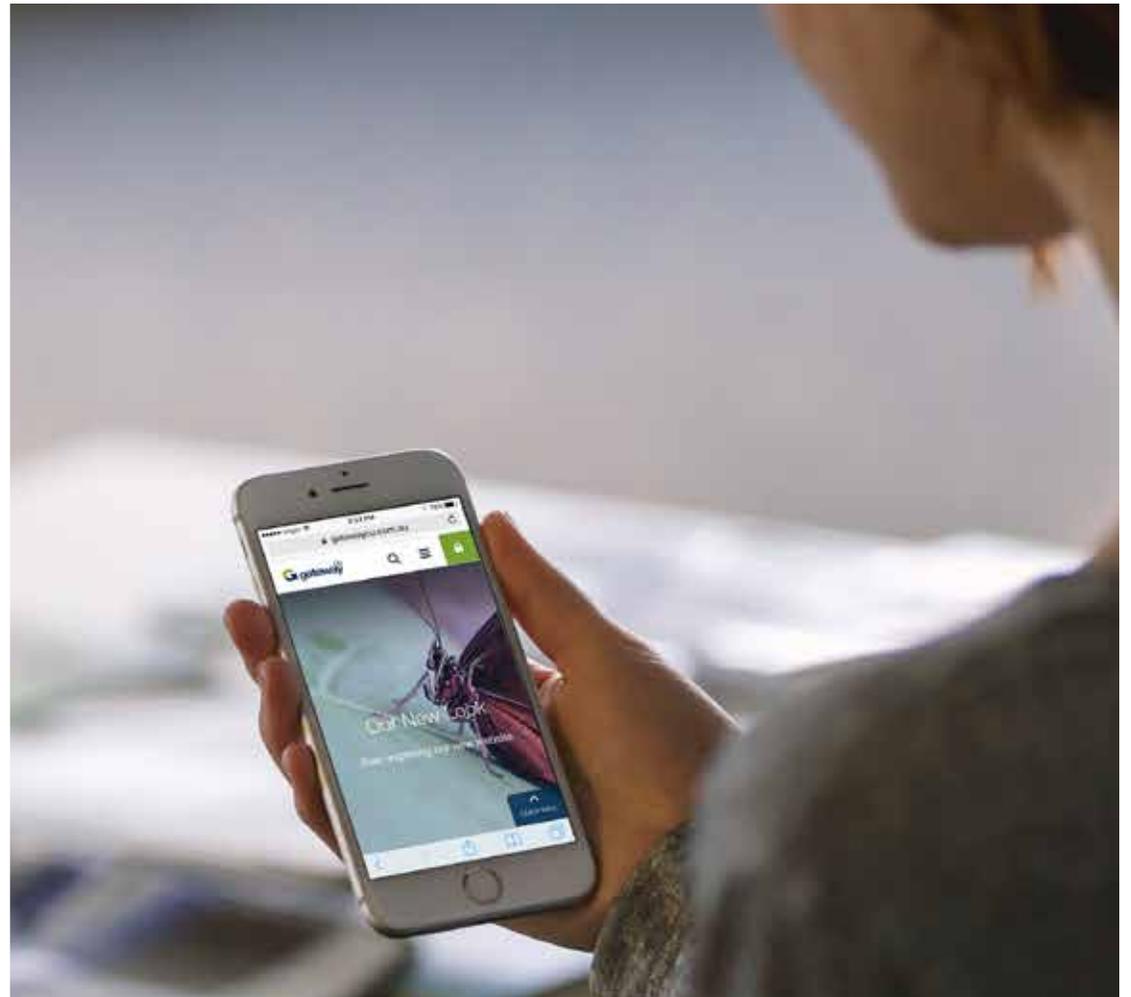


Gateway Credit Union

Annual Report 2016



The theme for this year's Annual Report is to propel forward. Similar to the way in which an archer meticulously handles his bow and arrow, sometimes one must pull back in the short term in order to propel forward over the longer term.

