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Bendigo Bank

You and your Company

Bendigo Bank is committed to providing Shareholders with opportunities to participate in their Company.

Around 500 Shareholders recently took the opportunity to hear the Chairman report on our progress and to question Directors. Three hundred and twenty Shareholders attended our Annual General Meeting in Bendigo on 22 October, more than 100 attended an information evening in Melbourne on 23 October and a further 70 Shareholders were in Ipswich on 24 October.

Shareholder communication was an issue raised at each meeting, with various suggestions for ways in which we can communicate efficiently through meetings, our Annual Report, shareholder newsletters and email.

We are currently evaluating our options but wish to assure Shareholders that they are welcome at any time to contact us with questions, compliments or concerns.

Securities Registry 1800 646 042
share.register@bendigobank.com.au
PO Box 480, Bendigo, Vic. 3552

Chairman's Address

BY RICHARD A. GUY OAM

An edited text of the Chairman's Address to Bendigo Bank's 136th Annual General Meeting.

Recently the chief of a big bank took a colleague of mine aside at a gathering. "You know," he said, "there are only two banks in Australia at the moment with a distinctive strategy." No prizes for guessing one of them – his own – but the other he nominated was Bendigo Bank.

Naturally I accepted this comment with a pinch of salt, but I suspect it also contained more than a grain of truth. Bendigo Bank has developed a unique and distinctive strategy, one recognised even by other banks.

The public certainly recognises we are different. The number of new accounts we open each month has doubled in just two years. During 2001 we have consistently seen 10,000 to 15,000 new customers join us each month. While it is impossible to read their minds, we can make some educated guesses as to what attracts people to our Bank.

Firstly, they now know about us. Six years ago, when we converted to bank status, we were largely unknown outside Victoria. Now, we have a nationwide awareness largely driven by the widespread media coverage of our Community Banking initiative. Then there are those aspects which stand us apart:-

> We remain Australia's only regionally-based bank.

> We are opening branches while many competitors close theirs.

> We are expanding our rural and regional presence, again at a time when many service providers are centralising.

> We have clear fee principles which do not discriminate against low-income customers or those who wish to visit our branches.

> Finally, our strategy is quite unique.

Building the foundations

When we became a bank we took a long-term view of what we needed to do to succeed. Rather than seek short-term, price-driven market share, we laid foundations for the future. We built systems, recruited people, developed product, built alliances and undertook community development projects. We equipped ourselves to help improve the prospects of our customers and their communities. If they become more successful, and we are their preferred banker, then our business, too, will be more successful.

We have invested heavily in this strategy. Community Bank, Community Telco, the Lead On youth development program, our Regional Development Fund and Bendigo Stock Exchange have all required funding. All of these projects, though, help develop more secure and dynamic markets for Bendigo to bank – successful communities create a successful bank.

And we are becoming more successful.

It was almost a full house as about 120 shareholders attended Melbourne's Holiday Inn in St Kilda Rd on a wet and blustery evening.

A measure of success

New customer numbers are at an all-time high and we now boast more than 600,000 customers and 950,000 accounts Australia-wide. Account numbers have doubled in just over three years.

Shareholder numbers, too, grow at record rates. When we converted to a bank in 1995 we had just 8400 shareholders. Today that figure approaches 40,000 predominantly small shareholders.

Total lending approvals for 2000/2001 were $2.49 billion, a 35 per cent increase on last year.

Total Group deposits grew by 42 per cent to $6.2 billion, and Sandhurst Trustees' Common Funds increased by 31 per cent, to $863 million.

Retail deposits now comprise an overwhelming 84 per cent of the Bank's funding, an indication of the attraction of the Bendigo brand in a highly competitive investment market.

Group assets grew by $2.1 billion, to $7 billion. We also securitised a further $393 million in loans as part of our ongoing capital management strategy during the year.

All these numbers translate into increasing profitability and higher dividends for shareholders… although therein lies a more complicated story.

Profit – the underlying story

Firstly, though, let's deal with the facts, which show that the Group's 2000-2001 profit before tax was $55 million, a 47 per cent increase on the previous year. Our after-tax profit was up by 56 per cent, to $33.3 million, helped by a slightly lower company tax rate.

