



CHAIRMAN'S SPEECH – KERRY BETROS

Annual General Meeting

30 October 2019

Good afternoon and welcome to the Heritage Bank AGM for 2019.

It is my honour on behalf of the Board to again have the opportunity to report to members on the achievements of Heritage Bank and on what lies ahead for us.

I would like to begin by acknowledging the Giabal and Jarowair peoples, the Traditional Custodians of the land that we're meeting on today, and pay my respect to elders past, present and emerging.

This year has been notable at Heritage for many reasons. We have again announced strong financial results in 2018/19, with growth in our overall loan portfolio, our retail deposits, our total assets, and in the capital that underpins our Bank. We achieved that despite a generally subdued operating environment.

Our CEO will provide more detail on our financial results shortly but suffice to say our Bank is in excellent shape.

A major highlight of the year has been surpassing the milestone of \$10 billion in total consolidated assets. That is a significant achievement and speaks to the continued success and strength of this organisation. A key strategic goal at Heritage is building a bank to be proud of, and one of the ways we achieve that is by continuing to build the value of the asset that our members collectively own. We've done that successfully throughout our 144-year history, and I'm very proud that we've grown to now rank as Australia's largest customer owned bank. It's interesting to note that we reached \$1 billion in assets as recently as 1995. That grew to \$5 billion by 2005, and we've now surpassed \$10 billion. I look forward to continued growth in the years ahead.

The Australian banking sector is currently facing unprecedented circumstances. Official interest rates are at their lowest level in history, now sitting below one per cent, and are likely to remain low for an extended period. That's compressing interest margins for retail banks. The economy as a whole is sluggish and trade tensions overseas are not helping confidence. It's an environment that financial institutions have never before had to deal with.

Having said that, I am extremely optimistic that Heritage Bank has the right strategies in place to continue to thrive well into the future. We are targeting strong customer growth in the years ahead, with a goal of reaching 450,000 customers within the next decade. That is a challenging target but is definitely within our reach. We will succeed in doing so by continuing to place our members at the centre of our decision making at all times.

We do that because our ownership structure means our members are the reason we exist. We do not have the inherent conflict that the ASX-listed banks face in trying to serve two masters at the same time – shareholders and customers. At the end of the day, their prime responsibility is to

generate a return on investment for their shareholders – their owners.. So there is an inherent conflict in trying to serve the best interests of both shareholders and customers at the same time.

Heritage does not have that conflict. Our customers are our owners, so we are very clear about whose interests we act in. Our profits stay in our business, and we use them to help provide better value to our members.

That is our point of differentiation compared to the big banks. Our customer-centric orientation flows through into all our decision-making and is a core component of the service proposition that will help us attract new members. It's why we enjoy such high levels of customer satisfaction and deliver such great financial benefits.

In fact, independent analysis from research company Canstar found that Heritage members were \$79 million a year better off in 2018/19 through banking with us rather than one of the big four banks. Despite our difficult operating environment, that's up considerably from the \$68 million our members saved the previous financial year.

In fact, over the last five financial years, according to Canstar, Heritage members have received a total additional benefit of \$293 million by banking with us, rather than with one of the big four banks.

That's a compelling demonstration of the financial value that banking with a customer-owned institution delivers.

But it's not just about financial value. It's about providing a rewarding and satisfying banking experience as a whole. I'm proud that Heritage continues to deliver in that way as well. Our success in doing so can be gauged through the external awards and recognition that we received in the 2018/19 year.

We can all be particularly proud that Heritage was acknowledged by Roy Morgan as the Bank of the Year for Customer Satisfaction in 2018. That accolade was based on the results of monthly surveys Roy Morgan carries out across Australia, with our customers consistently giving us the highest satisfaction rating of all financial institutions in the country.

That level of customer satisfaction also comes about because we do place great value on the interests not just of our members, but of the communities that they live in. We understand that we have wider responsibilities to foster growth and development in our society.

With that in mind, I am delighted to advise that in the 2018/19 year we finalised all the legal and regulatory requirements to make the Heritage Bank Charitable Foundation operational.

I announced at last year's AGM our intention to set up the Charitable Foundation, as the philanthropic arm of Heritage Bank. This is a standalone entity that will provide grants to worthy charitable organisations working to improve wellbeing and life outcomes for communities across Australia.

The Foundation is now up and running. Heritage provided seed funding of \$2 million in 2018/19 and will contribute a further \$500,000 in the 2019/20 financial year.

The Foundation is now also able to accept tax-deductible donations from the public, and building up the coffers will continue to be a focus. The Foundation will fund its grants program from the interest it earns, so it is vital to build up a sizeable pool of funding.

We know just how generous our customers and our communities are, and we are confident they will put their support behind the Foundation's activities.

Our intention is to launch the first round of grant applications in 2020.

The Heritage Bank Charitable Foundation embodies our "People first" philosophy and will make a positive contribution to the world we live in.

So, Heritage has a lot to offer, for our members and our communities. Our challenge is to translate that fantastic proposition into increased market share, so we can build and grow our business.

