Westpac Banking Corporation

2016 Annual General Meeting

Adelaide, Australia

Friday, 09 December 2016

Chairman's Address

Lindsay Maxsted

Introduction

We are delighted to be holding our AGM in Adelaide. South Australia is an important State for Westpac: it is a core market for two of our brands, Westpac and BankSA; and home to important operations centres for mortgages, wealth management and customer service.

Our history in this state is rich, extending back almost 170 years when BankSA first opened its doors in 1848.

We also have a solid ownership base in South Australia with over 40,000 shareholders directly holding close to 100 million shares.

To put that in perspective –more shares are held in South Australia than some of the largest financial centres in the world including London, New York and Hong Kong.

As your representatives, the Board and I greatly appreciate your support.

Performance

I hope that you have had the opportunity to read my report in the Annual Review as well as the CEO's letter. In these reports we provide a detailed account of our performance and strategic progress and discuss some of the challenges faced by Westpac and the industry more generally.

As we stand back and assess 2016 as a whole, it has been another significant year. We have seen further regulatory change, interest rates have fallen to record lows and there have been renewed bouts of global volatility.

Against this backdrop, the Group's financial performance was solid with cash earnings flat at $7.8 billion. Our statutory net profit at $7.4 billion was lower year-on-year, mostly reflecting the significant gains linked to the partial sale of BT Investment Management included in last year's net profit, but which were excluded from our calculation of cash earnings.

A pleasing aspect of the result was the disciplined way it was achieved with good growth in target areas, well managed margins and controlled expenses. Westpac continues to be the most efficient bank in the sector.

The highlight for the year has been the strengthening of the Group's balance sheet, with a material lift in capital and a further improvement in both the quantum and quality of our liquid assets.

The combination of sound growth, a much strengthened balance sheet and good strategic progress has helped Westpac end the year in a stronger position.

The Board determined a final fully franked dividend of 94 cents per share which will be paid on 21 December 2016. Due to the lift in shares on issue and flat financial performance, the dividend has been unchanged for the last three halves.

The Group's dividend payout ratio of 80% is a little higher than what we consider to be optimal for our growth and return on equity settings. However, with a common equity Tier 1 capital ratio comfortably above our preferred range we had capacity to maintain the dividend at 94 cents.

Management performance

In February last year Brian Hartzer was appointed Westpac's 25th Chief Executive Officer. Since his appointment, Brian has implemented a new operating structure, refreshed his management team, as well as refined and sharpened the Group's service strategy.

The new team has performed well for shareholders in its first full year. Each of the Group's divisions has maintained or improved its strategic position and all have responded well to the operating environment.

Westpac was again rated the world's most sustainable bank by the Dow Jones Sustainability Index – the third year in a row and an achievement of which we are very proud.

Remuneration is always of great interest to shareholders and the Board has continued to respond to market feedback while ensuring we retain and attract executives of the highest calibre.

As I outlined last year, we have sought to ensure that remuneration levels of new executives are lower than the executives they replaced. Last year, Brian Hartzer commenced on a target salary some 16% below the prior CEO whose salary in turn had not been adjusted for 4 years. Consequently, there has been a significant reduction in his real remuneration compared to his predecessor.

We have maintained this discipline with newly appointed executives commencing on salaries generally below their predecessors. This includes two executives who commenced their roles in the new financial year and whose remuneration will be reported to shareholders next year.

While the Board feels the management team performed solidly in 2016, we have taken into account that earnings per share, economic profit and return on equity were lower. While recognising that these impacts were largely due to changes in regulatory capital requirements, the Board felt it was appropriate to reduce short-term incentive payments for the CEO and the executive team. On average, these payments were around 11% below that of 2015.

At the same time, long-term executive incentives issued in 2013 did not meet the hurdles set by the Board for either total shareholder return or earnings per share. As a result, no executives received shares from long-term incentives plans this year. These long-term incentives make up around one third of each executive's remuneration.

In aggregate – remuneration outcomes have reflected performance for the year and the value created for shareholders.

Looking ahead, the Board has decided to adjust the performance hurdles applied to long-term incentives. The total shareholder return hurdle has been retained for half of these incentives. However, the earnings per share hurdle will be replaced with a cash return on equity target. Full details of these plans are outlined in the Remuneration Report.

Banking Sector

In my report to shareholders, and in other forums, I have expressed my views on the criticism directed at Australia's major banks in recent times.

There is no doubt that there have been examples of poor behaviour and instances where the industry has fallen short of community expectations. Brian will discuss how the industry and Westpac is responding to these issues to rebuild community trust. In the midst of this criticism it is important to have a balanced debate and not lose sight of the positive contribution banks make to society.

Banks have overwhelmingly supported the Australian and New Zealand economies. Indeed, Australia's banks are recognised as global leaders in performance, strength and sustainability.

As shareholders and owners, it is important you have access to facts on the value your bank has delivered for you, for the economy and for the communities in which we operate.

To help balance the debate and address some of the banking myths I make the following observations:

- First, the Australian banks were not a drag on the economy through the financial crisis. Unlike many other developed nations, no tax payer funds have been injected into the banks. In fact the reverse is true, in addition to remaining profitable and paying their fair share of tax, the sector contributed an additional $4.5 billion in fees directly to the Reserve Bank for a guarantee that was never used.
- Secondly, Australian banks are significant tax payers. This year, Westpac had an average tax rate of 29.9%, with a tax expense of over $3 billion - that makes Westpac one of the largest taxpayers across Australia and New Zealand.

