

# 2018 RESULTS PRESENTATION

4 OCTOBER 2018

Year ended 31 August 2018  
SIAM OF OCEANLAND LIMITED AND 12 OTHER SUBSIDIARIES

## RESULTS OVERVIEW

**Jon Sutton** Managing Director & CEO

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## FINANCIAL DETAIL

**Matt Baxby** Chief Financial Officer

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## SUMMARY & OUTLOOK

**Jon Sutton** Managing Director & CEO

- 1 Evolution of the business continues
- 2 Good underlying result in a difficult environment
- 3 Consistent growth in commercial niche segments
- 4 Asset quality remains a key strength
- 5 Utilising strong capital position to invest for the future

Good morning everyone.

I will start with the highlights of the results.

The strategy we have been implementing in the past few years has transformed BOQ into a resilient, multi-channel business that is geographically diverse.

It is therefore pleasing to report that this evolution of BOQ has continued throughout this financial year.

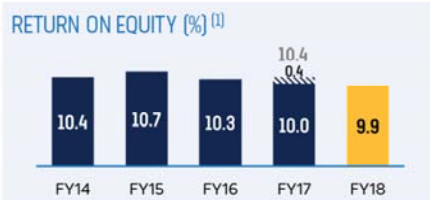
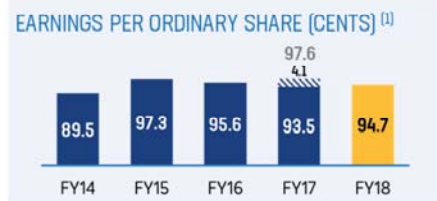
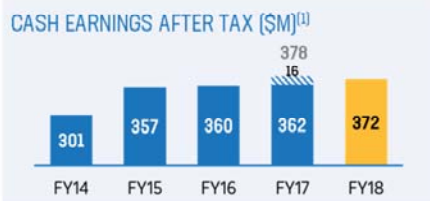
In FY18, we delivered a good underlying result in what has been a significantly difficult operating environment.

We have achieved consistent lending growth in our commercial niche segments.

Asset quality across our loan portfolio has improved further and remains a key strength.

Our strong capital position provides us with options to invest in the future and enhance shareholder returns for the long term.

## KEY ELEMENTS OF THE RESULT



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(1) FY17 shows an adjusted view to exclude the \$16m profit on disposal of a vendor finance entity

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Looking at the key elements of the result.

Cash earnings after tax decreased two per cent over the year to 372 million dollars. Excluding the 16 million dollar one-off profit on disposal of a vendor finance entity, which occurred in FY17, cash earnings increased three per cent.

While earnings per share decreased three per cent on a headline basis, it did increase one per cent on an adjusted basis.

Return on equity decreased 50 basis points to 9.9 per cent, or 10 basis points on an adjusted view.

The ordinary dividend has been maintained at 38 cents per share, bringing the full year dividend to 76 cents per share.

## DRIVERS OF THE RESULT

### LENDING GROWTH (\$M)



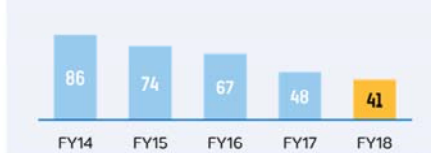
### NET INTEREST MARGIN (%)



### COST TO INCOME RATIO (%) <sup>(1)</sup>



### LOAN IMPAIRMENT EXPENSE (\$M)



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(1) FY17 shows an adjusted view to exclude the \$16m profit on disposal of a vendor finance entity

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Turning to the drivers of the result.

We achieved lending growth of 1.5 billion dollars. This was close to 800 million dollars more than in 2017.

We also delivered a five basis point improvement in net interest margin to 1.98 per cent.

Our cost to income ratio was 47.5 per cent, an increase of 20 basis points from the underlying level of 2017.

Loan impairment expense reduced seven million dollars to 41 million dollars, or just 9 basis points of total loans.

## SUMMARY

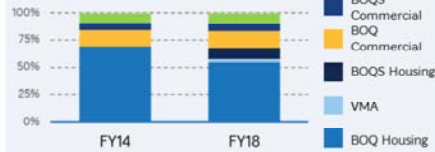
- > More diversified business mix
- > Managing the business for long term returns
- > Next phase of evolution will involve implementation of new customer-facing systems and processes

## BOQ BUSINESS LENDING BALANCES (\$B)



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## LOAN PORTFOLIO MIX



## SYSTEMS & PROCESSES

- > Focused on enhancing customer experience across brands
- > Evolving from manual, paper-based back office to more digitised operations
- > Modernisation of technology infrastructure towards hybrid cloud and API gateways

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There has been a significant shift in our business mix.

Our strategy to diversify our channels has delivered material benefits.

Noticeable improvements in the business mix, channel and geography, positions BOQ to be more resilient over the long term.

Loans originated through Virgin Money Australia and BOQ Specialist now account for 20 per cent of the loan portfolio. Since acquiring these businesses, both have delivered consistent organic growth which we expect will continue into the future.

BOQ Business increased cash earnings by 10 per cent this year with revenue growth of five per cent. It now contributes close to 60 per cent of the Group's cash earnings. Since FY14, it has delivered an average uplift in lending balances of six per cent per year.

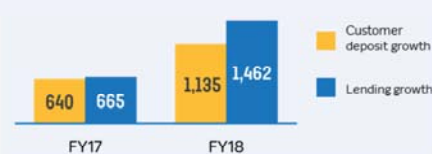
In addition, we have made good progress in digitising our back office as well as our systems and operations.

This evolution is continuing, particularly in the technology space.