We have taken a number of key strategic decisions to put us in a better position to secure those increased member numbers. I will talk briefly about two of those.

First, is our interstate expansion. I am extremely excited to tell you that our first branch in Sydney will open at Castle Hill tomorrow. This is a hugely significant moment in Heritage's history as this is the first branch we've ever opened outside our heartland in southern Queensland. We'll open a second branch at Parramatta in early December. That rationale for moving interstate is as simple as it is compelling. You may have heard the saying "fish where the fish are". That's exactly what we are doing. In Sydney, we are targeting the western corridor, which is already home to many thousands of people who match the demographic profile that are attracted to the Heritage brand. With the second Sydney airport now being built at Badger's Creek, this area will add a population equivalent to the cities of Canberra and Adelaide in coming years. We want to be part of that growth, with up to 10 branches in western Sydney. Similarly we will look to target growth areas of Melbourne, which also has many thousands of people who can be attracted by what Heritage has to offer. Expanding interstate is a challenging but extremely rewarding move and I'm excited at what it can achieve for Heritage.

The second is an increased focus on our business banking division. We've offered business banking services for a long time, but in a fairly limited way. We've decided to put much more effort into developing new products and capabilities in this area, with a focus on the small to medium enterprise (SME) sector. We'll start to offer our business lending services through the business broker market, which will open up many more potential avenues for customer acquisition. Our target here is to more than triple the worth of our business banking portfolio to reach \$550 million over the next three years. Again, that's an ambitious goal but one I believe we can achieve.

One reason I am optimistic about our growth ambitions is a welcome legislative development that occurred early in 2019. The Treasury Laws Amendment (Mutual Reforms) Bill 2019 passed through parliament this year, based on recommendations that came from the Hammond Review. These reforms open up opportunities for mutual institutions to issue capital-raising instruments, without losing their mutual status. This is significant because access to capital has always been a limiting factor on the ability of mutuals to expand and offer greater competition to the big banks. We have always relied on retained profits as our only source of capital. These reforms make another source of capital potentially available to us, enabling us to increase our lending, accelerate our digital investment, and grow more quickly. Today, as part of our AGM, we will be introducing a number of amendments to the Heritage constitution that will enable us to take advantage of these new capital-raising opportunities.

However, the devil is in the detail, and there is still much work to do before we will be in position to issue a capital-raising instrument. We have to be sure that the costs of issuing a capital instrument will not outweigh the benefits. Heritage will continue to lead the customer-owned sector in investigating how we can best take advantage of this legislation.

Another issue that we will continue to raise is the need for proportionate regulation in the banking sector. The Hayne Royal Commission handed down its findings in early 2019 and the results were hardly surprising, based on the evidence that had been uncovered in the hearings. It

was disappointing that the Commission found many instances where the pursuit of profits and personal gain took priority ahead of the best interests of the customer. This reflects poorly on the banking profession as a whole – a profession that plays an integral role in the effective functioning of our society. Tellingly, no customer-owned institutions were asked to appear before the hearings, or were identified as displaying the kind of questionable behaviour that was found at the big banks.

That shouldn't surprise anyone. Customer-owned banks, by their very nature, exist for the benefit of their members. We are the original peer-to-peer lenders. We don't face the conflict I mentioned earlier of also having to serve the interests of shareholding investors – a conflict that motivates actions which put profit ahead of people at other banks.

It's ironic, then, that the customer-owned sector may actually be punished for the sins of the big banks. The inevitable reaction to the Royal Commission seems to be an increase to the amount of regulatory requirements that are being placed on us. The problem is that smaller customer-owned institutions like Heritage will be hit disproportionately harder by the increased costs of regulation if we are treated in exactly the same way as the big banks.

Those extra costs will actually make smaller institutions less competitive. That means the big banks will be rewarded for their poor behaviour by regulatory actions that make it harder for smaller banks to be competitive. The money and resources needed for extra regulatory compliance would reduce our ability to offer better prices and services to customers. I'm sure that's not the intended outcome of the Royal Commission. Heritage will continue to lobby the Government strongly for proportionate regulation in the banking sector, recognising that the requirements imposed on the customer-owned institutions should be appropriate to their size and structure.

I'd like to finish by thanking and congratulating our CEO and Senior Executives, and all our team members, for their efforts throughout the year. They are the ones who live our culture and deliver the outstanding service that our members value so highly.

I also thank my Board colleagues for their support and commitment over the year. In particular, I would like to acknowledge the contribution of Susan Campbell, who retired from the Board in July this year, after almost 14 years as a Director. Susan was the first interstate Director ever appointed to Heritage and her expertise, particularly in the finance and risk areas, has been of enormous benefit to Heritage. I also acknowledge our most recent addition to the Board, Wendy Machin, who joined us in March this year and has already provided extremely valuable counsel.

It is an honour to be Chairman of this Bank, and to represent our customers, both past and present, who have helped make Heritage the successful and respected organisation it is today.

We look forward to growing stronger and more successful in the years ahead.

Thank you.
Kerry Betros
Chairman of Directors