

# Shareholder Review

Information for shareholders  
of Bendigo Bank Limited

Welcome to the first edition of Shareholder Review, your shareholder news update. Four editions will be published each year: February (interim profit), August (full-year profit) and November (report on Annual General Meeting). In September, we will publish the Annual Review.

## Profit result 2006/07: Retail bank drives strong profit growth

*Chairman Robert Johanson and Managing Director Rob Hunt report on the Company's 2006/07 profit results*

We are pleased to announce a 15.6 per cent increase in cash profit after tax, to \$118.5 million for 2006/07. This reflects Bendigo's continued progress after years of investment in our alternative style of banking.

The profit represents a 13.3 per cent increase in cash earnings per share, which slightly exceeds market guidance provided in April.

Directors declared a fully franked final dividend of 34.0 cents per share. Dividends for 2006/07 totalled 58.0 cents, up from 52.0 cents last year.

The growth was driven by a robust retail banking performance, a growing diversity of revenues and a strong net interest margin which reflects the broad mix of business attracted by Bendigo's branded retail strategy.



Robert Johanson – Chairman (left)  
Rob Hunt – Managing Director

This is a high quality result reflective of the Bendigo brand value and our long-term customer and community focus.

It shows our customers are choosing to buy from us because of the value Bendigo adds to them and their communities.

### **Customer satisfaction a key to business growth**

We have not been drawn into unsustainable price discounting to win business – we win it on fair pricing that reflects our high service proposition and our commitment to improve the prospects of the communities we serve.

This has been our strategic focus for more than a decade now and we believe we have the balance about right.

Our customer satisfaction rating continues to lead the banking industry and tells us our service standards have kept pace with business growth; the vast bulk of our **Community Bank**<sup>®</sup> partners are doing well and are increasing the financial contributions they make to their communities; and our own shareholders are clearly seeing how these factors are driving improved performance outcomes for Bendigo.

### **Sixth consecutive year of strong earnings growth**

The 2006/07 result marks the sixth year in a row we have grown cash earnings per share and shareholder dividends by more than 10 per cent.

We believe we will achieve that again in the current financial year, when we are targeting an increase in cash earnings of 12 per cent. Our prospects are buoyant as we head into a proposed merger with Adelaide Bank.

## Branded retail strategy continues to grow business

Each month, approximately 6,000 new customers join us and in 2007/08, we expect to open a further 25 branches. Community demand for our model remains strong in the face of growing branch banking competition, and our strategies to deepen customer relationships are beginning to take effect, as evidenced by the continued growth of our wealth management offering. This is a particular focus going forward and we are happy with our progress.

Lending volumes have increased strongly since last November. Deposits slowed as customers directed funds into superannuation pre-June 30, but they have rebounded in July. We expect our brand will attract a good share of retail deposits moving back into the banking system.

## Adelaide Bank merger growth opportunities

Adelaide Bank will bring 25 established branches and a strong position in the South Australian

market into our group. They also bring expertise in wholesale banking and a range of skills and products that will expand our offering to customers. We are confident that our core retail business will continue to grow strongly while the merger with Adelaide Bank proceeds.

In recent years, we have made substantial investments in the business infrastructure required to support future growth and as we come together with Adelaide Bank, the business is well placed to continue the track record of both banks delivering substantial shareholder returns.

## Your dividend

The final dividend of 34.0 cents per share, fully franked, will be paid on 28 September 2007 to shareholders registered at 31 August 2007.

The total dividend for 2006/07 was 58.0 cents per share, fully franked.

	June 07 \$m	June 06 \$m	% Increase (Decrease)
<b>Result</b>			
Interest income	1058.6	907.5	16.7
Interest expense	701.5	592.4	18.4
Net interest income	357.1	315.1	13.3
Other income	205.1	184.5	11.2
Total income	562.2	499.6	12.5
Bad and doubtful debts expense	8.2	7.0	17.1
Other expenses	368.8	338.1	9.1
Profit before tax and significant items	185.2	154.5	19.9
Income tax expense	56.7	46.2	22.7
Profit after tax before significant items	128.6	108.3	18.7
Significant items after income tax	(6.8)	8.4	-
Profit after tax	121.8	116.7	4.4
Cash profit after tax	118.5	102.5	15.6
Cash earnings per ordinary share	82.9	73.2	13.3
Cash basis return on average ordinary equity	15.4	14.5	6.2
Dividends per ordinary share	58.0 cents	52.0cents	11.5
<b>Other key data</b>			
Total equity	1015.0	899.5	12.8
Gross loans under management	15.8 bill	14.1 bill	12.1
Deposits & funds under management	18.6 bill	16.6 bill	12.0
Cost to income ratio	64.6%	66.6%	(3.0)



Photos courtesy of The Advertiser (Bendigo)

**The merger proposal**

On Thursday 9 August the Boards of Bendigo Bank and Adelaide Bank announced their intention to merge and create a unique customer and partner focused financial services organisation.