But while those are striking headline numbers, they need to be put in context. There are several factors complicating understanding of our true profit growth:

> Last year's write-down of a one-off loan exposure in Asia.

> This year's provision to cover a court judgment against the Bank, and

> The acquisition of First Australian Building Society.

I propose to show how these factors have affected our reported profits and then to exclude them and look at how we would have performed without them. This is termed "underlying profit".

I will concentrate on post-tax profit, from which your dividends are funded.

In 1999 our after-tax profit was $19.7 million. Profit in the following year was reduced by an abnormal write-down related to a one-off exposure to Asia. This effectively reduced the 2000 after-tax profit by $6.5 million. So while actual profit was $21.3 million, underlying profit was $27.8 million.

Further complicating the picture is a write-down appearing in the June 2001 accounts in the form of a $3.5 million after-tax provision for a Federal Court judgment awarded against the Bank. We will appeal this judgment and we will also pursue a claim against the liquidator of our insurer, HIH. Any recoveries from these actions will be brought to book in future.

The fact remains, though, that because we have fully provided the judgment, our profit was $3.5 million lower than expected. While actual profit declared was $33.3 million, underlying profit was $36.8 million.

Strip away these one-off items, then, and our underlying profit progression is $19.7 million in 1999, $27.8 million in 2000 and then $36.8 million in the year in review. Growth in underlying profit, was therefore 32 per cent, and not the headline 56 per cent – however 32 per cent growth in profit is still an excellent result.

That being the case, then, why did earnings per share grow by just 14.7 per cent, and your dividend by eight per cent?

The answer lies in our acquisition of First Australian. Nine months contribution from First Australian grew our after-tax profit by $6.3 million. At the same time, though, we issued 28 million new shares to former First Australian shareholders in order to acquire their company. This grew Bendigo's share base by one-quarter and meant we had that many more shares across which to spread earnings and dividends.

The net result was that we were able to increase your annual dividend by two cents per share. Don't forget, though, that we also paid, from retained profits, a special cash dividend of 15 cents per share. This distributed to shareholders available tax credits fully franked at 34 per cent. As you know, the company tax rate has since been reduced to 30 per cent.

Shareholder Mervyn Woodgate (left) congratulates Managing Director Rob Hunt on his address to the Melbourne Shareholder Information Session held on 23 October.

The growth business

One of the difficulties in making profit comparisons is that we are always comparing apples with pears. Our company is growing rapidly and is constantly entering new markets.

Since last year, for instance, our network has been augmented by two new company-owned branches, in Colac and Wagga Wagga, 21 new Community Bank branches, the acquisition of First Australian Building Society's 47 branches, and the first three Tasmanian Banking Services branches – Burnie, Rosny Park (in Hobart) and Launceston.

I wish to briefly touch on the last three initiatives, as each of them illustrates our core business strategy – to improve our prospects by improving those of our customers and their communities.

Queensland

Our merger with First Australian is the largest transaction in our history – an investment of $137 million.

This investment was made by way of a one-for-two share issue to First Australian shareholders, rather than a cash purchase. Why? Because we believe our long-term prospects are enhanced if we are relevant to our shareholders, customers and communities.

Queenslanders now own a quarter of our company and therefore directly benefit from its success. This same principle applies equally to our joint venture in Tasmania and to each of our Community Bank alliances.

Having invested heavily in acquiring First Australian, we received an immediate return through its contribution to the year's after-tax profit. This current year, we will have a full year's contribution from our Queensland network.

To enable our new Queensland arm to achieve its full potential, we made additional investments. We established our national loans centre in Ipswich. In response to the way in which customers embraced the Bendigo style of banking, we rebadged all 47 branches as "Bendigo Bank". We hired specialist staff such as branch managers and business bankers. And, of course, we converted all First Australian accounts to Bendigo Bank. This last exercise was a massive undertaking, with 165,000 accounts converted and almost 500,000 pieces of correspondence mailed to customers.

