IMB Ltd

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2011 Annual General Meeting

Chairman's Address
Michael Cole

A review of IMB's performance for the financial year 2011 is best undertaken against the backdrop of a dramatically changing regulatory environment.

IMB's performance at the operating level was solid. Each of the major Key Performance Indicators (KPIs) was matched or exceeded expectations:

- New Lending Approvals surpassed the stretch budget target of $826 million
- Net Interest Margin exceeded 2% pa;
- Commission Income was over $2 million;
- Efficiency Ratio was 58.7%;
- Return on Equity was 13.5%; and
- Credit impairments were below national industry averages.

The above KPIs combined to generate a record net profit after tax of $31.018 million, an increase of 6.7% over the previous corresponding period.

IMB's strategy continues to deliver a sound risk return outcome. Management remains focused on excellent execution of the business plan.

In the current financial year net profit performance for the first quarter has improved on last year and exceeded budget. The economic outlook is not without its uncertainties for the balance of the year. However, it is the regulatory environment for IMB that presents the current greatest challenge.

A post mortem review of the Global Financial Crisis (GFC) by global banking regulators has resulted in a significant focus on the capital adequacy and improved asset quality requirements for Authorised Deposit-taking Institutions (ADIs). Whilst the Basel III rules have yet to be fully finalised, an identifiable common theme is that volatility in financial markets is to be lowered by de-risking the activities of participant ADIs. Specifically, this would result in a further de-leveraging of balance sheets, improving asset quality and achieving higher liquidity levels.

These responses by the global banking regulators are understandable. The business of banking in a deregulated monetary system has a number of financial characteristics which mean the margin for error at the operating level is very small. Accordingly ADIs require a relatively high level of balance sheet leverage to generate an acceptable return on shareholders funds.

A sharp deterioration in the number of loans defaulting would quickly erode the slim profit margin and in the extreme case of heavy loan or security losses destroy the capital base of the ADI. The net profit spread after operating expenses is very fine and for most ADIs markedly less than 1%.

It is now widely accepted in Australian markets that the potential return for shareholders investing in banks has changed post-GFC. The reduced level of gearing required to now operate banking businesses will have the result of lowering Returns on Equity (ROE) and reducing shareholder returns.

The global bank regulators have concluded that the benefits which ADIs receive from unique access to the deposit, lending and payment systems impose heavy reciprocal responsibilities. In other words in the future shareholder returns will more closely emulate heavily regulated public utilities. It appears highly likely that banking regulation will continue to increase for the foreseeable future and in a very prescriptive manner in the Australian environment.

IMB's Capital Adequacy Ratio

At 30 June 2011, IMB's capital adequacy ratio was 12%, above current regulatory requirements, and was unchanged from the prior year. For the financial year IMB's net profit after tax and after shareholder member dividend payments contributed approximately a 1% lift in the CAR. This residual increase was almost fully eroded by changes to regulatory treatment of past securitised assets and loan and securities growth in risk weighted assets.

While current capital levels are in line with historical levels, which have ranged from 11.0% to 12.4% since 2006 (30 June ratios), it is clear to the Board that this level of capital will need to increase in light of the changing regulatory environment, ongoing market volatility and limited access to efficient capital instruments.

In consideration of these factors, IMB's Board have set a target to lift IMB's capital ratio over the medium term to 15% to ensure that it continues to be well capitalised having regard to these regulatory requirements and existing volatile market conditions. Core to this strategy will be increasing IMB's Tier 1 capital ratio. The implementation of this strategy negatively impacts the short term annual net profit growth of IMB and will limit further improvements in the cost/ income ratio. These adverse impacts have already been incorporated into current IMB budgets.

IMB has a number of alternatives available to achieve this capital adequacy goal. These include slowing loan asset growth, optimising liquidity levels and using capital instruments such as subordinated debt and securitisation. All these options are being systematically evaluated. To this end, IMB recently concluded a $200 million Commercial Mortgage Backed Securitisation (CMBS) issue and a $15 million subordinated debt issue which when combined lift the capital adequacy ratio by well over 1%.

Shareholder Member Dividends and the Payout Ratio

This topic was the focus of number of questions submitted by the shareholder members. Any analysis of Tier 1 capital adequacy ratios must inevitably include a review of dividends paid to shareholder members. As a result the Board paid a final dividend for the 2010/11 financial year of 15 cents (compared to 19 cents last year). This resulted in a total dividend for FY 2011 of 25 cents per share. The resultant payout ratio is 32%.