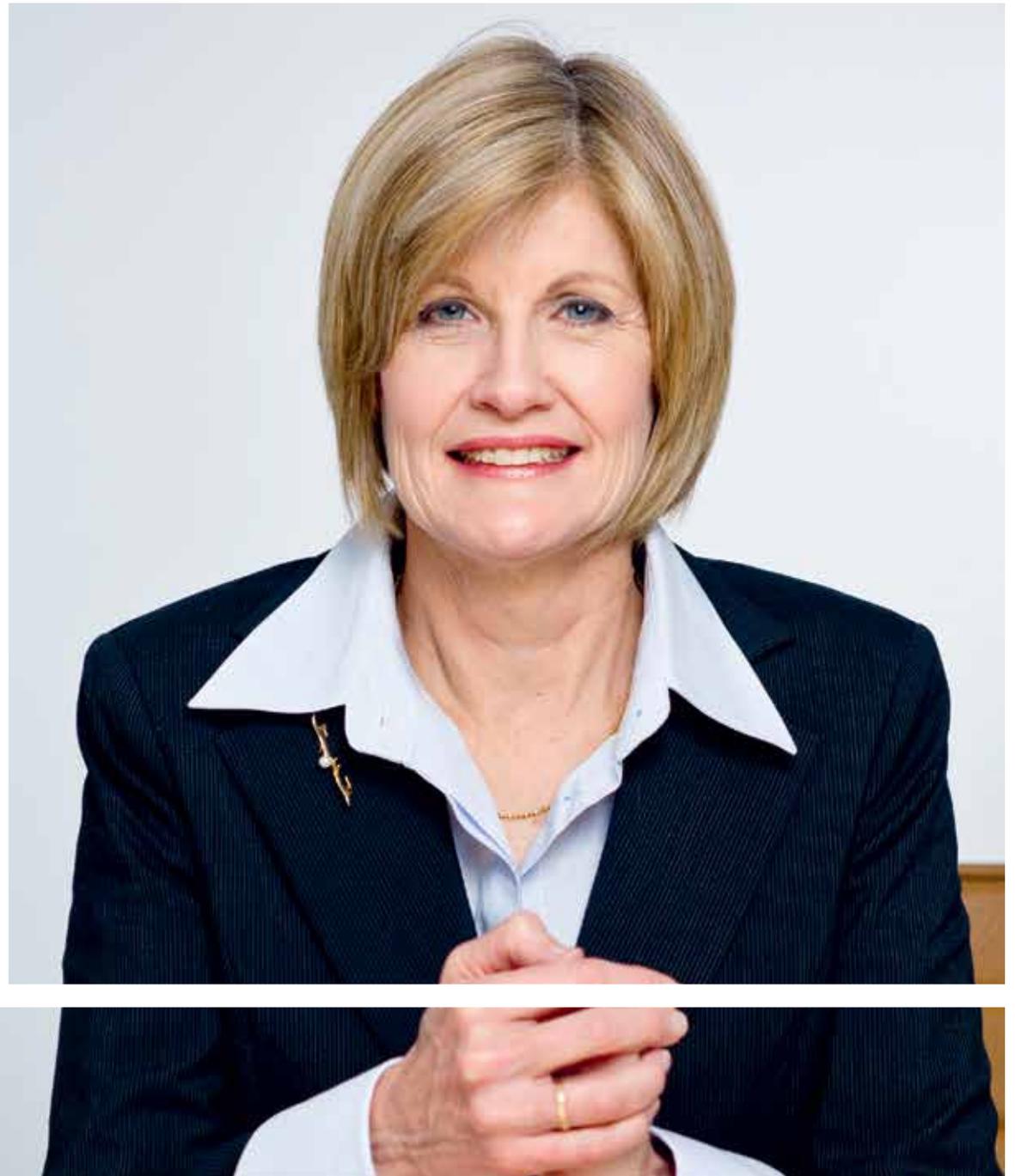


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Confronting the headwinds

Despite a patchy economic environment and a tighter regulatory framework, we achieved good outcomes under adverse conditions while winning multiple awards along the way. Fiscal 2016 saw us take difficult but necessary steps to ensure future sustainability.



Chairman's Report

Ladies and gentlemen,

Each financial year has its challenges, and so it was for Gateway in 2016. We made several important strategic and structural changes to position us for continuing success in 2017 and beyond. The decisions were neither easy nor obvious but make sense when you consider the background and context of our moves.

Gateway first entered the mortgage broker market over six years ago, and for some years now, we have sourced the majority of our new lending business here. The volume of this new lending has meant that we have been one of the fastest growing credit unions in Australia.

However, the very low interest rate environment and the cost of broker origination have put pressure on margins, and during the year, we took the decision to de-emphasise broker-originated business. We are by no means abandoning this channel - after all, around half of Australians choose to use a broker when seeking a new home loan. But we do need more satisfactory

margins to grow and thrive. After careful consideration, we decided to adjust our strategy to attract a different mix of loans to Gateway.

