

ANZ 2008 Annual General Meeting

Chief Executive Officer's Address
Mike Smith

Thank you Charles. Good morning everyone.

Let me add to Charles's comments about being here in Brisbane.

For a banker, there is a lot to like about Queensland. It is one of the strongest growing states in Australia with an ambition to be the strongest. By 2030 Queensland will be approaching our second largest state and by the middle of this century it could have a population of seven million people. Importantly, it is also a leader in innovation.

So you can see why the state features so prominently in our growth plans. We have invested both in building new branches and in building our management depth. In July this year we appointed Russell Shields as our first Queensland State Chairman.

Now, this is my second annual general meeting since I joined ANZ some fourteen months ago.

At my first annual general meeting I spoke about my concerns for the global economy. While some suggested I was being too alarmist, in retrospect, I may have been too optimistic. Today, what I want to provide you with is a sense of how the world is viewing the global financial crisis; my perspective of what it means for our region and for ANZ; and a picture of how we are building a stronger, more resilient, more successful super regional bank.

Charles has said that ANZ weathered a challenging year in 2008. He said that while our performance was disappointing compared to some of our domestic peers, compared to many international banks it was commendable.

I think it is very important that we retain perspective.

2008 was an extraordinary year for the whole world, and in some ways Australia has been protected from the full impact of what has been happening.

I think that without spending time in the northern hemisphere, it's very hard for those of us living in Australia and New Zealand to understand the true depth of this crisis.

Twenty five banks in the United States have failed. 230,000 jobs have been lost in banking so far.

The expectations are that job losses could reach half a million people in financial services world-wide. And write offs by financial institutions globally are around US\$1 trillion.

To restore confidence, governments across the world have had to support banks with capital and with day-to-day liquidity, along with offering guarantees on deposits and guarantees on bank debt.

Whilst the turmoil was initially in the financial sector, it is now being felt in the real economy throughout the world.

Many advanced economies are in the early stages of a recession and there is a slowdown already taking place in the emerging markets.

While Australia is better positioned - one of the few OECD economies with a budget surplus and no public debt - it has not given us immunity.

We are also extremely fortunate to have a strong banking sector.

As Charles mentioned, today only 14 banks in the world are rated AA. One of those fourteen is ANZ.

Let me amplify this point.

The Australian Government decided in October, to guarantee Australian deposits and to guarantee term wholesale funding for banks, building societies, and credit unions who are regulated by the Australian Prudential Regulation Authority.

But the four major Australian banks have not required any government capital.

This is unlike the northern hemisphere, where banks have had governments effectively becoming shareholders.

The major Australian banks are in a strong financial position and have not required taxpayer funded support or bailouts of any sort.

Nevertheless, with the environment for bank wholesale funding continuing to be very difficult, the Government Guarantee for bank term funding has placed us on a level playing field with other international banks for offshore borrowings. This has been an important element in the success of ANZ's recent US bond issue, although the pricing reflects that the appetite for Australian Government risk is not deep and investors are presently spoilt for choice.

But, here at home in Australia, all the signs of a significant economic slowdown are already with us. Retail sales growth is slowing, unemployment is rising, the Australian dollar has fallen dramatically, house prices are weakening in some areas, commodity prices have dropped and company profits are softer.

Next year the Australian economy will grow, but our economists forecast this will be by just half a per cent. This compares to growth of over three per cent in recent years.

In New Zealand the economy will likely shrink by one per cent. But the major countries in our region, like China and India, are expected to grow by 5 to 8 per cent.

For shareholders such as you and me, the consequences of the turmoil in financial markets and the impact of de-leveraging on economic growth have been significant. The share prices of major Australian banks have fallen by an average of 50% over the last year while ANZ's share price is down around 45%.

Internationally, the effect has been more dramatic. In the United States bank shares have fallen by an average of 60%, and in the United Kingdom by an average of 55%.

The fact is however, that while ANZ's market capitalisation has fallen, based on a table that I looked at recently, ANZ has overtaken leading European banks such as Fortis and Lloyds TSB, and now is about the same size as Barclays and Germany's Deutsche Bank. And today, we were around half the size of one of world's premier banks - Citigroup.