If this total payout is referenced against the mid-point of the shareholder members contributed funding, the payout ratio to shareholder members adjusts to 74%. The Directors consider the integrity PWC Contributed Funding Report analytical framework remains intact and is an initial consideration in the Board's determination of dividend levels. The overarching consideration remains IMB's financial performance, capital requirements going forward, regulatory requirements and economic/market conditions.

It would be inconsistent with the Director's corporate responsibilities to target a payout ratio as an independent variable. Rather the payout ratio will always be a dependent variable which is the outcome of the above deliberations. Finally under S254T of the Corporations Act, Directors are required to resolve, amongst other matters, that a dividend is fair and equitable to company shareholders as a whole. The Board so resolved when determining the final dividend following the adoption of the FY2010/11 audited accounts on the 29th of August, 2011. A market announcement of the results and the dividend was made the same day.

No one could have foreseen the depth, breadth or neither sustained period of market volatility nor the unprecedented period of uncertainty recently experienced.

In 2008 we operated and made decisions within known bands of market behaviour based on many years of experience in the market. As a result in 2008 before the GFC hit we communicated to members that the payout ratio may stabilise at around 45%. Subsequently however in 2010 when the negative impact of the GFC was apparent we had to inform our shareholders that the payout ratio would be reduced below 40% but may still permit continued dividend/share growth if sound net profit growth was delivered.

Most recently we have had no control over the highly prescriptive approach of the regulator to the Basel 111 regulations. The result is that any downward adjustment in the payout ratio that we hoped could also be accompanied by a lift in dividend/ share is no longer available to IMB. On the basis of this past experience and having explained the dividend setting process it is not helpful to offer any comment on prospective dividend levels and the payout ratio.

It is fully understood by the Directors that the dividend reduction has had an immediate negative cash flow impact on IMB shareholder members. These funds however do not exit the system but are retained within IMB to further strengthen the business to the benefit of all members. The higher level of retained earnings over the past five years has assisted IMB to raise the ROE from 11.8% to 13.5%.

IMB Capital Structure Review

The impact of the increased Tier 1 capital adequacy ratio regulatory requirement has been to highlight to Directors the challenges of the IMB business model with shareholders members in a peer group universe made up of predominantly guarantee member only mutual ADIs. These ADIs are able to improve their capital ratios annually by simply retaining all net profits given their zero payout ratios. For this reason IMB will be subject to additional regulatory scrutiny on an ongoing basis.

From the regulators perspective, the IMB peer group is the Credit Union and Building Societies (CUBS) which include over 100 ADIs. In the most recent period for which financial data is available, the median CUBS capital ratio was 17.3% and the upper quartile was 23.2%. IMB's 15% capital ratio target looks modest against the peer group benchmark in this tougher regulatory environment.

As a consequence, the Board has initiated a wide ranging review to be assisted by Grant Samuel (corporate advisors) and Watson Mangioni (lawyers). The terms of the review are to examine all the capital structure options available to us, which would meet the requirements of the local regulators consistent with an optimal outcome for all IMB members. It is anticipated that the initial work should be completed in time for the half year results.

There were a number of questions from shareholder members that will be covered under the capital structure review. These include the issue of preference shares, use of accumulated franking credits, operation of a dividend reinvestment plan (DRP), restructuring as a bank, merger with other ADIs, demutualisation and ASX listing. None of these issues are currently under active consideration by the Board but all are within the ambit of capital structure review.

Director Renewal

During the year we farewelled IMB two directors, George Edgar and Steve McKerihan.

George retired after contributing to the Board for 10 years. He served with distinction during his directorship with his lasting legacy being the OH&S culture that is instilled throughout IMB.

Steve on the other hand was only able to serve on the Board for a short period of time before ill health forced him to resign. I am very saddened to report that Steve passed away over a fortnight ago. He was an outstanding banker, a wonderful person to have worked with and in his short time with us made a valuable contribution to IMB.

I also acknowledge the passing of Roger Soden who served as a director from 1969 to 1992, and was Chairman from 1986 to 1992. We are currently working with the Wollongong Conservatorium of Music to establish a scholarship in recognition of Roger's contribution to IMB.