The merger will be implemented by a Scheme of Arrangement of Adelaide Bank which will require approval by Adelaide Bank shareholders at a meeting expected to be held in early November 2007. Adelaide Bank shareholders will receive 1.075 Bendigo Bank shares per Adelaide Bank share.

**The Bendigo Bank/Adelaide Bank merger proposal**

Since announcing the proposal to merge Bendigo Bank and Adelaide Bank, the chiefs of both have been busy speaking with staff, shareholders, customers, the media and banking analysts.

Both companies announced record profits for 2006/07. Bendigo Bank Managing Director Rob Hunt and his Adelaide Bank counterpart Jamie McPhee toured broking firms in Melbourne and Sydney before joining Bendigo Bank Chairman Robert Johanson to address staff meetings in Bendigo, Melbourne and Adelaide, as well as information sessions for shareholders of both banks.

Following are edited excerpts of their addresses and answers to questions.

### 'It is rare to have a merger where none of the customers are disaffected or feel threatened'

Mr Hunt told Bendigo-based staff that the merger represented a rare instance in which two banks could be brought together without impacting on their customers.

This was because both banks had chosen different styles of banking after converting from building society status in the mid-1990s.

"Bendigo chose to build a brand and a retail distribution network, while at the same time keeping a toe in the wholesale business through National Mortgage Market and starting to stretch into wealth management.

"Adelaide Bank felt a wholesale operation was the best focus for them, so we were drawing on very different customers.

"There is a litany of mergers that failed to meet community and customer expectations, and therefore failed to meet shareholder expectations.

"It is rare to have a merger where none of the customers are disaffected or feel threatened, but because we have virtually no overlap between customer bases, here is the chance to do so.

"As there is no change to distribution – the customer-facing parts of the businesses – it means we can keep the momentum of both businesses going while we concentrate on bringing two head offices together to create a structure that can accommodate very strong growth into the future."

Mr McPhee acknowledged that Adelaide Bank had underinvested in its 25-branch retail network.

"It's not that we didn't want to be in retail – we have a good retail business with 180,000 customers – it's just that every time we had investment decisions to make there were better opportunities to employ our capital in other areas of the business."

Faced with the need to increase investment in its retail arm, Adelaide Bank had canvassed various options before turning to "the organisation that has connected with its customers and markets better than anyone in banking, and that's Bendigo".

Mr McPhee saw three key strategic strengths pointing to a successful merger.

"The customers want to be with both organisations, the partners want to be with both organisations, and both of us have an engaged workforce – 93 per cent of our staff say Adelaide Bank is a good place to work.

"Our competitors are all trying to increase customer satisfaction and staff engagement and we both have that."

Mr Hunt and Mr McPhee told staff that while bringing the banks together promised to save up to \$65 million, much of this was in technology, licensing fees and compliance, rather than in staff redundancies.

Measures would be taken to place as many current staff as possible in the new company, but it was inevitable there would be some instances in which staff would be displaced. Both Managing Directors pledged to be clear, frank and fair to all staff through the merger process.

### Questions from the shareholder information session

On 16 August, Bendigo Bank Chairman Robert Johanson, Managing Director Rob Hunt and Adelaide Bank Managing Director Jamie McPhee conducted a shareholder information session in Bendigo to provide shareholders with the chance to ask questions about the Adelaide Bank and Bendigo Bank merger proposal. Following is an edited report of their answers.

**Question:** How does Mr McPhee view the impact of the problems now facing the wholesale funding market (sparked by problems in the US sub-prime mortgage market)?

**Answer (Mr McPhee):** We are seeing a period of extreme volatility in which the quality of credit is paramount – good credit will always find a home. Our credit quality is very good; our arrears are the best they have been since December '05. The mortgage market is the largest market in the world and it will settle down. We need to look at how it settles and then decide the best way to fund our portfolio going forward.

There has been some criticism of Adelaide's low-documentation loan portfolio, but this ignores the fact that we have not priced these loans at the same margin as those for which we have full documentation. When we were obtaining a one per cent premium on low-doc, they represented over 50 per cent of our book; now they are 20 per cent.

**Question:** Can you give us EPS (earnings per share) and dividend predictions for the merged bank? And are we simply fattening the pig for the big four to take us over?

**Answer** Both banks have provided market guidance for 2007/08 – Bendigo EPS growth of 12 per cent and Adelaide Bank 10 per cent plus. We are confident of achieving the cost

savings outlined over the first couple of years of the merger. We have made no predictions about gaining extra business out of the merger but we do expect each business will improve as a result of each business gaining different skills and capacities. Dividends will be paid on the same basis as both businesses have to date – around the 70 per cent payout ratio. Both banks have been disciplined in balancing shareholder returns with capital retention for business investment.