So, given this background, I am pleased that we have maintained our dividend at \$1.36 per share fully franked.

However the Board did not appoint me to run an average bank or to deliver an average performance.

But, the game has changed in global banking and the next two years are about the survival of the fittest.

In financial services the gaps between strong and weak institutions will widen further.

Stronger banks will attract more deposits; they will get the pick of new clients as other banks retreat from the market; and they will have the ability to re-price to reflect the higher cost of funds and risk. This is ANZ's space.

At the opposite end of the spectrum, it will be difficult for weaker banks to fund their lending and the quality of their loan book will deteriorate as their best customers migrate to competitors.

The two most precious resources in the world going forward will be capital and debt.

What's also obvious is that the companies that are on the front foot will have the most choice because the current crisis will offer rare opportunities.

US and European banks operating in the region are retreating to their home markets and are being forced to offload good clients and good assets to shore up their domestic businesses.

The effect of what's called de-leveraging - of companies and individuals reducing their levels of debt - will also create opportunities to secure existing customer business that makes sense and business that we have not previously held.

And of course, in this environment, bank share prices, price earnings ratios and price-to-book multiples have been reducing which is creating potential opportunities to advance our strategic agenda in Australia and in Asia in a disciplined and measured way.

The relatively high rates of economic growth in Asia and the opportunities that are available to ANZ, are why the super regional strategy we announced to shareholders at this meeting, just 12 months ago, makes so much sense.

Despite the compelling logic, we are the only one of the major Australian banks with the presence in the region, the capability and the ambition to create a super regional bank.

That is why it is so critically important we position ourselves to be able to capitalise on these opportunities.

For ANZ, like other companies, the key to surviving and thriving in these challenging times is to quickly get on with taking the necessary and unavoidable actions that will put us in the best possible shape, to come out the other side in a winning position.

When I started at ANZ in October last year, I was very clear with shareholders about what I saw happening in world credit markets.

As a result, we started taking action to get ANZ into shape for that very uncertain and very difficult environment.

What we found in 2008 after 17 years of uninterrupted economic growth however was that some parts of ANZ's business were not as resilient as the Board expected them to be, or as I had hoped they would be.

This has been one of the most difficult aspects of this year - that we have had to spend so much time on remedial action; so much time and money on addressing legacy issues.

Nevertheless, ANZ has 40,000 staff doing a great job day in, day out looking after our customers and working to the very highest standard.

We have built on this foundation by systematically and decisively taking the necessary action to prepare ourselves for the new reality which faces us.

Let me outline those key actions specifically.

We have increased capital throughout the year by actively undertaking initiatives including hybrid raisings and underwriting the Interim and Final dividends. As a result, Tier One capital now stands at 8.35%.

Using the UK Financial Services Authority methodology this equates to 10% which compares very strongly with any other international bank.

We have strengthened the balance sheet by raising our collective provision charge for the full year to include \$293 million for growth and movement in our book, and \$525 million to take into account the current environment.

This will bring our provision cover to over 1.1% of credit risk weighted assets which I think is a prudent and responsible level in the current environment.

With the existing market conditions, liquidity is crucial and we have significantly increased liquid assets to over \$55 billion, nearly three times as much as we had available in 2007, which places ANZ in a very strong liquidity position and allows us to repay all our offshore term and short term debt for a year should markets close.

Inside ANZ, we began to make some changes to key personnel to increase the number of executives with deep banking experience.

This was to address squarely what I believe to have been one of the fundamental problems in banking today – that the world got to a point after so many years of easy economic growth that there were more banks than bankers.

Today we have a strong senior team with over 250 years of banking experience on our management board.

Some of you may think this is an old fashioned view, but having managed my way through seven financial crises over the past 30 years; I am absolutely convinced that there is no substitute for bankers with experience of good times and bad, and the experience to understand and see a crisis through.

And as you can imagine at times like this, bank executives with that sort of experience are in short supply and in high demand.

We also created a new business model to simplify the way we run the bank, to reduce risk and to reduce complexity, to lift customer focus and to start the process of driving strategic cost reduction and performance improvement.