Changed distribution strategy

The loans we write directly with borrowers are more profitable than the loans we write through brokers. Yet only 20% of our mortgage lending is done directly with Members via our most profitable distribution channel - our B2C or business-to-consumer channel. The remaining 80% of our business comes via the less profitable B2B or business-to-business broker channel. We took steps in February, 2016 to correct this channel imbalance.

The board resolved that management should direct less time to the B2B broker channel and deploy more human and financial resources to grow the B2C channel. Over time, we believe this change in emphasis will widen our net interest margin and result in a more acceptable level of profitability as we do not pay commissions or ongoing trails on B2C loans.

These two cost components inherent in broker loans add up and each year we pay more and more for the cost of this commission structure. On top of the broker commissions we pay, broker originated loans are much more price sensitive and the customers less loyal. The B2B market is a battleground with lenders locked in a war of attrition, grinding down mortgage rates in an effort to steal customers from each other.

Price skirmishes intensify

The major banks fight hard to prevent rivals, like credit unions, from taking a bigger share of home loans, even though most lenders do not like the price battles, with the resulting deep discounts and near break-even propositions. But in a market which is being driven by price, all lenders must have an appetite for some level of price risk if they wish to stay in the game.

In Gateway's case we decided, like other lenders during fiscal 2016, that we were reaching our risk appetite for lower margin business in our quest for loan growth. The collective judgment of our board and



management was that it was time to focus more on the B2C channel, on meeting directly the service and product needs for Australians seeking home loans.

Pain before gain

This channel decision had an immediate effect. From February, as expected, we experienced a marked fall in the volume of loans coming to us via the broker channel. This trend continued for the remainder of fiscal 2016 and resulted in our loan book not growing for the full year to 30 June. In fact, it fell by 2.9% or \$25.7m, but we predicted this decline and so are not discomfited by the dip in loan balances.

Sometimes in business, as in life, you have to take a step back for a short while to propel yourself forward over the longer term. We will forge a new future by adapting to the realities of the marketplace. In the immediate term, this will mean our loan book

will continue to decline as we build volumes in our more profitable B2C channel to replace volumes in our less profitable broker channel.

Margins under pressure

This re-balancing of our loan book reflects the ongoing changes in the financial services industry and the complex and still-evolving regulatory environment. Overarching this is the prevailing economic conditions which are producing winners and losers. Super-low interest rates may be good for borrowers, but they are a nightmare for savers and a real challenge for financial institutions as they squeeze profit margins.

Our net interest margin - the income we get from loans less the cost of funding them - remains under pressure from heavy discounting of loans and increases in debt funding costs. Also, it has not been possible - in response to Reserve Bank of Australia rate cuts - to trim already rock bottom deposit rates as sharply as lending rates. This caused the spread between our deposit and lending rates to narrow and is reflected in our profit for fiscal 2016.

Rocky terrain ahead

Against this background, our bottom line profit before tax of \$3.807m is a credible result. However, the real possibility of a further slump in rates will be a drag on profitability - not just for Gateway but for all financial institutions, and in particular small ones. Very cheap credit translates

into scant profits from lending and writing mortgages. Post GFC, Australia had avoided ultra-low (even negative) rates seen overseas. But these rates have now reached our shores.

In May, the Reserve Bank moved to head off fears about deflation by cutting the cash rate to an historic low of 1.75%. Deflation is the scourge of an economy. Our policy makers are keen to ensure that Australia does not catch the same deflation bug that has afflicted countries like Japan and some euro-zone nations where weak demand, flat wages and heavy discounting by retailers have driven prices down.

People who lead

The post GFC world remains challenging and has taught all of us that nothing substitutes for human judgment in evaluating business risks and setting the right course of action. Your board did just that during the past year and stepped up to the plate in discharging its corporate governance duties. It takes a courageous and proficient board to make counter-intuitive decisions and I thank each of my fellow directors for their diligence.

Management also showed leadership in challenging conventional wisdom and are to be commended for their tireless efforts. In thanking our excellent CEO, Paul Thomas, and his strong and capable Senior Leadership Team, I am pleased to acknowledge

the entire Gateway team. They are a resilient and close-knit group who do us proud every day. Their dedication and passion for Members is both impressive and a source of competitive advantage.

Appreciation to owners

Finally, and as I always do, I reserve my biggest thanks to you, our Members. I have said this before but it bears repeating - *you* are the reason for our existence and *you* are the focus of everything we do. As a financial co-operative, we have no shareholders, our Members are our owners.

So, we are clear what our role is and who we serve. In line with our Mission, I hope that in some small way over the past year we were able to assist you financially to achieve your hopes and dreams. Thank you for trusting us with your business. It is an honour to serve you.