## SUMMARY

- > Significant headwinds facing the sector
- > Underlying revenue growth of 2%
- > NIM increased 5bps to 1.98% despite impact of basis
- > Lending growth funded by improved deposit mix
- > Expense growth contained while still investing in the business

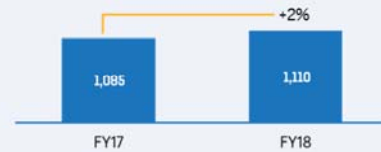
## LENDING & DEPOSIT GROWTH (\$M)



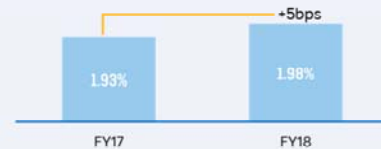
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(1) Excludes the \$16m profit on disposal of a vendor finance entity in FY17

## UNDERLYING REVENUE GROWTH (\$M)<sup>(1)</sup>



## NET INTEREST MARGIN



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While the business continues to grow, we have maintained focus on delivering results.

There is no doubt that 2018 has been a tough year for banking sector. Public scrutiny and regulatory change, slowing credit growth and changing customer expectations have all had an impact.

Despite this, we have delivered underlying revenue growth of two per cent. This result was supported by a five basis point improvement in net interest margin.

Lending growth was almost fully funded by customer deposits. There was also an improvement in the funding mix.

Expense growth was prudently managed at three per cent with core expense growth of just one per cent. This was achieved while still investing in the business.

## SUMMARY

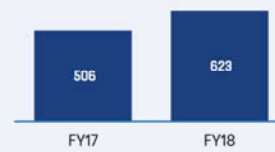
- > Total loan growth of \$1.5bn with above-system growth in commercial
- > VMA & BOQ Specialist continue to drive housing loan growth
- > BOQ Finance delivered particularly strong growth
- > Branches funded lending growth through solid levels of deposit growth

## HOUSING LOAN GROWTH (\$M)

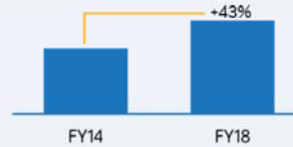


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## COMMERCIAL NICHE SEGMENT GROWTH (\$M)



## DEPOSITS PER BRANCH



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The performance of our commercial niche business segments has been a stand-out again.

We achieved lending growth of 623 million dollars across these segments which include the health sector, retirement living, hospitality and agribusiness.

In the housing loan portfolio, Virgin Money Australia and BOQ Specialist continued to deliver strong levels of growth. These businesses contributed to 653 million dollars of total housing loan growth.

BOQ Finance had a particularly strong year with growth of 250 million dollars. The prospects for this business remain strong. In the new financial year we established a new partnership with Harley-Davidson to provide finance through their 46 Australian dealerships. This demonstrates our capability in delivering finance solutions to iconic global brands.

The loan book in the branch network contracted. This is in line with the expansion of our channels and corresponds with a 27 per cent reduction in branch numbers from FY14 to FY18.

Despite this, we have seen an increase in deposit balances, with deposits per branch increasing 43 per cent over that period. This shows the important role that our branches continue to play in our distribution footprint and the overall funding of the group.



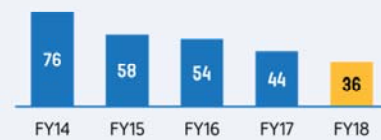
## SUMMARY

- > Impaired assets down 15%, loan impairment expense down 15%
- > Arrears levels remain benign and favourable to peers
- > Ongoing improvement a direct consequence of clear risk appetite and responsible lending practices

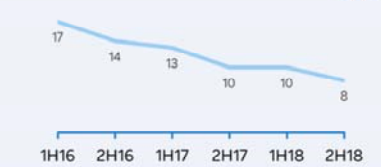
## 90-DAY HOUSING ARREARS (bps)<sup>(1)</sup>



## IMPAIRED ASSETS % OF GROSS LOANS (bps)



## GROUP IMPAIRMENT EXPENSE / GROSS LOANS (bps)



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(1) Peer data based on Pillar 3 Residential Mortgage disclosures

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The improvement in our asset quality metrics is very pleasing.

Impaired assets and loan impairment expense both reduced 15 per cent from FY17. Our bad debt expense was just eight basis points of total loans in the second half. Arrears levels remain low and steady, comparing favourably with peers.

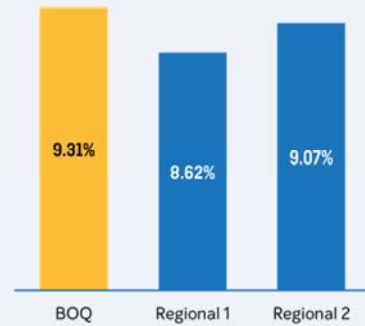
These metrics are the direct result of the very deliberate approach we have taken to risk management. We have a clear risk appetite with responsible and robust lending practices.

As I have said in the past, we have also benefitted from validating 100 per cent of home loan applications.

## SUMMARY

- > CET1 ratio compares favourably with peers
- > Customer expectations around digital experience continue to rise
- > Additional capital investment will help to position the business for future success
- > 7bps of additional CET1 to be utilised for digital banking platforms and customer experience improvements

## CET1 CAPITAL VS PEERS<sup>(1)</sup>



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(1) Peer data based on most recent full year disclosures for Bendigo & Adelaide Bank and Suncorp Bank

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Our capital position remains strong with a common equity tier one ratio of 9.31 per cent.

Customer expectations are rapidly changing when it comes to digital experience. We have therefore decided to take advantage of our strong position and invest for the future.

We plan to increase capital expenditure in FY19 to focus the business for future success.

This will involve utilisation of seven basis points of additional CET1 to enhance our digital banking platforms and improve customer experience.

I will talk more about this in the outlook.

For now I will hand over to Matt to discuss the financials in more detail.