Our new structure will create clearer accountability and greater transparency. But it will also reduce numbers of middle management employees in Australia and New Zealand with around 800 people leaving ANZ in 2008.

Customer-facing staff in such areas as our branches and call centres have been largely unaffected by these changes. And most of the change will be completed in the next three months.

These changes are difficult and they are undertaken with a heavy heart, but, they are absolutely necessary for the long term interest of ANZ.

No one wants to see anyone lose their job. We have worked hard to make sure that all our employees, those who have left ANZ and those who remain, are treated consistently and with dignity.

Those people who leave ANZ are being given the appropriate notice and compensation and they are being given access to outplacement services to help them find their next role.

When we have to make difficult decisions about our business, our values of integrity, collaboration, accountability respect and excellence help us steer a path through the highs and lows of the business cycle.

There have been many difficult decisions this year to place ANZ on a new and stronger footing.

One of the most painful tasks for ANZ as a company and for me, as the chief executive, was the independent review of the issues surrounding our Securities Lending business and the actions that we took to address the shortcomings in its operation.

This Review was thorough. No stone was left unturned and it spared no one.

Charles has spoken about this issue and how the comprehensive 13-point remediation plan has addressed all the management control and accountability issues identified in the report.

We took action involving a number of employees. This included the departure from ANZ of eight managers and executives, cuts to remuneration and formal notes placed on employment records.

As I said at the time, there have been no winners from these events. The collapse of brokers has had a significant affect on the lives of many people.

The changes in our business that I have just outlined aren't cosmetic or about shifting the rudder five degrees.

They are aimed at dealing decisively with the issues facing ANZ specifically, and banking in general; and the need for us to accelerate change - to lift customer focus, to drive performance improvement and to ensure ANZ becomes a super regional bank.

The bottom line is that ANZ is now on a much stronger footing than it was a year ago.

And because of that we are very much open for business. Our underlying business is performing well with customer deposits and lending up.

As you can see from our numbers, underlying revenue was up by 12% but was hit by the accounting treatment related to credit impairment on derivatives. We expect those to substantially reverse over time.

While not insignificant, these issues are manageable.

Turning to our businesses and to add to Charles' comments:

- Australia had an excellent performance and is one of the country's best performing retail banks.
- Asia Pacific also performed very strongly, demonstrating the growth opportunities available in the region.
- New Zealand maintained market share during the year while managing the impacts of an economy in recession.
- In Institutional, there were good performances from Working Capital and Business Banking which was pleasing. However, some past issues together with the challenging business environment impacted results.

I don't want to underplay this.

Provisions, in particular individual provisions, were high - and while we will substantially write back our credit default swap exposures, what's disappointing is that those exposures came from business which was not related to our core customer franchise.

And so we have systematically tackled a number of deficiencies in the Institutional business. It is now clear some parts of the business had regularly under performed over the past decade. Institutional is now turning around, although it will probably take a further two years to complete.

Looking ahead, I believe it will take another two or three years for the world to work through the current financial situation and its economic impact.

It is clear, at least in the financial markets and banking, we will never go back to business as usual.

We are at one of those points in history where the game has changed, the paradigm has shifted.

In this environment, we have to maintain our position of strength in the world, and to ensure we are on a better footing and fully prepared for the economic challenges and the opportunities that we are facing.

My intention, and the Board's intention, is that ANZ comes out of this period as one of the strongest, best positioned and most successful banks in the region.

Our super regional strategy focussed on Asia will stand us in good stead.

The new game - the new paradigm in financial services - is the re-emergence of mega-regional banks in the US, in the UK, in Continental Europe and in Asia.

With the significance of problems in the US and Europe now being more broadly understood, the importance of China, India and the rest of Asia to the future of the world economy is now completely obvious.

So in summary, I believe we have delivered a reasonable result in difficult circumstances in 2008.

- we have maintained our dividend for shareholders;
- we have provided security and confidence for our customers;
- we have significantly improved the strength of the balance sheet; and
- we have continued to work hard to meet community expectations with responsible, sustainable banking practices.

Most importantly, I believe ANZ has put in place the right strategy and we are taking the right actions to adapt and build our business now, and in the future, to deliver stronger performance for all our shareholders.

Many thanks for listening to me today.