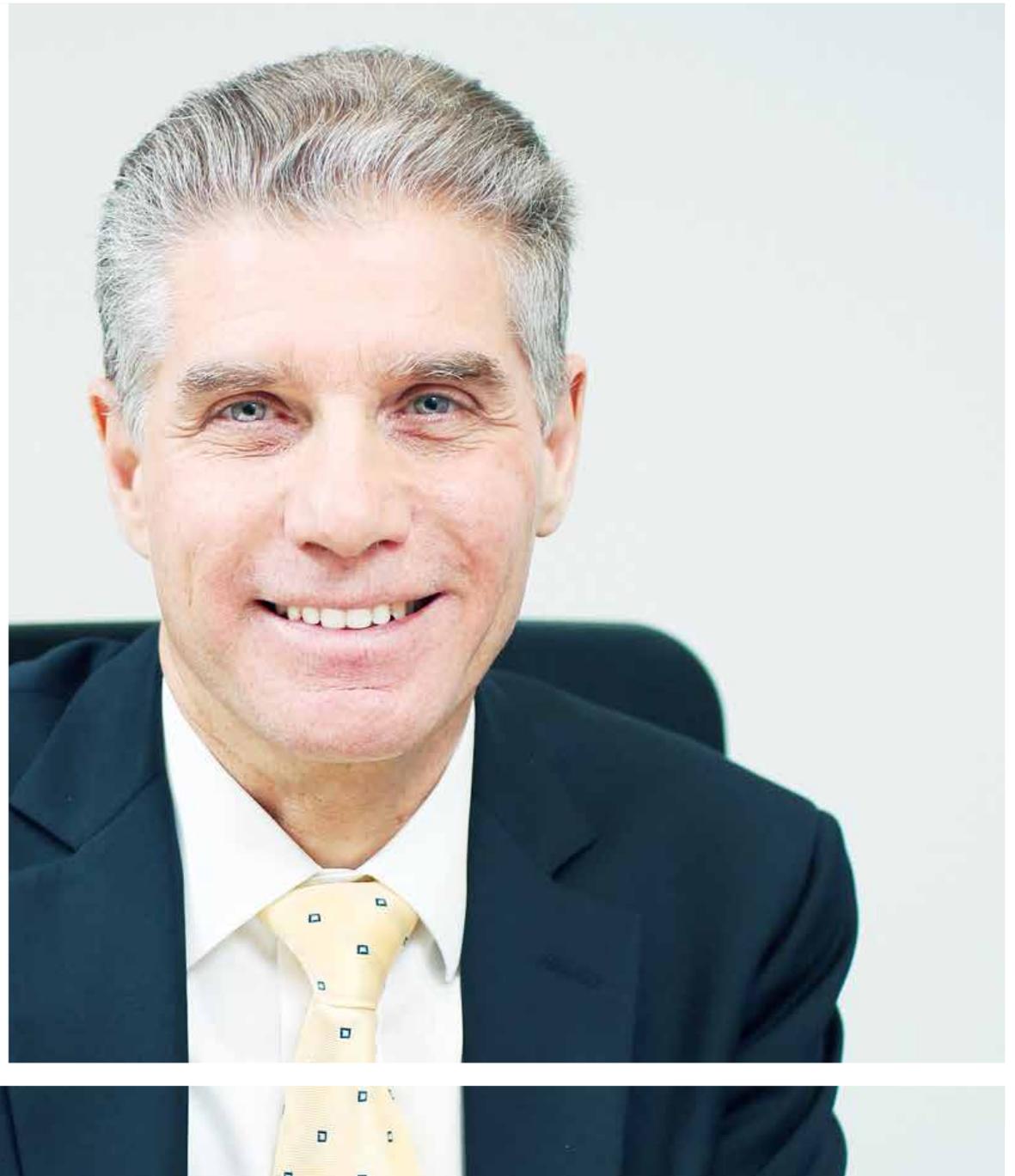


C M Hallinan
Chairman



New road map

Against the backdrop of a lackluster economy and a cooling housing market, Gateway shifted gear. We fastened our seat belts for an unconventional ride which saw us take a different but necessary direction. We deliberately slowed down our lending growth with the aim of ramping up demand via new initiatives.



CEO's Report

Fellow Members,

Each year we use these pages to report our progress. As the Chairman has already conveyed in her message, fiscal 2016 was a year of challenge for Gateway. Eight years ago the world was shaken by the Global Financial Crisis (GFC) and we are still feeling the after effects. As all sectors of the business world have learned, market crashes have far reaching and long lasting impacts on the economy.