# FINANCIAL DETAIL

MATT BAXBY  
CHIEF FINANCIAL OFFICER

## FINANCIAL PERFORMANCE: YEAR ON YEAR

	FY18	FY18 v FY17	FY18 v FY17 adjusted <sup>(1)</sup>
Net interest income	\$965m	4% ▲	4% ▲
Non interest income	\$145m	(17%) ▼	(9%) ▼
<b>Total income</b>	<b>\$1,110m</b>	<b>1%</b> ▲	<b>2%</b> ▲
Operating expenses	(\$527m)	3% ▲	3% ▲
<b>Underlying profit</b>	<b>\$583m</b>	<b>(1%)</b> ▼	<b>2%</b> ▲
Loan impairment expense	(\$41m)	(15%) ▼	(15%) ▼
<b>Profit before tax</b>	<b>\$542m</b>	-	<b>3%</b> ▲
Income tax expense	(\$170m)	5% ▲	5% ▲
<b>Cash earnings after tax</b>	<b>\$372m</b>	<b>(2%)</b> ▼	<b>3%</b> ▲
Cash basic earnings per share	94.7c	(3%) ▼	1% ▲
Return on average tangible equity	12.9%	(80bps) ▼	(30bps) ▼

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<sup>(1)</sup> Excludes the \$16m profit on disposal of a vendor finance entity in FY17

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Thanks Jon. I'll begin with the group profit and loss on slide 12. We've shown the headline numbers here as well as an adjusted view. As Jon mentioned earlier, we had a 16 million dollar profit on disposal of a vendor finance entity in FY17. The adjusted view excludes this, due to its one-off nature.

Our cash earnings after tax increased three per cent on an adjusted basis to 372 million dollars.

Growth in lending assets and an improvement in margin helped drive net interest income growth of four per cent.

Expense growth was tightly contained at three per cent which meant underlying profit growth was two per cent on an adjusted basis.

Loan impairment expense reduced 15 per cent.

## FINANCIAL PERFORMANCE: HALF ON HALF

	2H18	2H18 v 1H18	2H18 v 2H17 adjusted <sup>(1)</sup>
Net interest income	\$490m	3% ▲	3% ▲
Non interest income	\$70m	(7%) ▼	(11%) ▼
<b>Total income</b>	<b>\$560m</b>	<b>2% ▲</b>	<b>1% ▲</b>
Operating expenses	(\$265m)	1% ▲	2% ▲
<b>Underlying profit</b>	<b>\$295m</b>	<b>2% ▲</b>	<b>1% ▲</b>
Loan impairment expense	(\$19m)	(14%) ▼	(10%) ▼
<b>Profit before tax</b>	<b>\$276m</b>	<b>4% ▲</b>	<b>2% ▲</b>
Income tax expense	(\$86m)	2% ▲	2% ▲
<b>Cash earnings after tax</b>	<b>\$190m</b>	<b>4% ▲</b>	<b>2% ▲</b>
Cash basic earnings per share	48.2c	4% ▲	-
Return on average tangible equity	13.0%	10bps ▲	(20bps) ▼

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(1) Excludes the \$16m profit on disposal of a vendor finance entity in FY17

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Turning to the half on half performance on slide 13.

There was good momentum evident in the second half relative to the first, although this is partially driven by a higher day count.

Net interest income grew three per cent, expense growth was kept to just one per cent and we saw a 14 per cent improvement in loan impairment expense.

All of this resulted in a four per cent increase in second half cash earnings.

## SEGMENT PERFORMANCE: YEAR ON YEAR

	RETAIL BANKING		BOQ BUSINESS	
	FY18	FY18 v FY17	FY18	FY18 v FY17 adjusted <sup>(1)</sup>
Net interest income	\$458m	3%	\$514m	7%
Non interest income	\$67m	(3%)	\$59m	(5%)
<b>Total income</b>	<b>\$525m</b>	<b>2%</b>	<b>\$573m</b>	<b>5%</b>
Operating expenses	(\$281m)	3%	(\$228m)	4%
<b>Underlying profit</b>	<b>\$244m</b>	<b>1%</b>	<b>\$345m</b>	<b>6%</b>
Loan impairment expense	(\$15m)	7%	(\$26m)	(24%)
<b>Profit before tax</b>	<b>\$229m</b>	<b>1%</b>	<b>\$319m</b>	<b>10%</b>
Income tax expense	(\$72m)	3%	(\$100m)	11%
<b>Cash earnings after tax</b>	<b>\$157m</b>	<b>-</b>	<b>\$219m</b>	<b>10%</b>

In the first half we began reporting on segment performance, which reflects the way we manage the business day to day.

To recap, Retail Banking includes housing loans and deposits originated through the branch network, direct channels, Virgin Money Australia and our mortgage broker channel. For clarity, it excludes home loans originated by BOQ Specialist and also excludes SME loans originated through branches.

These sit with BOQ Business which also comprises our BOQ branded commercial loans as well as BOQ Specialist and BOQ Finance.

BOQ Business saw strong earnings growth of 10 per cent on an adjusted basis, driven by above-system lending growth and lower impairment expense.

In the Retail Bank, cash earnings were flat year on year with margin improvement and good expense management offset by slightly higher impairments.

## SUMMARY

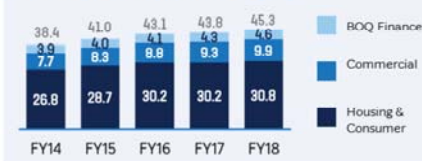
- > Gross loan growth of 3% in a slowing market
- > Commercial lending growth of 1.2x system, driven by niche segments
- > Housing growth driven by VMA and BOQ Specialist, with improvement in branch network
- > Maintained discipline around credit standards

## TOTAL LENDING GEOGRAPHIC MIX



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## GROSS LOANS & ADVANCES (\$B)



## HALF YEARLY GROWTH COMPOSITION (\$M)



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Moving to the loan portfolio on slide 15, we delivered total loan growth of three per cent for the year. This represented a year on year improvement of 797 million dollars.