I am delighted to report, however, that First Australian was fully incorporated into the Company within 12 months and that business is already beginning to respond.

Tasmania

Tasmania will be another excellent market for us.

The opportunity for Bendigo Bank in Tasmania was created by the absorption into Commonwealth Bank of Trust Bank, thereby removing local ownership from the banking market. In partnership with Tasmanian Trustees, we created a new 50 per cent locally-owned banking company, Tasmanian Banking Services, which currently operates five branches.

We expect our network to be augmented by Community Bank branches, the first of which we hope to open early next year in the Huon Valley. Our prospects will be further enhanced if Tasmanian Trustees and Perpetual Trustees merge as expected. This will create a one-billion dollar trustee business and create a potentially large customer base for our joint banking company.

Community Bank

Community Banking embodies our business strategy. It empowers local communities to improve their prospects, and, by doing so, to improve ours. And it is working, both for communities and for our bank. Community Bank is already a billion-dollar business. The first ten communities are all making sustainable surpluses, as are a number of others. Profits are being distributed to local shareholders and funds are flowing into community projects. But what about Community Bank's contribution to your Bank?

In the year ended June 2000, Community Bank contributed a million dollars to our pre-tax profit. In the year under review it was $2.5 million; this current year we expect it to be $6 million. There is no question, too, that we have benefited in other ways. Based on advertising rates, for example, we estimate we have received well in excess of $5 million in free publicity through television, radio, newspapers and magazines.

There is certainly no shortage of demand for Community Bank. We have received 1800 inquiries and are currently working with around 80 communities. We open our 50th branch on Friday (26/10) and we expect the network to keep growing at a similar, or even faster, rate.

e-bank

This concentration on opening new branches tends to mask the fact that Bendigo is also a vibrant electronic bank. On a per capita basis, e-banking is more popular with our customers than those of many competitor banks. Around ten per cent of our customers are already e-bank users and that proportion is growing daily. Some of the services we offer our e-banking customers are at the forefront of Australian banking.

Electronic banking transactions already outnumber branch transactions by four-to-one and this proportion will continue to grow. The newer forms of banking – internet, telephone and direct entry – were non-existent in 1997 yet already command more than one-third of all transactions. Branch transactions have fallen dramatically as a proportion and now comprise just 20 per cent of total transactions. Note, though, that the total number of branch transactions continues to rise. We are committed to enabling customers to choose their preferred style of banking. We therefore continue to open new branches and invest in electronic systems to further improve customer service.

Future prospects

I wish to deal briefly now with our immediate plans for the future and to comment on the business environment in which we are likely to operate.

Currently our Group manages and advises on $7 billion in deposits and another $2 billion in funds under management. We will continue to focus on the obvious potential to broaden our relationships with our depositors to win more of their investment business.

To co-ordinate our efforts, we are bringing our various funds management and advice businesses together in a new "wealth creation" structure.

One of those businesses, Sandhurst Trustees, endured a difficult time last year, with its corporate trustee income evaporating in the wake of legislative changes. Despite developing some new income streams, Sandhurst's contribution to Group profit fell by 41 per cent. However, Sandhurst has developed a range of investment products which will make it a pivotal player in our new wealth creation division.

This is already taking shape. The management structure and team are in place, and we will make Bendigo Investment Services part of the Bendigo stable by acquiring IOOF's half share. Our intention is to make it easier for investors to do business with us and to provide better links between our retail banking and wealth creation arms.

By growing funds under management and advice, we aim to secure a substantial fee-based income stream. Fee income is less vulnerable to fluctuations in interest rates which can compress margins.

We are happy to form alliances with partners who complement our strengths.

I have spoken of our alliance with Tasmanian Trustees and of our prospects in Tasmania. Our longer-established joint venture, Elders Rural Bank, completed its first year as a stand-alone bank with an after-tax profit of just over $10 million and buoyant prospects. As joint shareholder of this rural sector bank, we are entitled to half the profit, $5 million. Elders Rural Bank and Bendigo are working closely together to improve services to rural areas and some products of both banks are now available at the branches of each. We will gradually grow this relationship.