After the GFC hit, some commentators (erroneously) characterised it as a temporary shock - a classic "V" shaped disruption featuring a sharp downturn and a rapid recovery. As we have long since discovered, the global economy has not bounced back. Today's operating environment - the so called "new normal" - is one of low rates, low growth and low inflation.

Economic policy response

While Australia emerged relatively unscathed from the GFC, it is not immune from some of its long-term implications. Around the world, there has been an over reliance on monetary policy to combat deflation and spur growth. But low and even sub-zero rates have not stopped falling prices and sagging demand. Australia now has ultra-low rates with the Reserve Bank of Australia also embracing unprecedented monetary policy settings.

The downward path of interest rates undermines the profitability of financial institutions. Gateway has already experienced this with a marked drop in the return it generated on liquid investments during the year under review. Against this backdrop, our financial results for fiscal 2016 are not unsatisfactory given the prevailing economic conditions. However, we remain committed to raising profitability to bolster our capital reserves.



Search for yield

This, of course, is easier said than done. The threat of even lower rates from another easing cycle will further erode investment returns - not just for financial institutions but also for savers and retirees. Ironically, ultra-low rates are discouraging spending which is the exact opposite effect that they are supposed to achieve.

Gateway uses the funds deposited by Members to invest in loans to other Members. With mortgage rates at an all-time low, the return on the loans we have built up in our loan portfolio - which represent the bulk of our interest earning assets - has also fallen. We are being buffeted from all sides and this ongoing pincer movement continues to impact profitability. This is why we are keeping a close eye on operating costs.

Focus on costs

Our operating costs for fiscal 16 rose by 3%. This is one of the smallest year-on-year rises in the past decade. We have and will continue to work hard to extract operating efficiencies which will be delivered via a combination of automation and process improvements. We will not, however, fall into the trap of indiscriminate cost cutting as this can impact quality and customer service.

As a measure of our financial discipline, we would expect to see a gradual fall in our cost-to-income ratio over the next 2-3 years. This ratio is one of the most closely watched and targeted numbers for all financial institutions as it measures an institution's efficiency in using expenses to generate income. At 81.8%, our prevailing cost-to-income ratio is too high.

Award winning rates

Another reason our profit is under pressure is because of ongoing price wars. Such battles are challenging for financial institutions as they result in lower net interest margins. But they are a bonus for savers and borrowers who benefit from higher rates on deposits and lower rates on loans. Gateway was able to match the best offers on both sides of the ledger and this was recognized by Mozo in awarding us credit union of the year.

Mozo is an independent comparison website that helps Australians compare banking products to find the best deal for their needs. Mozo also undertakes its own comparisons and makes Experts Choice awards in a number of product categories. These awards recognize Australia's best value financial products. During the year, Gateway won more product category awards (six in total) than any other credit union.



Best of the best

In the home loan category, Gateway was recognised as having the **Best Value Offset Home Loan** and the **Best Value Fixed Rate Home Loan**. In the personal loan category, Gateway won the **Best Unsecured Personal Loan**. In the bank accounts category, we won the **Best Value Fee Free Bank Account** and the **Best Value Kids Savings Account**. And in the travel money category, we won the **Best Value Travel Debit Card**.

While we don't actively seek recognition, this independent validation by Mozo of our Member-first approach is very gratifying. The individual product category awards reinforce our reputation as a leading

lender and a competitive provider of savings products. And the overall best-in-class award is a prestigious accolade and the icing on the cake in our efforts to offer Members value for money products that deliver on their needs