This was made up of strong growth in commercial lending at 1.2 times system, driven by niche segments. BOQ Finance also made a strong contribution with growth of 250 million dollars. Housing loan growth of 653 million dollars was driven by Virgin Money Australia and BOQ Specialist.

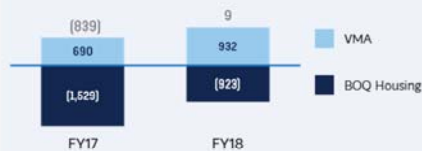
This growth has been achieved while maintaining discipline around credit standards and further diversifying the portfolio by geography and line of business.

Our Queensland exposure has reduced from 60 per cent in 2012 to 44 per cent in 2018, and our channels of origination have also been diversified, with the broker channel delivering 30 per cent of home loan settlements.

## RETAIL BANKING SUMMARY

- > Improved growth profile supported by VMA and BOQ Broker channel
- > Growth being balanced with margin and risk
- > Branches focused on deposit gathering and MFI customer growth

## RETAIL HOUSING LOAN GROWTH BY CHANNEL (\$M)

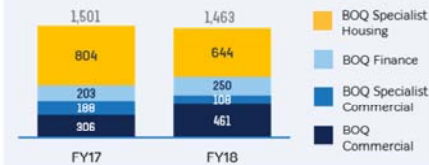


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## BOQ BUSINESS SUMMARY

- > Consistent growth across all business lines
- > BOQ Specialist mortgage growth remains strong
- > Niche segment growth of \$623m
- > BOQ Finance delivered solid growth through structured programs

## BOQ BUSINESS LOAN GROWTH BY CHANNEL (\$M)



16

Looking at loan growth by segment, on slide 16 you can see the breakdown by channel within each division.

In the Retail Bank, Virgin Money Australia has continued momentum with 932 million dollars of housing loan growth in FY18 compared to 690 million dollars in FY17.

There was a 606 million dollar improvement in BOQ housing loan performance, although the portfolio contracted as the impacts of lower branch numbers and more stringent credit practices relative to peers continued to be felt.

In BOQ Business, there was solid, above system growth across all channels, demonstrating the value of our relationship-based service offering to business customers. BOQ Specialist's mortgage business saw continued strong growth, as did commercial lending to our niches of retirement living, hospitality and agribusiness. In total, these niches delivered 623 million dollars of commercial lending growth during the year.

BOQ Finance delivered continued year on year and half on half growth through structured programs in its target vendor and equipment finance customer segments.



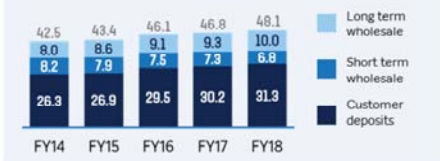
SUMMARY

- > Customer deposit growth of 4%
- > Deposit to loan ratio of 69%
- > Shift in mix towards savings from term deposits
- > Selective long term wholesale issuance when market conditions permit

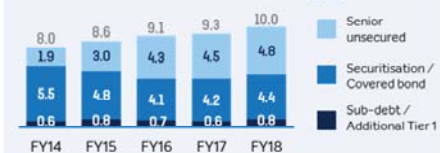
CUSTOMER DEPOSIT MIX



OVERALL FUNDING MIX (\$B)



LONG TERM WHOLESALE FUNDING (\$B)

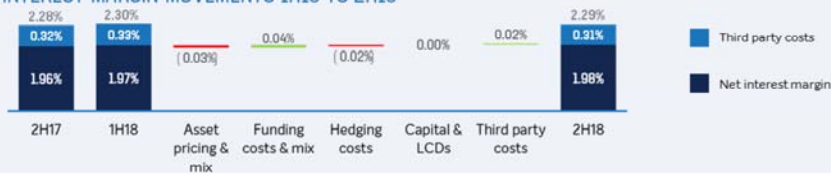


Moving to our funding mix on slide 17, there has been four per cent growth in customer deposits with our deposit to loan ratio at 69 per cent.

This was driven primarily through our branch network, where our branches have become more focused on growing relationship based at-call savings balances. This means we have been less reliant on term deposits.

We also took opportunities to tap wholesale markets when pricing was tight earlier in the year, which set us up nicely for the second half.

## NET INTEREST MARGIN MOVEMENTS 1H18 TO 2H18



### 2H18 CONSIDERATIONS

- > Hedging cost headwind mitigated by improvements driven through funding mix and asset pricing
- > Front book vs back book impact ongoing
- > 2bps benefit from extension in weighted average life of housing loans, reflecting portfolio trends

### SUMMARY OF KEY MOVING PARTS<sup>(1)</sup>

Element	2H17	1H18	2H18
Asset pricing benefits	+6bps	+4bps	+2bps
Front book pricing & mix	(4bps)	(5bps)	(5bps)
Funding costs & mix	+5bps	+2bps	+4bps
Hedging costs	-	-2bps	(2bps)
Capital & LCDs	(2bps)	(1bp)	-

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(1) Other moving parts include a -1bp impact in 1H18 and a +2bps impact in 2H18 related to Third party costs.

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This improved funding mix helped to support our net interest margin in the second half, with an increase of one basis point to 1.98 per cent. This represented a five basis point improvement in NIM year on year.

We made a change to the weighted average life of our housing loans based on behaviour we have been observing in the portfolio over time. Due to the accounting treatment of deferred acquisition cost, this change increased net interest income and resulted in a two basis point NIM benefit in the half. This is evident through the third party cost element in the chart. If this did not occur, our NIM would have contracted one basis point in the half.