Two new Directors were appointed during the year. Noel Cornish was appointed in September 2010 following George's retirement and Margaret Towers was appointed in May this year. Noel and Margaret bring complementary skills to the other members of the Board and their appointment further strengthens the Board.

Noel's appointment was ratified by Members at the 2010 Annual General Meeting (AGM) and shareholders will be asked to support Margaret's appointment at this year's AGM.

There were a number of questions from members about the Director nomination and appointment process. IMB continues to appoint Directors in accordance with the IMB's Constitution and as detailed on our website. Following shareholder member enquiries, IMB's process was benchmarked against other mutual ADIs and determined to be consistent with the processes used by other major mutual building societies and the Board is of the view that the current process operates very effectively.

The Fit and Proper test imposed by APRA with regard to the appointment of Directors is a minimum requirement and is subject IMB's skill set requirements together with the regulator also articulating specific views on Board skill composition.

Other Issues

Let me deal with other questions received from members including:

- Branch Expansion: Subject to availability of suitable locations, IMB remains committed to opening two new branches each year;
- IMB Membership: IMB's net member number has increased slightly to 181,000 members with 12,000 new members last year offset by member loss and natural attrition due IMB member demography;
- Stakeholder Engagement: Deferred last year due to internal resource limitations but is scheduled for current FY;
- AGM Venue: Changed because Novotel was unavailable on required date;
- Director Assessment: The Board as collective group and as individuals are reviewed annually by Polaris Consulting. This year's assessment was that the Board is comprised of Directors of significant commitment, collective and individual capability, qualifications and experience; and
- Corporate Diary and Dividend Notices: Both these suggestions are under active consideration.

Expressions of Gratitude

It has been a challenging time for most ADIs not only in Australia but globally. You can be assured that every single IMB director is committed to meeting the challenges, in particular those confronting us now in this new regulatory environment. On a personal note and I would like to thank all the Board members for their contributions during the year.

On behalf of the Directors I would also like to thank the CEO Robert Ryan, the Executive team and all the staff at IMB for their continued contribution to IMB and their commitment to servicing the needs of all our members.

Finally, I would like to thank you, our members for your continuing support of IMB.

CEO's Address
Robert Ryan

Thank you Michael.

Good morning everyone.

As Michael mentioned, IMB has delivered a solid result in what continues to be a challenging environment. This performance has been achieved despite increased competition for deposit funds and loans by major banks, waning consumer confidence and a subdued housing market. The results reflect the strength of IMB's business model, the commitment of IMB's management and staff and the support of IMB's members.

Earlier this year, a full review of IMB's Strategic Plan was undertaken to ensure that IMB's direction and strategies over the coming three years will support IMB's position as a mutual banking alternative. The overarching strategic themes coming from that review are:

- IMB will remain a mutual ADI
- Member focus will support IMB's position as an alternative to the banks
- Organic and sustainable growth will continue supported by branch expansion, productivity gains and channel expansion including online and Business Banking
- Investment in people and technology will be key to delivering the strategy

An overview of IMB's refreshed Strategic Plan will be provided shortly, but first I will provide a summary of IMB's performance for 2010/11:

Performance Summary

Notwithstanding the continued volatility of the financial markets, which continues to impact IMB's business today, IMB delivered a solid result for 2010/11:

- operating profit after tax increased by 6.7%;
- total assets grew by $116 million;
- there was strong growth in retail deposits of $164 million
- loan approvals increased by 14% over the previous year to $826 million;
- IMB's efficiency ratio improved from 60.1% in 2010 to 58.7%;
- Return on equity was 13.5%
- We maintained levels of liquidity and capital; and pleasingly
- Over 12,000 new members joined IMB during the year
- Member satisfaction levels remained high at 96%

Profitability

IMB's Group profit after tax was $31.0 million, up $1.9 million over the previous financial year.

This increase in operating profit was largely driven by:

- increased loan writings
- management of balance sheet composition and
- disciplined cost control.

Excluding abnormal items, underlying profit after tax grew by 7.8% over the previous year.

IMB's net interest income increased by $3.5 million for the year to $96.5 million, with the interest margin being sustained above 2.00% and at an average of 2.05% for the year compared to 2.11% last year.