Digital transformation journey

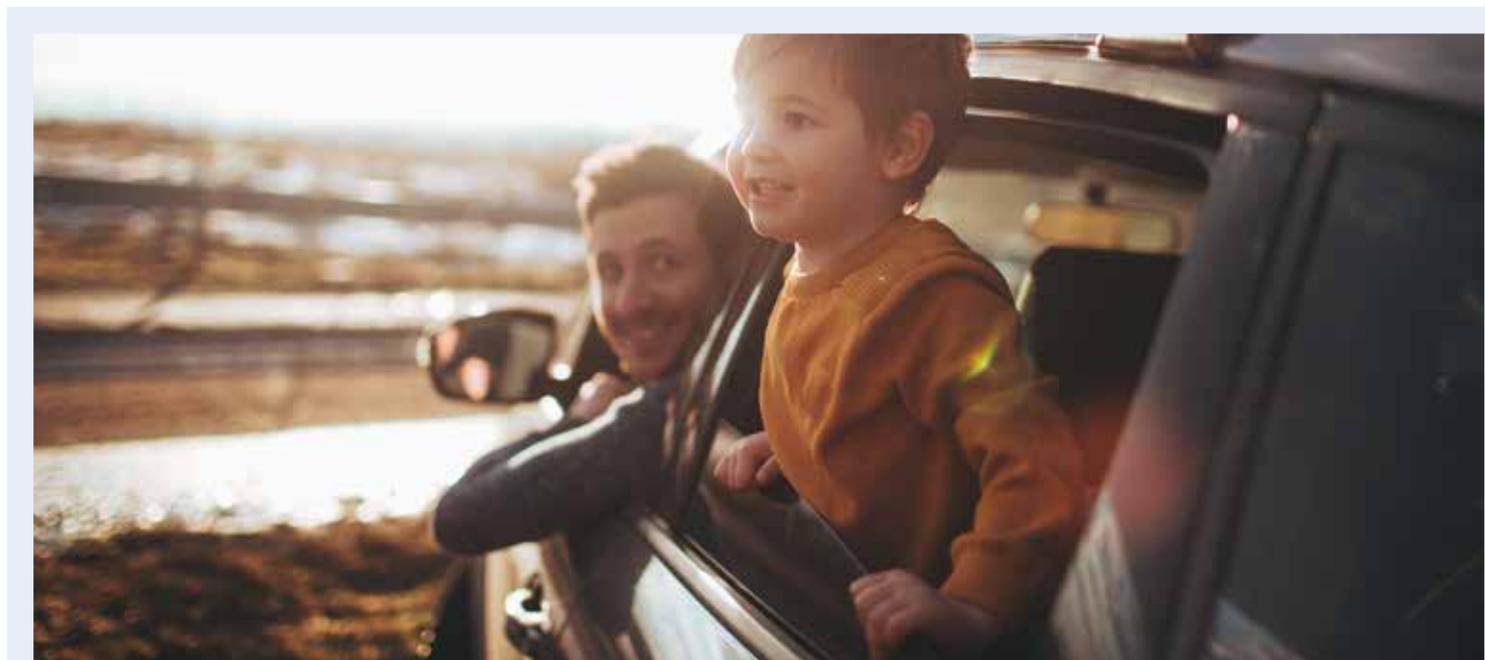
Value, of course, comes in many forms including the technology we make available to Members to access their accounts and manage their financial affairs. In mid-May, we upgraded our Online Banking in order to provide greater functionality. Members warmly embraced the clean, intuitive design and added features. Not content to rest on our laurels, in late June we

launched our new state-of-the-art website.

Website visitors are now greeted with a more responsive platform that delivers a user-friendly experience on any device - desktop, laptop, tablet or smartphone. The website detects the type of device being used and automatically rearranges and resizes the screen and its orientation. The revamped website, the enhanced Online Banking functionality and the new product offerings all owe their existence to the dedicated Gateway team.



**Variable Home Loan
Owner Occupied**





Thank the team

I am truly proud to lead such a talented group of professionals. They are a source of competitive advantage and have delivered a credible set of achievements. I would like to make particular mention of my C-suite colleagues - Lexi Airey (CCO), Gary English (CRO) and Peter Gilmore (CFO). They are a savvy group with a potent combination of technical skills and commercial acumen.

Gateway's board is also deserving of special mention. Your directors are passionate about the business and doing that which is in the best interests of Members. The board is ably led by Catherine Hallinan whose exemplary stewardship sets the right tone for the organisation and ensures it is focussed on the things that matter. Her high energy and deep engagement make her a role model for others to emulate.

The road ahead

As we look to the future, record low interest rates are expected to continue along with soft GDP growth. So, we expect little support from the macroeconomic environment. Nonetheless, we will press ahead with our reform agenda to make Gateway an even better organisation. We know it is in our hands to make further change happen and we are committed to doing this. We will work hard to close the gap between our results and our ambitions.