Stepping through the other moving parts here on slide 18, the second half has played out slightly better than we expected.

The front to back book pricing dynamic is having an ongoing impact, with a drag of five basis points in the half. If anything, with the current pricing behaviour in the market we are seeing the gap between the front and back book widen as the demand for new lending slows.

We also benefitted from some of the portfolio repricing activity during the half which provided two basis points support for NIM.

This helped to offset the impact resulting from the spike in bank bills relative to the cash rate. Elevated basis and hedging costs impacted our margin by two basis points in the half.

On a positive note, and as I touched on in the previous slide, we took a number of steps to improve our funding mix which benefitted our NIM by four basis points in the half. This included reducing carded term deposit rates and utilising analytics and negotiated pricing to improve spreads in the TD book. We also saw good growth in savings accounts and took opportunities in the wholesale market when they arose.

The outlook for net interest margin is always difficult to forecast. I will take you through the moving parts as we see them.

Absent a change in the market, the front to back book pricing dynamic is ongoing, and we would expect a headwind of around five basis points per half on this aspect.

The last round of BOQ's mortgage repricing took effect in July, and we would expect a benefit of around three basis points to flow through in the first half of FY19.

The cash to bills spread does appear to be structural, and if this is correct, it will remain a headwind in the period ahead. We have managed to hedge our exposure out to the new calendar year, but at elevated levels.

Capital and low cost deposits is expected to reduce NIM by around one basis point if current rates implied by the forward yield curve prevail.

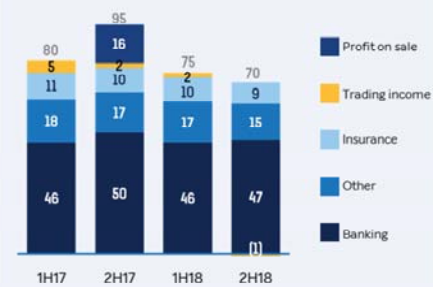
That leaves funding costs which can go either way depending on competition and market conditions.

As always, though, competitive dynamics and funding markets can influence these elements quite significantly in a short space of time.

## SUMMARY

- > Ongoing pressure on banking fees
- > Limited opportunities for trading income generation
- > Insurance income continues to trend lower
- > Digital financial market offering to launch in FY19 should start to provide some offset

## NON INTEREST INCOME BREAKDOWN (\$M)



Moving to non interest income on slide 19.

We have been saying for a number of periods that non-interest income is a very challenging line to maintain. This has been evident in this half with a five million dollar reduction.

Banking fees face ongoing pressure as customers gravitate towards low- or no-fee products.

There have been limited opportunities to generate trading income which has been reflected in other bank results as well.

Insurance income continues to trend lower.

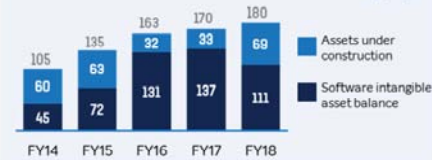
To address these headwinds we have been investing in a digital financial markets platform which is scheduled for launch in 2019. This will deliver a competitive offering for our business customers to transact in foreign currencies as well as hedging their interest rate and currency risk.

We have also seen year on year growth in Virgin Money Australia's white label product distribution business, particularly in the credit card portfolio.

## SUMMARY

- > Expense growth contained to 3%; CTI 47.5%
- > Core expense growth of 1%<sup>(1)</sup>
- > Amortisation increasing with ongoing IT investment
- > Increased capital investment flagged for FY19

## CARRYING VALUE OF INTANGIBLE ASSETS (\$M)



## OPERATING EXPENSE BREAKDOWN (\$M)



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(1) Core expenses excludes amortisation and costs associated with the Virgin Money mortgage offering

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Turning to operating expenses on slide 20 and we have maintained a disciplined approach given the lower revenue growth environment.

The increase of three per cent was driven primarily by higher amortisation as we have continued investing in technology to support the business for the long term. We have increased annual capitalised investment spend from 29 million dollars in FY13 to around 70 million dollars in FY18. This is still only six per cent of revenue, so not excessive by any means.

Core expense growth was one per cent year on year, which is a very strong result. We have benefitted from initiatives such as increased digitisation and improved vendor management which have helped to reduce costs.

The rising cost of compliance, plus the investment required to support our faster growing businesses, means we continue to look for better ways to do things and make our processes more efficient.

The software intangible asset balance reduced by 26 million dollars over the year. 16 million dollars of this reduction was largely due to a more conservative assessment of the remaining useful life of intangible assets.

	FY18	FY17
<b>Cash earnings after tax</b>	<b>\$372m</b>	<b>\$378m</b>
Amortisation of acquisition fair value adjustments	(\$7m)	(\$13m)
Hedge ineffectiveness	(\$3m)	(\$9m)
Integration / transaction costs	(\$1m)	(\$1m)
Regulatory / compliance	(\$9m)	-
Software changes	(\$11m)	-
Legacy items	(\$5m)	(\$3m)
<b>Statutory Net Profit after tax</b>	<b>\$336m</b>	<b>\$352m</b>

Given the one-off nature of these software changes, the expense has been excluded from cash earnings, which is an 11 million dollar after-tax impact.

There were two other specific items that have been excluded from cash earnings this year due to their one-off nature.

The legacy items category totalling five million dollars is primarily related to the costs associated with the settlement of the Petersen class action, which was concluded in the second half.

And the regulatory and compliance category totalling 9 million dollars relates primarily to external legal costs associated with the Royal Commission and other regulatory events considered to be extraordinary in nature.

We believe that given the one-off nature of these items, it is appropriate to exclude them from cash earnings. This should enable more effective comparison of BOQ's underlying performance across reporting periods.