We are also gradually increasing our presence in NSW, through both company-owned and Community Bank branches. Bendigo Bank currently has 11 branches in NSW, including seven Community Bank branches. Our first Community Bank in suburban Sydney will open before Christmas.

We expect to double this NSW network within 12 months, including the opening of both company-owned and Community Bank branches in the Sydney metropolitan area where demand for our style of banking is evident. We consider we have excellent prospects of success in the NSW market.

Sharing a cup of tea and a chat with Chairman Richard Guy OAM at the Melbourne session were shareholders Jock and Susan MacKay.

The business environment

Given the extraordinary recent events - the attacks on America and the company collapses of HIH, OneTel and Ansett - I present now an assessment of the possible repercussions for our business.

There is no question that the events in America, in particular, have produced great uncertainty and a re-evaluation by world stockmarkets. Even prior to the attacks, the global economy was weakening. Japan has been in recession, Asia and Europe are both weak and the world's biggest economy, America, is probably now in recession.

Australia, however, is better placed than most economies to weather the storm. Our economy has been growing quite strongly. While we will doubtless be affected by world sentiment and the flow-on effect of downturn in demand for our exports, the current strengths of the Australian economy do provide us with a measure of protection most others do not enjoy.

Domestically, the Ansett collapse in particular will be hurtful, as was the HIH collapse. We have no direct exposure to Ansett and little to no exposure in the airline, tourism or travel industries.

This is not to say, of course, that we are immune from any flow-on effects from downturns in those industries. Efforts are being made to rapidly rebuild the carrying capacity of the airline industry in order to minimise any damage to the economy. We are hopeful that any flow-on effects might not be as dramatic as first feared.

The Bendigo outlook

So how is Bendigo Bank placed as we move into this period of global uncertainty?

I have already outlined our strategy and the investments which underpin it.

Our company has been consistently growing at 20-plus per cent per annum for the past five years and our first three months trading for 2001/2002 has been ahead of our budget.

The Bank's prospects are excellent. It should be remembered that many of our new businesses are less than three years old and, like any start-up businesses, take time to build scale. These businesses are now rapidly increasing their income and their contribution to Group profit.

Bendigo is well positioned in the market and demand for our style of banking is strong. Again, last month was a record for new customers, with another 17,500 people joining us. The quality of our existing loan book remains sound and our lenders are mindful of the need for prudence as we enter this period of economic uncertainty.

Shareholders have been patient during five years of consistently heavy investment, but we expect a strong result in the current half to reaffirm our improving performance. The future, while challenging, will be exciting and rewarding for the Bendigo.

AGM Resolutions

The following resolutions were passed by the 320 shareholders present at the AGM. The Chairman also voted approximately 15 million proxies in favor of the resolutions.

> The meeting affirmed the reappointment of four Directors – Kevin Roache and Jenny Dawson from Victoria, and Queensland-based Directors Neal Axelby and Terry O'Dwyer.

> Shareholders unanimously renewed their approval of the Staff Share Scheme for a further three years. This means shares which might be issued under that scheme are not counted under the ASX's so-called "15% Rule". This rule limits companies to issuing 15 per cent of their shares in any one year without shareholder approval. By removing staff shares from the calculation of the 15 per cent, we have more flexibility should there be a need to issue capital (as was the case when we acquired First Australian last year).

> The AGM also voted – with just one shareholder opposed – to issue our Managing Director, Rob Hunt, with 200,000 shares under the Staff Share Scheme. This issue is made under exactly the same conditions as all other staff in the Bank and requires Rob to purchase the shares. Rob has served this company with great distinction for 28 years – 14 as chief executive – and the Board was unanimous in its view that the share allocation was an appropriate way to reward his loyalty and further align his interests with those of shareholders.

Shareholder Questions

To broaden the forum for questions, we now enclose with your Notice of Meeting a question sheet inviting those Shareholders who are unable to attend the Annual Meeting to submit questions beforehand.

Scores of Shareholders availed themselves of that opportunity and many took the trouble to compliment us on the manner in which we conduct our business. This feedback is greatly appreciated.