IMB's interest margin at 30 June was 2.12% and we are forecasting that the margin will be maintained at 2.00% for the year ahead due mainly to the strong competition for retail funds across our sector and the need to increase our capital levels.

Non-interest income has decreased by $1.1 million as compared to last year, to $13.7 million. This reduction was mainly due to lower levels of break fees being charged due to the changed interest rate cycle and lower overall transaction fees to members due to changes in IMB's fee structure throughout the year and changes in the manner in which our members transact.

On the expense side, non-interest expenses totalled $62.6 million for the year – a slight increase of $0.1 million over the previous year, however, excluding the expenses relating to the write down of IMB's land inventory, non-interest expense increased by $1.0 million or 1.7% as compared to the previous year. This increase was significantly less than CPI for the year and achieved whilst IMB continued to invest in the growth of the business and improved services for members.

Efficiency

IMB's efficiency ratio has continued to improve and for the financial year was 58.7%. The maintenance of IMB's interest margin, and containment of non-interest expenses has contributed to the reduction in the ratio and management will be aiming to at least maintain the efficiency ratio in the short term and reducing it further over the medium term.

Assets

Moving onto the balance sheet, IMB's balance sheet grew over the last 12 months to $4.8 billion, an increase of $116 million over the previous year. The balance sheet growth has been driven by higher loan approval levels, growth in deposits and good loan retention levels.

Loan approvals reached $826 million this year, an increase of $101 million over the previous year, driven by continued strong direct loan writings through branches and mobile lenders, which increased by over 14%. Through a number of initiatives that have been put in place, we have increased our direct loan approvals by 83% since 2008.

IMB's deposit base grew by $164 million over the last year. This growth has continued to be primarily sourced from retail deposits driven by competitive products and pricing and ongoing marketing activity. Over 77% of IMB's funding is sourced from retail members.

IMB also has a significant wholesale funding capability.

In August this year, IMB undertook a $200 million securitisation issue, backed by Commercial Mortgage Backed Securities. This issue was well received by investors in an increasingly volatile market.

Asset quality

IMB's asset quality remains very strong and this is reflected once again in our arrears position being less than half both the NSW and National averages. At the end of the financial year only 19 of our 20,000 residential and commercial loans were in arrears by greater than 90 days – this is an excellent result reflecting our strong underwriting standards and arrears management. We continue to review our underwriting standards to ensure credit quality is maintained.

Liquidity and Capital Adequacy

Throughout the GFC and more recent market volatility, the Board and management have remained highly focused on ensuring the financial strength of our Balance Sheet. It is pleasing to report that we have maintained very strong levels of both liquidity and capital, with both the liquidity and capital ratios improving over the 12 month period to close the year at 28.4% and 12.0% respectively.

IMB's return on equity has decreased slightly from 13.9% in 2010 to 13.5% for this financial year.

I would now like to provide an overview of our strategic focus areas:

First choice alternative to the banks

During the year, the Board and management refreshed IMB's business strategy to ensure that it remained appropriate in the rapidly changing environment in which we are operating.

The review confirmed IMB's strategic goal to be the first choice alternative to the banks and to remain a profitable, independent, member owned financial institution that will focus on identifying and fulfilling the needs of its members.

IMB's strategy is driven by the aims of growing our members, maintaining profitability, maintaining high satisfaction levels and delivering value to all stakeholders.

This will be achieved by offering Better Value Banking, which aims to provide members with better products, better service and overall Better Value delivered by staff who are empowered and equipped to deliver member value and superior service. To this end:

- Over 80% of IMB's members do not pay any transaction fees and we continue to review our fees and charges to ensure that they reflect the cost to IMB and that our members enjoy low and fair fee structures as compared to our competitors.

- IMB's overall member satisfaction rating was maintained above 95% last year. This rating is a testament of the member service provided by our staff and the competitiveness of our products and provides a basis of differentiation to the banks.
- IMB had home loan, personal loan and deposit products that were rated as five star or 'best in category' by various independent financial services reviewers including Cannex, Mozo and Your Mortgage magazine.