## SUMMARY

- > Ongoing improvement evident across all metrics
- > 15% reduction in impaired assets and loan impairment expense
- > Low volume of new impairments

## LOAN IMPAIRMENT EXPENSE BY PRODUCT (bps)



## IMPAIRED ASSETS (\$M)



## NEW IMPAIRED ASSETS (\$M)



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The asset quality trends you can see on slide 22 are all heading in the right direction. This is a direct result of the disciplined approach we have taken to managing within our clearly defined risk appetite.

Impaired assets reduced 15 per cent, while loan impairment expense was the equivalent of nine basis points of gross loans over the year.

After two unusually low halves, loan impairment expense for BOQ Finance returned closer to historic levels and more in line with what we regard as ‘through the cycle’ loss experience. We have seen continuing strong arrears performance and have no concerns about the quality of this portfolio.

## SUMMARY

- > Arrears level remain low and steady across all portfolios
- > Small increase in commercial arrears
- > No areas of concern emerging

## HOUSING ARREARS (bps)



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## COMMERCIAL ARREARS (bps)



## BOQ FINANCE ARREARS (bps)



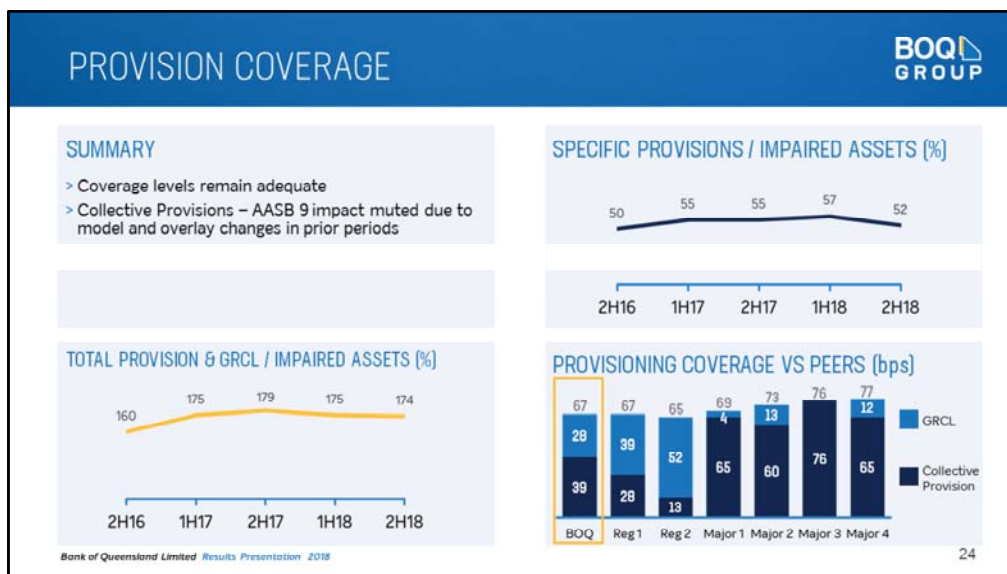
23

The story is similar for arrears performance across our other portfolios, which have remained steady at low levels.

Although some banks have reported an increase in housing arrears in recent periods, this is not something we have experienced. We credit this to our disciplined approach to lending standards and continued diversification of our lending portfolio.

The slight increase in both 30 and 90 day commercial arrears is attributable to three facilities totalling 15 million dollars that are expected to return to the performing category in the next half. If these facilities are excluded, arrears is in line with previous periods.





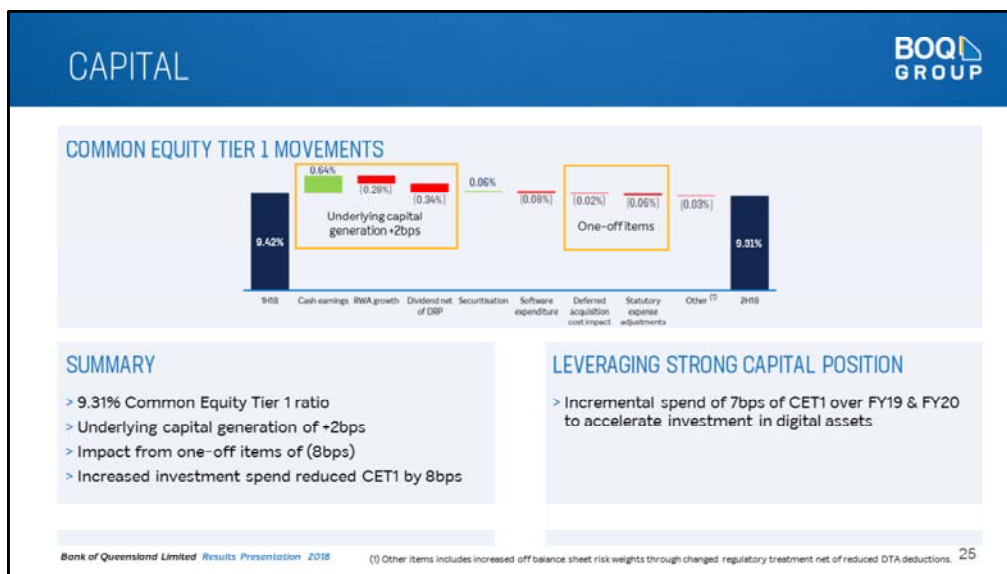
Provisioning levels remain adequate across the portfolio.

Total provisions decreased by 26 million dollars during the year. The majority of this reduction was due to the specific provisioning balance, which declined in line with the reduction in the impaired asset balance.

Our provisioning coverage is in line with our peers when looking at collective provisions and general reserve for credit losses, relative to risk-weighted assets.