All questions received have been sorted and circulated among appropriate managers for consideration. While it is not possible to address all questions, we will answer many in this newsletter and in the February 2001 edition.

Q: What was the cost to the Bank of GST compliance?

A: The GST, during 2000/2001, added $6 million to the Bank's costs. This is because tax legislation severely limits the capacity of banks to recoup the GST they pay on business inputs. Balancing that, it should be remembered that GST was part of a wider tax package which included a substantial reduction in company income tax… so what we lose on the swings we pick up on the roundabouts.

Q: When can we expect to see Community Bank provide the same return on equity (ROE) as the rest of the business?

A: Community Bank was started from scratch three years ago and required a substantial investment. Like any startup business, it will take time to establish full profitability. The returns will come as we achieve efficiencies of scale. We currently have 50 branches and expect ROE to match ROE of the core business in the next year or two. Once we have 100-plus branches we could even see a ROE greater than our core business. It should also be remembered that Community Bank has generated in excess of $5 million in publicity which has raised awareness of our business across Australia.

Q: What were the circumstances surrounding the transactions which formed the basis of the judgment against the Bank in the Tab Fried v. NAB and Others case?

A: As this matter is sub-judice pending our appeal, we cannot comment except to note we have legal opinion that our appeal is strongly based. We will report to shareholders on the outcome of our appeal.

On home turf. Queensland-based Director Neal Axelby with Trevor Fuelling, of Toowoomba, at the Ipswich session.

Q: The Bank has said it aims to increase its fee income. In the wake of anger about bank fees, how can you do that as well as retaining our reputation for being socially responsible?

A: The term "fee income" is a lot broader than just transaction fees, on which much of the public anger is focused. For example, we expect significant growth in management fees generated by our wealth creation initiative. Bendigo Bank's fees are based on a set of clear principles. We will outline these fully to shareholders in the February 2002 edition of The Bendigo Shareholder.

Q: In 2000 the Bank's auditors received $85,000 in "other" fees; this year it was $1.8 million. Why the increase?

A: Our auditors were asked to complete major projects during the year, including the centralisation of our treasury and foreign exchange activities and some significant work on reconciliation procedures. These changes were all designed to position the Company for significant growth. The auditors were chosen because they had the expertise required and because they know our business so well that significant efficiencies were achieved in project delivery.

Q: The Bank's performance ratios – ROE and earnings per share (EPS) are low by industry standards, and its costs are high. What are you doing to address this situation?

A: (Given by Mr Hunt at the Melbourne shareholder session). I could deliver you immediate improvement in all these ratios simply by cutting costs and stopping our investment program… but I could only do it once. After a while, all such programs run into the same problem – there is nothing left to cut and investment has been pared back to the point where the business' future prospects suffer dramatically. We are a different business and we operate in different markets. We have been building a platform for long-term, sustainable growth in earnings and shareholder returns and we are confident these ratios will improve substantially.

Q: Why did the cost-to-income ratio rise after showing a downward trend in recent years?

A: We foreshadowed this increase last year. It was due to the acquisition and integration costs of the First Australian merger. We expect the ratio to fall below 70 per cent again this year and our medium term aim is to achieve a figure in the low 60s. Given our strategy, and the predominantly regional nature of our network, we will not achieve benchmark industry lows.

Q: It would seem both IOOF and Elders have sold down their holdings in the Company. Does this threaten our joint venture activities?

A: No. Joint venture activities are protected by contracts binding the parties. All parties remain committed to the joint ventures. All shareholders have the right to sell shares at any time and IOOF and Elders have exercised that right.

Q: I had five accounts with First Australian and the amount of mail that arrived on my doorstep got to the stage of being junk mail. I would suggest that in future when you do have another acquisition, that you put all those documents in a folder and send it out in the one mailing.

A: The law demands that we actually write separately to every account-holder. I don't think it makes any sense but the law demands that this must happen. We are preparing a submission about this very issue.

Bendigo Bank Limited
Fountain Court, Bendigo VIC.
ABN 11 068 049 178

Bendigo Bank

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