We cannot preclude a takeover offer for the merged company. Our job is to grow shareholder wealth in a sustainable and reliable way. We are focused on our unique positioning and the opportunities that brings. If we continue to listen to our communities, plan our response, build and then run our businesses, we will retain our relevance and increase the chance of creating sustainable value by looking after the interests of all stakeholders.

**Question:** Will the offer to Adelaide Bank shareholders change if share prices fluctuate?

**Answer** The proposal was not constructed based on last night's share price, but reflected relative values over a long period. We took into account prospective earnings and dividends, and what needed to be done to get the transaction done without unsettling other stakeholders. We are committed to this proposal.

**Question:** Media commentators have questioned the wisdom of Bendigo merging with Adelaide Bank given its poor bad debts record and its over-dependence on home loans.

**Answer (Mr McPhee):** We have worked hard to diversify our revenue. In 1994, at bank conversion, home lending was virtually 100 per cent of our revenue; today, business lending and margin lending now comprises more than 50 per cent of the bank's profit. Our bad debts are up modestly this year but from a very small base, and we are comfortable with our arrears level. In June we stress-tested 20,000 mortgages and fully provided for any that looked like they could develop problems. We are very comfortable that our asset quality is in as good shape as it could be.

**Question:** Why is this offer superior or different to the Bank of Queensland offer? And why wasn't that offer put to shareholders?

**Answer** Bank of Queensland could have put an offer directly to our shareholders, but chose to put it forward in a form that specifically required the enthusiastic support of our Board. The Board carefully considered the proposal and considered that it was not in shareholders' best interests. The reaction of our staff and many customers – meant there was little prospect of it being approved. Independent polling by specialist consultants showed the proposal was not supported. Significant differences existed in long-term business investment philosophies and customer engagement strategies. There were adverse Capital Gains Tax consequences for many shareholders with the cash proposal.

The Adelaide Bank merger is compelling on many fronts. The merger has been agreed and unanimously supported by the Boards of both banks. Management at Bendigo Bank and Adelaide Bank are aligned in terms of long-term strategy. There is a high level of confidence in a successful integration, which is critical for any banking merger.

Both banks are leaders in terms of staff and customer/partner satisfaction and this will be an ongoing focus of the merged group. It brings together two complementary businesses which have little overlap in their retail banking networks, and the new business will be more diverse and able to perform well in a variety of market conditions. Both banks are committed to high levels of stakeholder engagement, understanding that it is the success and prosperity of their partners and customers which drive their own success. And there are cost synergies estimated at \$60 – 65 million dollars and significant potential for revenue synergies.

**Question:** Why did Bendigo not consult with its shareholders before announcing the Adelaide Bank merger proposal?

**Answer:** These negotiations must be confidential. There is little likelihood of successfully negotiating a merger proposal in the public gaze. Under ASX listing rules, both banks were bound to announce the proposal to the market before beginning consultation with shareholders and other stakeholders.

## Community News

Six **Community Bank**<sup>®</sup> branches opened in the last four months – at Caloundra (Queensland), Creswick (Victoria), Wallan (Victoria), Alice Springs and Katherine (Northern Territory) and Bendigo's 200th **Community Bank**<sup>®</sup> branch at Dromana (Victoria).

The Dromana community had been working on its campaign for just over 12 months and received generous support from locals, who bought \$1 million in shares in the company in just one week.

Across Australia, the **Community Bank**<sup>®</sup> network has 51,000 local shareholders, 1300 directors (mostly volunteers) and has directly created 950 jobs.



## Your Company news

### AGM and Annual Report

The Bank's Annual General Meeting will be held at Bendigo's Capital Theatre at 11.00am on Monday 29 October. Copies of the Bank's Annual Report (for shareholders electing to receive it) and/or an Annual Review colour booklet will be mailed to you in September 2007.

### Changing address?

Please ensure you advise of any change of address. Broker-sponsored shareholders should advise their broker, not our Share Registry (which is unable to process your request).

Issuer-sponsored shareholders should complete a Change of Address Form and return to Bendigo Bank Share Registry, PO Box 480, Bendigo, Victoria 3552.

Forms can be downloaded from our Online Share Registry, or contact Share Registry on 1800 646 042 to receive a copy.

### Have you received multiple reviews?

If your household has received multiple copies of this review and you would only like to receive one, please advise us in writing to Bendigo Bank Share Registry, PO Box 480, Bendigo, Victoria 3552.

### Become an e-shareholder

By registering to become a Bendigo Bank e-shareholder, you will receive most of your documents online, including your Annual Report and shareholder reviews.

To register, simply log on to [www.bendigobank.com.au/e-shareholder](http://www.bendigobank.com.au/e-shareholder) and enter your details.