The Bank's new collective provisioning model has continued to be refined during the year and is reflective of the Group's improved credit quality and model enhancements. As previously flagged, the new model has been designed in accordance with the requirements of AASB 9, which was formally implemented on 1 September 2018.

As has been observed across the industry, the adoption of AASB9 in the FY19 financial year has resulted in a one time transitional adjustment. This has been recognised against BOQ's opening retained profits as at 1 September 2018. There will be a 3 basis point impact on capital arising from this, but no impact on the FY19 cash or statutory profit results.



Finishing with capital on slide 25, our CET1 ratio remains strong at 9.31 per cent.

Underlying capital generation was two basis points. The impact from risk-weighted asset growth was higher than in the first half, partially due to a higher mix of commercial loan growth relative to housing loan growth. This is how our two halves tend to play out.

The dividend impact was also slightly higher as there was a lower level of DRP participation compared to prior periods.

There were a number of one-off impacts to CET1. The regulatory and legacy costs we flagged resulted in a six basis point reduction in CET1, while the change in the weighted average life of housing loans consumed two basis points. The non-recurring adjustment to software assets taken in the half had a neutral impact on CET1.

There was a positive impact of six basis points due to the capital efficient securitisation transaction we completed in the half.

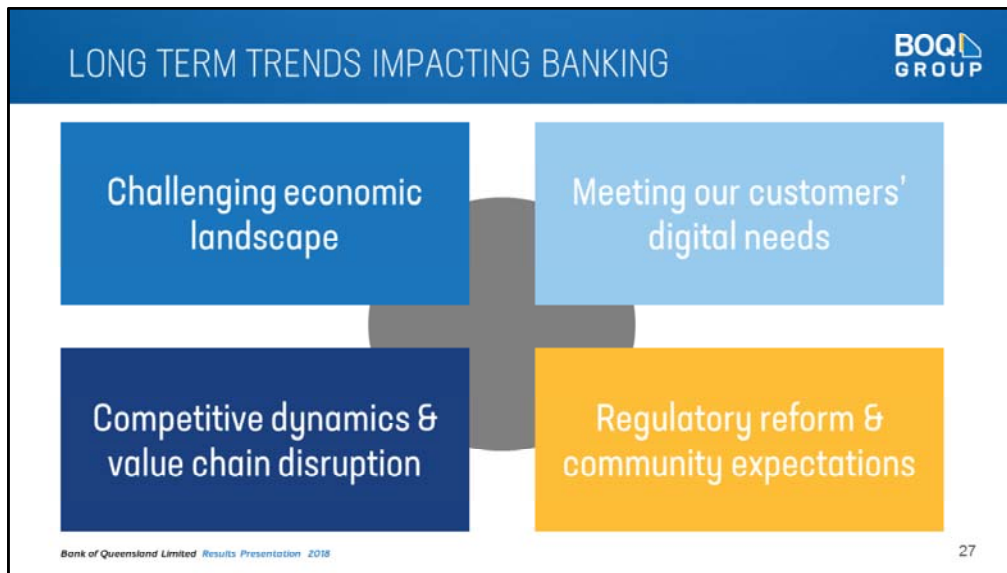
There was a CET1 deduction of eight basis points due to an increase in software spend as part of our BAU portfolio that occurred during FY18. This was more pronounced in the second half but we expect this will continue in FY19.

At this stage we are planning to utilise the equivalent of seven basis points of CET1 to support additional investment during the next 12 months, in order to accelerate our digital transformation.

I'll hand back to Jon to provide some more colour on the outlook and how this will support the execution of our strategy.

# SUMMARY & OUTLOOK

JON SUTTON  
MANAGING DIRECTOR & CEO



Thanks Matt.

Looking at the broader picture, there are a number of long term trends that are shaping the sector. These will create a host of challenges, but also opportunities, especially for BOQ.

The economic landscape is changing. Slower housing credit growth, lower house prices and stagnant wage growth will have an impact on revenue across the industry.

Customer digital needs remain a key focus, and we recognise increased investment is required.

We remain in a highly competitive environment and as a result value chain disruption continues at pace.

In addition, banks face ongoing public scrutiny and the likelihood of further regulatory change.

We believe BOQ is well positioned because of its simpler business model and risk based approach.

STRATEGIC FOCUS					BOQ GROUP
Execution pillars	Customer in charge	Grow the right way	Always a better way	Loved like no other	
<b>BOQ goals</b>	<ul style="list-style-type: none"> <li>&gt; Achieving digital parity and meeting our customers' digital needs</li> <li>&gt; Delivering a seamless customer experience</li> <li>&gt; Tilting to higher margin segments</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Lift MFI penetration through deposit gathering and pricing for risk</li> <li>&gt; Treat data as a strategic asset</li> <li>&gt; Ensuring a state of readiness to respond to regulatory reform</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Overhauling key processes</li> <li>&gt; Developing capabilities to drive efficiency through digitization</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Define and bring to life our purpose for our people and customers</li> <li>&gt; Deliver a differentiated service offering</li> </ul>	
<b>Key initiatives</b>	<ul style="list-style-type: none"> <li>&gt; Upgraded or new digital banking platforms and apps</li> <li>&gt; Accelerate VMA digital bank opportunity</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Focus distribution channels towards deposit gathering and MFI</li> <li>&gt; Close key product gaps to support deeper customer relationships</li> <li>&gt; Develop strategic response to potential regulatory reform</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Establish lending centre of excellence</li> <li>&gt; Continuous improvement initiatives</li> <li>&gt; Digitisation of processes</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Engage our people to define and start to embed our purpose-led culture</li> <li>&gt; Revitalise BOQ core business market positioning</li> </ul>	

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Our strategy to diversify lines of business is the right one. An example of this is the growth of Virgin Money Australia, BOQ Specialist, BOQ Finance and our niche commercial segments.

Progress has been made with improving our technology.