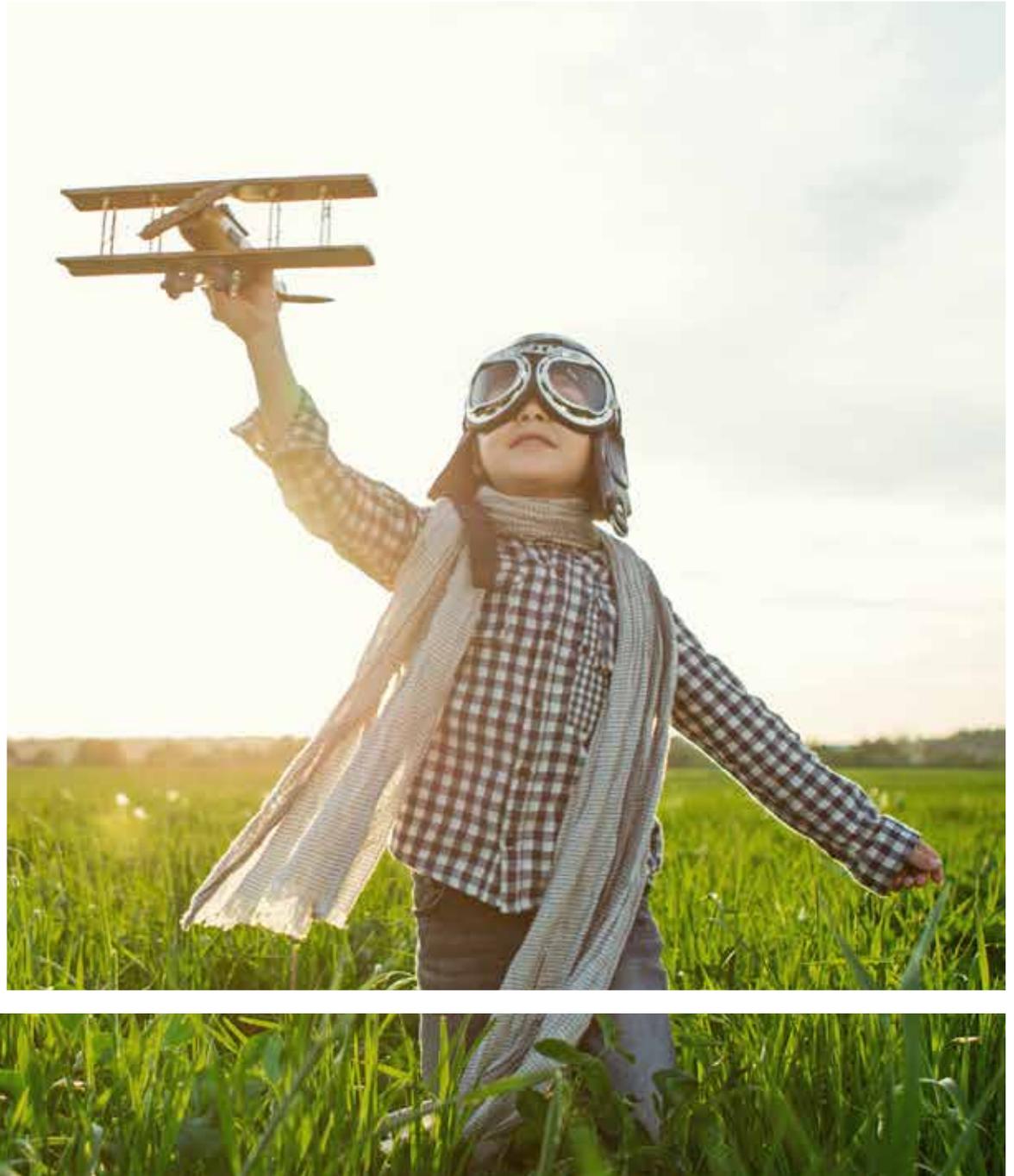
Finally, we will continue our never ending journey to partner our Members in achieving their hopes and dreams. Thank you for your continuing support of Gateway.

Paul J Thomas
Chief Executive Officer

Board of Directors

Putting Members First

Representing the interests of Members, the Gateway Board has shown engagement and involvement with major strategic changes. Their knowledge and expertise has assisted the business to operate effectively in an ever-changing environment.





Catherine M Hallinan
Chairman

BA (Hons), MBA, F Fin.,
FAICD, FAMI

Experience and special responsibilities

Catherine joined the Board in June 2006 and was appointed Chairman in May 2012. Catherine is also a director of HCF Life Limited, Lawcover Insurance Pty Limited, Lawcover Pty Limited and St. Catherine's Aged Care Services. She has over 30 years experience in banking, finance and management consulting.

