased to say that these cultural elements are ingrained in Westpac and we have a very strong risk culture. At the same time, our people are enormously proud of our track record of supporting communities, our commitment to diversity and flexibility, and our efforts on sustainability where we continue to pursue tangible efforts in support of a two degree economy.

As a Board, these are all part of the elements we monitor closely to ensure Westpac’s long-term sustainability and growth.

And so as a banking system, we must consider all these elements of strength if we are to be seen as unquestionably strong, while also achieving the right balance between these factors. This is particularly important at a time when our economy is in need of both confidence and investment. Similarly, we need to work constructively on implementation that minimises adverse impacts and delivers sensible outcomes and solutions for all stakeholders.

Performance Summary[1]

The Group has had another solid year in 2015. Cash earnings were $7.82 billion, an increase of 3% over 2014. As I've spoken about previously, the company uses cash earnings as a key metric for determining dividends and believes it is the most appropriate measure for assessing financial performance.

Statutory net profit in 2015 increased 6% to $8.012 billion. The higher growth in statutory net profit was due to significant infrequent items including a gain on the partial sale of BT Investment Management.

Cash earnings growth was supported by a solid operating performance across all divisions which led to a 4% rise in operating revenue, and a 3% lift in core earnings.

The Group's key financial metrics also remained strong with a cash return on equity of 15.8%, and an expense to income ratio of 42%. This latter efficiency metric places Westpac as one of the more efficient banks in the world.

A hallmark of the Westpac Group is strength, and shareholders should be pleased to know that all dimensions of the business relating to strength improved in 2015.

Credit quality continued to strengthen with impaired assets declining 19%. The level of stress in the portfolio is now in line with pre GFC levels. Consumer delinquencies also remain relatively low supported by our strong underwriting standards and from an economic backdrop of low interest rates and improving employment levels.

Our funding and liquidity profile continues to remain strong with the proportion of stable funding increasing over the year and total liquid assets reaching $136 billion.

In January this year we also began operating under new liquidity coverage ratio requirements to help protect the Group from possible liquidity shocks. This ratio aims to ensure that we have sufficient liquidity to cover potential outflows in the case of stress, and we are required to maintain a ratio above 100%. The ratio ended this year well above this level at 121%.

1 Financial results based on cash earnings unless otherwise stated. Refer page 4 of Westpac's Full Year 2015 Financial Result for definition. All comparisons are FY15 versus FY14 unless otherwise stated.

Dividends

The Group's solid financial performance has supported a further increase in dividends this year. The 2015 final dividend was 94 cents per share fully franked, and combined with the 2015 interim dividend, total dividends for the year were 187 cents per share, an increase of 3%.

While dividends have increased, because of our capital initiatives, the path of increases has slowed with a one cent per share rise over the last two halves. We continue to pay out a high portion of profits as dividends to distribute franking credits that are valued by shareholders.

Board Composition

2015 saw just one change to non-executive directors as we welcomed Craig Dunn in June. Craig is a strong addition, and as the immediate past CEO of AMP Limited, he brings experience as a recent executive and a deep understanding of wealth management—a key area of growth for the Group.

Craig also brings additional digital insights to the Board as Chairman of the recently established Stone and Chalk. Stone and Chalk is a fintech hub supporting digital innovation in financial services in Australia.

Outlook

We continue to be positive about the outlook for Australia and New Zealand. Both economies have relatively low unemployment, controlled inflation and moderate growth. Growth in Australia has been below trend this year as the slowdown in mining investment has not been fully offset by improved spending or from the effects of the lower Australian dollar.

In the 2016 year we expect a modest lift in Australia's real GDP growth rate back to around 2.75%. That compares with growth of around 2.2% over the last year.

The higher growth expectations rely on some improvement in household spending, non-mining investment, and exports. Partially offsetting these factors is an expected further contraction in mining investment and a smaller contribution from residential construction. Underpinning these forecasts is some further weakness in the Australian dollar, ongoing record low interest rates, and a stable year for our terms of trade.

A bright spot will be the recovery in Australia's net exports of services that are benefitting significantly from the competitive Australian dollar.

For banking, we are expecting broadly similar credit growth for the system to that achieved in 2015 although the composition is expected to be a little different, with improved business lending and an easing in housing growth.

Summary

In summary it has been another good year for Westpac. Our various divisions are in good shape, performance has been sound and we have materially strengthened the company's balance sheet. At the same time our clear strategy, strong management team and investment program sees the Group well placed to continue delivering sound returns.