We have successfully implemented a number of projects utilising our API gateways, allowing us to partner with third parties to deliver better solutions. For example the new Virgin Money Australia credit card app and a digital financial markets platform which is scheduled for launch early next calendar year.

In 2019, work will continue on modernising our technology infrastructure, simplifying our core banking platform and shifting towards a hybrid cloud environment.

These initiatives will help us deliver improved digital banking platforms that meet the changing needs of our customers.

Importantly, we know digitally active customers are more engaged, more profitable and are increasing in numbers. We recognise that there is work to do so that we meet the needs and expectations of these customers.

## FASTER TRACK TO DIGITAL PARITY

- > Investing in platforms that can be leveraged across all brands
- > Focus on enhancing connectivity with customers
- > Keeping pace with expectations of digitally active customers

## VMA OPTIONALITY RETAINED

- > Proven power of Virgin brand to attract new and valuable customer segments
- > Exploring options to leverage the potential of the brand

## ACCELERATED INVESTMENT PRIORITIES



In 2019, we are accelerating a series of targeted investments to fast track our digital strategy.

This will include upgrading our digital banking and customer engagement platforms and modernising our call centre systems. These initiatives will be leveraged across all of our brands.

The proven success of Virgin Money in Australia across multiple products gives us great confidence in this brand's future. Our aspiration remains for it to become a full service digital bank.

We are looking closely at new technologies which will significantly enhance the customer experience and develop the potential for this strong brand.

- 1 Strategy delivering results
- 2 Asset quality resilient
- 3 Investing for future customer needs
- 4 Ready to respond to regulatory reform

In summary, the environment remains one of change but we firmly believe that our strategy is the right one.

What is particularly pleasing is the acceleration of growth we have seen across our niche business segments and Virgin Money Australia.

We continue to deliver results while managing the business for the long term.

Our asset quality metrics demonstrate our portfolio is resilient.

We are taking advantage of our strong capital position to invest for the future.

While the likelihood of further regulatory change is high, we remain committed to delivering positive customer outcomes. We will also continue to advocate for competitive neutrality.

Our future focus will be on enhancing the digital capability across the Group.

Finally, we are confident that BOQ has a key role to play in servicing the needs of retail and commercial SME customers, now and in the future.

Thank you. I'll hand back to Tanny to moderate Q & A.

# APPENDICES



## SUMMARY

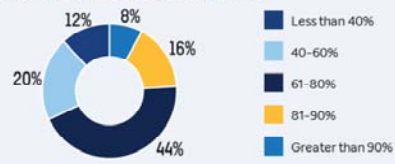
- > Broker settlements at 30% including VMA
- > Interest only settlements reduced significantly
- > Owner occupied P&I loans represent 50% of portfolio

## PORTFOLIO METRICS

Metrics(%)	2H17	1H18	2H18
Owner occupied	59	59	59
Investment	41	41	41
Interest only	37	32	29
Broker originated <sup>(1)</sup>	11	13	15
Weighted avg LVR	67	67	67
Line of Credit	8	7	6
Avg loan balance	\$269k	\$275k	\$280k
Variable rate	72	71	74
Fixed rate	28	29	26

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## HOUSING PORTFOLIO LVR BANDS



## SETTLEMENT METRICS

Metrics(%)	2H17	1H18	2H18
Owner occupied	63	61	61
Investment	37	39	39
Interest only	37	16	14
Broker originated <sup>(1)</sup>	28	30	30
Weighted avg LVR	69	68	69
Line of Credit	1	1	1
Avg loan balance	\$381k	\$354k	\$408k
Variable rate	72	72	80
Fixed rate	28	28	20

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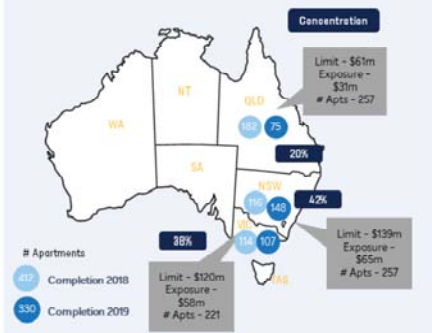
## APARTMENT CONSTRUCTION EXPOSURES

- > \$154m current exposure to residential construction
- > 14 developments across 3 states, completing 2018 through 2019
- > Well diversified intra-state within NSW and VIC

## OTHER HIGH RISK SECTORS

- > No material regional housing exposures
- > No systemic issues emerging
- > Direct mining exposure <\$100m

## LENDING TO RESIDENTIAL APARTMENT CONSTRUCTION



1H: First half of financial year	DTA: Deferred tax asset
2H: Second half of financial year	FPS: Earnings per share
30DPD: 30 days past due	FY: Financial year
90DPD: 90 days past due	GLA: Gross Loans & Advances
AASB: Australian Accounting Standards Board	GRCL: General Reserve for Credit Losses
APRA: Australian Prudential Regulation Authority	LCD: Low cost deposit
APS: ADI Prudential Standards	LOC: Line of Credit
Apts: Apartments	LVR: Loan to valuation ratio
AT1: Additional Tier One	MF: Main Financial Institution
Avg: Average	NIM: Net Interest Margin
BDD: Bad & Doubtful Debt Expense	OMB: Owner Managed Branch
bps: basis points	P&I: Principal & interest
CAGR: Compound annual growth rate	PCP: Prior corresponding period
CET1: Common Equity Tier 1	ROE: Return on equity
cps: Cents per share	ROTE: Return on tangible equity
CPS: Convertible Preference Shares	RWA: Risk-weighted assets
CTI: Cost-to-income ratio	SME: Small and Medium Enterprises
DPD: Days past due	TD: Term deposit
DRP: Dividend Reinvestment Plan	VMA: Virgin Money Australia

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