- Deputy Chairman (March 2010 to May 2012)

Committee Memberships

- Nominations & Remuneration (July 2014 to present)
- Risk (March 2014 to present)
- Audit (March 2014 to present)



John B Flynn
Deputy Chairman

FAMI

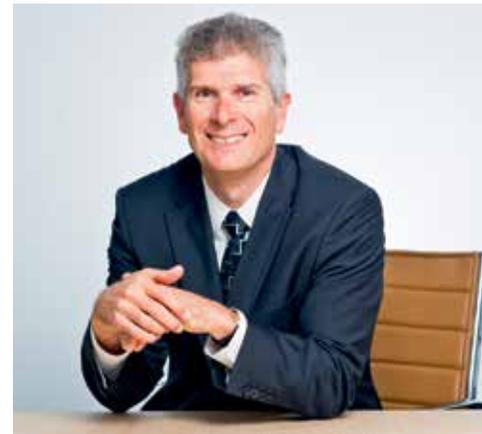
Experience and special responsibilities

John joined the Board in January 1989. John is currently a Finance Consultant with over 45 years finance experience, including 37 years with the Commonwealth Bank of Australia.

- Deputy Chairman (January 1998 to December 2002) (February 2013 to present)

Committee Memberships

- Risk (February 2015 to present)
- Convenor Audit (February 2015 to present)



Steven R Carritt
Non-Executive Director

BA (Accounting)

Experience and special responsibilities

Steven joined the Board in July 1992. Steven has over 38 years banking and finance experience and was formerly General Manager ALM with the Commonwealth Bank of Australia.

- Chairman (January 2005 to February 2010)
- Deputy Chairman (January 2003 to December 2004)

Committee Memberships

- Convenor Risk (March 2014 to present)



Robyn L FitzRoy
Non-Executive Director

BA, MA, FAICD

Experience and special responsibilities

Robyn joined the Board in January 2015. She is also a director of Habitat for Humanity Australia. She has over 20 years experience in the financial services industry and is a former Executive Director of Macquarie Bank. Robyn is a management consultant specialising in governance and is a former non-executive director of CUSCAL. She also is an accredited facilitator and author of courses for the Australian Institute of Company Directors.

Committee Memberships

- Convenor Nominations & Remuneration (December 2015 to present)
- Audit (February 2015 to present)



Malcolm S Graham
Non-Executive Director
 MA, F Fin., FAMI

Experience and special responsibilities

Mal joined the Board in July 1992 and has over 40 years banking and finance experience. Mal was formally a non-executive director of Australian Mutuals Institute (2007 - February 2016).

- Deputy Chairman (March 2008 to February 2009)
- Chairman (January 1998 to December 2004)
- Deputy Chairman (March 1994 to January 1998)

Committee Memberships

- Audit (February 2015 to present)
- Nominations & Remuneration (March 2014 to present)



Graham B Raward
Non-Executive Director
 BComm., M Applied Finance

Experience and special responsibilities

Graham joined the Board in June 2006 and has over 43 years banking experience. Graham is an Executive Manager, Group Funding of the Commonwealth Bank of Australia.

- Deputy Chairman (May 2012 to February 2013)

Committee Memberships

- Risk (March 2014 to present)



Irene H van der Loos
Non-Executive Director
 GAICD

Experience and special responsibilities

Rene joined the Board in February 2008 and was most recently General Manager, Living Well Navigator & Emerging Businesses at NRMA Motoring & Services. Rene has 14 years banking experience and was formerly a Director of Sydney Ports Corporation (2006 – 2012).

Committee Memberships

- Nominations & Remuneration (April 2008 to present)
- Audit (March 2014 to present)

Senior Leadership Team

Setting a new course of action

Progress occurs when leaders make bold moves to change things for the better. Our Senior Leadership Team has shown determination and courage in steering the business on a new course of action.



Paul J Thomas
Chief Executive Officer
MBA (Dist), MAICD, FAMI



Gary D English
Chief Risk Officer
M Mgt, FAMI



Peter W G Gilmore
Chief Financial Officer
B Bus, CPA



Alexis D Airey
Chief Customer Officer
BA (Hons), MSc



Improved customer experience by launching both a new website and Online Banking site



Awarded Australia's Best Credit Union 2016 by Mozo

Key Achievements

VALUE



Awarded three Canstar Outstanding Value awards



Introduced new products including granny flat home loans



Awarded six Mozo Experts Choice awards

Purpose, Ambition & Values

Purpose

To help people financially achieve their hopes and dreams

Ambition

To be the most trusted financial partner in Australia

Values

Service: We are here to please our Members – without them nothing else matters.

Excellence: We strive for continuous improvement in everything we do.

Respect: We treat others fairly, consistently and with dignity.

Integrity: We are fair and honest in all our interactions.

Learning: We are committed to developing the skills and capabilities of staff.

Teamwork: We trust, respect and support fellow employees and operate as a team.

Fun: We will have some fun along the way and value a sense of humour.



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