Delivering Strategy

In terms of our strategic initiatives, there have been a number of initiatives undertaken this year including:

- Opening two new branches at the University of Wollongong and Gungahlin in the ACT, supporting IMB's commitment to providing face-to-face access for our members
- Rolling out enhanced customer relationship management software in our branches and contact centre to deliver consistency of member experience and improved service levels
- The replacement of all IMB Visa debit cards with chip cards, the introduction of Verified by Visa and new fraud prevention tools, significantly increasing protection against fraud when members use their Visa cards either in store or on-line;
- Launching an upgraded Internet Banking site together with a mobile banking application, enhancing the security of on-line transactions, providing additional functionality and allowing members to manage their accounts via their smartphones.

Strategy 2011 - 2014

A number of initiatives have been identified that will assist IMB in meeting its strategic goals over the next 3 years. These initiatives include:

- Providing members with enhanced access and service through the channel of their choice, whether face to face, on the phone or online.
    - At the branch level, we will expand our network with 2 new branches to be opened each year over the life of the plan. We are currently reviewing opportunities in the Sutherland Shire and also in the ACT.
    - The structure of IMB's contact centre will be reviewed to support IMB Direct as the hub for online member contact and our telephony system will be upgraded to enhance the IMB Direct's service levels
    - From an online perspective, as mentioned, we recently upgraded our internet banking to provide members with an improved user interface, a more secure log-in process and the ability to bank via mobile devices. We will also be introducing SMS alerts to 2012 and as part of the evolution of our online channel, IMB is also investigating online identity verification utilising a specialist 3rd party solution. This investigation will ensure that IMB's stringent identification processes are maintained and in line with regulatory requirements and will support our ability to attract new members and deposits.
    - We will also be exploring the opportunities provide by social media
- Business Banking for small to medium enterprises remains a key opportunity for IMB and we will increase the size of the Business Banking team to support business growth, expanding our focus into the ACT and Southern Sydney during the period;

- Our marketing strategies will focus on improving the awareness of IMB as a member focused, competitive alternative to the major banks which will support the evolution of our brand positioning.
- IMB's staff are essential to the achievement of IMB's strategic goals and a number of initiatives are planned to enable IMB to attract, engage and retain suitable staff to deliver IMB's strategic plan. The development of the skills, knowledge and experience of IMB's staff through learning and development activities will also continue to be an area of focus.
- Over the planning period we intend to continue to invest in our IT platforms to ensure that they remain appropriate for meeting IMB's needs in the medium to longer term and invest in upgrading our hardware and capacity to meet the increasing demands and expectations, particularly with regard to online interactions.
- A continued focus for management will be the maintenance of IMB's performance through further productivity increases and tight cost control.
- A number of our mutual peers have converted to a Mutual Bank and IMB continues to maintain a watching brief over these activities as we consider IMB's long term strategies.

All ADI's continue to be required to comply with greater levels of regulatory requirements. Over the coming 18 months there are a number of new regulations that will apply to IMB including:

- New Austrac reporting which requires IMB to collect and report additional information with regard to transactions greater than $10,000;
- The implementation of the Personal Properties securities Act requiring the registration of personal property securing a loan to be listed on a national register;
- The Financial Claims Scheme which will require IMB to provide additional reporting to APRA; and
- The phased implementation of Basel III requirements from January 2013 which will to lead to higher minimum capital requirements and more stringent liquidity requirements

The Board and management continue to ensure that our Risk Management and compliance systems are adapting to these changing requirements and ensuring that IMB complies with its obligations.

IMB remains cautiously optimistic

Looking ahead, IMB continues to be cautiously optimistic about future financial performance. The strength of the core banking operation will continue to underpin performance, supported by a stable net interest margin, sound credit conditions and a continued disciplined approach to cost containment. Board and management continue to monitor the ongoing volatile financial markets and to adjust the business accordingly to ensure that IMB's sound position is maintained.

In closing, I would like to acknowledge the ongoing commitment and dedication of our staff. It is through their efforts, and their personal approach to providing member service, that IMB has been able to deliver a solid result and continues to deliver *Better Value Banking* to our members.

I would also like to thank the Board for their continued support and involvement over the past year. The additional time and effort that our Board members contribute to IMB's business in addition to their other duties is greatly appreciated, particularly as IMB continues to navigate the rapidly changing external and regulatory environment.

Entering our 132nd year of operation, IMB remains a strong and secure mutual financial institution providing our members with a competitive alternative to the banks and I look forward to building on this year's success to deliver an even stronger IMB in the future.

Thank you.