- Thirdly, while Westpac makes large profits, these reflect our size. Our return on equity is consistent with being unquestionably strong and is in-line with other high quality banks around the world and other quality Australian companies.
- Finally, customers are not paying more for banking now than in the past. Net interest margins for banks have steadily declined over recent years and so customers have received good value for the banking services they receive.

In addition to our business operations, Westpac makes a significant contribution to the communities in which we operate through a broad range of programs, including:

- Over 40 years of sponsorship for Westpac Lifesaver helicopters;
- Investing $100 million to support the next generation of Australian leaders through the Westpac Bicentennial Foundation;
- Providing secondees for over 15 years to the Jawun indigenous partnerships;
- The innovative scale up grants from the Westpac Foundation that are helping to give Australians, and new Australians a fresh start;
- And of course in South Australia we have our own BankSA Foundation supporting a range of charities in South Australia and the Northern Territory.

Underlying the support we provide to communities is our rich history.

On the 8th of April 2017, Westpac will become the first company in Australia to celebrate 200 years. This is something that makes the Board, management and all our 40,000 employees incredibly proud. Westpac has supported Australia and New Zealand through the ups and downs of wars, depressions, crises and economic booms.

Westpac's success depends on the success of Australia and New Zealand.

This is something we have never lost sight of.

Ultimately, our banks make a significant contribution to the economy. If we are to continue to support the country's prosperity and growth we must resist the negative and often self-serving rhetoric and continue to work constructively with our customers and communities.

Building strength

I spoke earlier of the strength that has been built into your bank, and I want to give you some perspective of these developments and how they impact shareholders.

It is clear that we need to have strong and resilient banks – and the Board is completely behind regulatory efforts to further strengthen the sector.

This year for example we added over $6 billion to average ordinary equity – that capital has been sourced from shareholders such as yourselves either directly or through capital retention. That is a 13% increase over the year and roughly translates to around $2 for every ordinary share on issue.

Over a longer period the increase is more material. Since 2009 the amount of capital we hold has increased over 60%. Similarly our liquid assets have more than doubled from around $74 billion to more than $144 billion.

This, combined with the high quality of our portfolio, has meant that Westpac has a materially stronger balance sheet today compared to 7 years ago.

However while strength is vital for banks, it does come at a cost.

We can see how that cost has impacted shareholders through both a reduced return on equity and flat dividends. It impacts customers through higher lending rates and it impacts the economy because it ties up resources that could be directed to other productive uses.

Looking ahead, regulators continue to assess what is needed for banks to be seen as unquestionably strong. These are important considerations that must take into account all elements of strength. This includes a well-managed balance sheet, excellent credit quality, strong profitability and a culture of doing the right thing and focussing on long-term sustainability – something that has been the hallmark of Westpac for almost 200 years.

It is important that we get these changes right, particularly at a time when our economy is in need of both confidence and investment.

Board Composition

While over recent years there have been some significant changes to the Board, this year the Board was unchanged. However since the end of September, as I said earlier, Elizabeth Bryan has announced that she would retire at the conclusion of today's meeting.

Last year, Elizabeth passed her nine year tenure on the Board and consistent with Westpac's policy, would normally have retired at that time. However, at my request, and with your support at last year's AGM, Elizabeth agreed to stay on the Board to maintain continuity as we progressed discussions with potential Board candidates. Her decision to remain on the Board reflects her commitment to your company.

Elizabeth has been an outstanding shareholder representative for the last 10 years. Perhaps her most important contribution has been her role on the Board Risk and Compliance Committee. She has been an outstanding Chair of that all-important Committee since 2010.

I would like to personally thank Elizabeth for her support to me and to the Board and for her dedication to Westpac.

Board succession planning is continually on our agenda and we expect to finalise discussions and announce the appointment of two non-executive directors in the first half of 2017. These candidates will add further strength and diversity to your Board.

Outlook

Our outlook for Australia and New Zealand remains positive and while growth is a little uneven across States, and the global environment seems particularly volatile at present, the domestic fundamentals are sound. The relatively low level of the Australian dollar and low interest rates have supported growth in the services sector, a rise in residential and infrastructure investment and improved net exports. These gains have offset the second order effects from the slowdown in mining investment.

These trends are expected to broadly continue in the year ahead with Australia's GDP expected to grow a little more than 3% with unemployment likely to hold below 6%.

These settings will likely lead to similar system lending and deposit activity in 2017 as in 2016. How growth evolves for banks will also depend on regulatory requirements including for capital and liquidity.

Asset quality is expected to remain sound in the year ahead, although it is likely that additional stress will emerge in sectors and regions undergoing some structural change.

With the banking sector in strong shape, competition is also expected to remain intense from both existing competitors and new entrants, particularly in the so-called Fintech space.

Summary

In summary, it has been another challenging year with much regulatory change, strong competition and increased criticism of the banking sector.

Westpac has dealt to these changes by materially strengthening our balance sheet while proactively responding to community expectations and rebuilding trust.

2017 will be a particularly exciting year for Westpac as we celebrate our 200th anniversary in April. This milestone is already generating great excitement and pride across the Group, and we will take this opportunity to build on our service based strategy for the benefit of customers and for shareholders.

As Chairman, I am proud that we approach our 200th anniversary in great shape.

Westpac is strong, our strategy is delivering, our operating divisions are well placed and our 40,000 employees are passionate about helping customers reach their financial goals.

With this foundation, we expect to continue generating long-term value and sound returns for shareholders for many years to come.