Adelaide Bank

RECORD PROFITS AND DIVIDENDS AS ON-GOING STRATEGY OUTLINED

Adelaide Bank Limited today announced a record profit for the 2004-05 financial year on the back of very strong lending growth, resulting in record shareholder dividends.

At the same time the Bank outlined its strategic direction for the next three years – a strategy aimed at achieving continued growth and further increases in shareholder returns.

The record-breaking result was at the top end of analysts' expectations with underlying earnings of $131.0 million -- which is an increase of 24 per cent on the $105.5 million recorded in 2003-04 -- and achieving growth in fully diluted cash earnings per share of 15.4 per cent from 67.63 cents to 78.03 cents.

Profit before tax and significant items ($1.3 million from the sale of Cashcard shares) was $116.3 million, compared with $94.0 million for 2003-04 – also an increase of 24 per cent, while profit after tax (before significant items) was $80.4 million, which was a 23 per cent increase on the $65.1 million recorded for 2003-04.

Details of the 2004-05 Adelaide Bank performance were announced jointly to the Australian Stock Exchange by the Adelaide Bank Chairman, Mr Dick McKay, AM, and Group Managing Director and Chief Executive Officer, Mr Barry Fitzpatrick.

In announcing the results, Mr McKay said: "The record results for 2004-05 fulfil Adelaide Bank's commitment to achieving double-digit profit and earnings per share growth while delivering increased shareholder value.

"This record-breaking performance is a clear indication the strategic direction taken by the Bank in recent years has been correct.

"Those strategies have recently been reviewed and a blueprint for a strong path forward has been ratified by the Adelaide Bank Board."

Shareholder Returns

Mr McKay announced the Adelaide Bank Board had approved a four-cent increase for the Final Dividend Payment to Shareholders, taking this payment to a fully franked 29 cents.

"This takes the full dividend for 2003-04 to 53 cents per share, compared with 44 cents for 2003-04 – an increase over the full year of 20 per cent," Mr McKay said.

“The 29 cent final dividend will be paid on October 17, 2005.

“This increased return to our shareholders represents a dividend payout ratio for the year of 75 per cent, which is slightly above the Board’s long term objective of achieving a dividend payout ratio around 70 per cent.

“During 2004-05 the Bank achieved a return on equity (pre amortisation of margin lending acquisition costs) of 18.7 per cent.

This compared with 17.6 per cent in the previous year and was well above the Bank’s target of 15 per cent.

“This translated into fully diluted cash earnings per share of 78.03 cents, compared with 67.63 cents in 2003-04 -- an increase of 15.4 per cent, leading to the increased dividend.”

Key Milestones

Key Milestones of the 2004-05 financial year included:

- The acquisition of the Goldman Sachs JBWere Equity Finance Pty Ltd margin lending business for $61 million, making Adelaide Bank the second largest margin lending operation in Australia.
- Loans under management increased by 34 per cent (including the Goldman Sachs JBWere Equity Finance portfolio of $890 million) – or $5.8 billion -- to $19.0 billion, compared with $14.2 billion at the end of 2003-04.
- Loan approvals reached a new record of $9.2 billion, compared with $8.1 billion for 2003-04 – an increase of 13 per cent.
- Funding from retail deposits increased $1.5 billion – or 19 per cent.

Lending

Loan approvals for the year were at record levels, driven by residential lending.

Home loan approvals increasing from $7.4 billion in 2003-04 to $8.5 billion. This represents an increase of 15 per cent.

As a result of this increase, Adelaide Bank continued to increase its share of the national mortgage market. Latest Australian Bureau of Statistics figures show Adelaide Bank lending approvals increased from 3.2 per cent at 3.9 per cent on a yearly accumulated basis.

Loans under management increased from $14.2 billion to $19.0 billion during 2004-05 – an increase of 34 per cent. If the additional loans that came with the Goldman Sachs JBWere Equity Finance portfolio are excluded, growth was still 28 per cent, which was well above the overall market.

At the end of 2004-05 lending outside of South Australia represented 75 per cent of mortgage loans under management. This compared to 70 per cent at the end of 2003-04 and 67 per cent at the end of 2002-03.

Mr Fitzpatrick comments: “The Bank’s strategic thrust in developing national business partners is continuing and is reflected in these figures.

“New partnerships with national mortgage brokers have resulted in the Bank increasing its loan approvals through this channel from one per cent to 17 per cent of its lending business over 2004-05 and we expect this figure to continue to grow throughout 2005-06 and beyond.”

Business Banking also increased its lending portfolio over the year from $1.2 billion to $1.6 billion, an increase of 33 per cent. Apart from continued traditional business banking growth, this increase was also impacted by the Bank’s entry into Portfolio Funding.

Margin Lending

Adelaide Bank’s margin lending business generated $12.8 million in pre-tax profit for the year. This compared with $8.6 million for 2003-04 – an increase of 48 per cent.

At the beginning of 2004-05 the Bank’s margin-lending book stood at $1.4 billion.

The acquisition of the Goldman Sachs JBWere Equity Finance business (with a portfolio of $890 million) makes Adelaide Bank the second largest margin lending operation in Australia with a total margin lending portfolio under management of just under $2.6 billion – or more than 15 per cent market share of national margin lending.

At June 30, 2005 the total margin lending portfolio under management was in excess of $2.6 billion.

Loans under management grew by 84 per cent during the year. Excluding the impact of the Goldman Sachs JBWere Equity Finance acquisition, portfolio growth was 22 per cent, reflecting strong growth in equity investment.

Asset Quality

Loan quality continues to remain very sound with gross non-accrual loans decreasing from $8.5 million at the end of 2003-04 to $6.3 million at the end of 2004-05.

This represents only 0.06 per cent of gross loans – down from 0.09 per cent.

Net non-accruals to total loans stood at 0.01 per cent and 0.27% of ordinary equity plus general provisions. Together these levels see Adelaide Bank continue to be at the upper end of credit quality for Australian retail banks.

Business Banking non accruals fell to 0.10 per cent of the portfolio, compared with 0.25 per cent in 2003-04, with only one non-accrual loan included in this figure, while non-accrual consumer loans remained at normal levels over the year.

Performing residential loans past due 90 days and over increased from 0.35 per cent at June 30, 2004, to 0.66 per cent at June 30, 2005, which is in line with historic levels.

Despite these excellent ratios, Adelaide Bank continued its prudent approach to credit quality and provisioning; increasing overall general provisions by $8.2 million to $39.0 million.

This maintains the ratio of general provisions to risk weighted assets at 0.51 per cent, once allowance is made for the expected securitisation of the Goldman Sachs JBWere Equity Finance margin lending portfolio.

Funding

Adelaide Bank continued to increase its level of funding from retail deposits over the year.

Retail deposits increased from $7.8 billion to $9.2 billion over 2004-05 – growth of 19 per cent.

In addition, a continuation of successful securitisation issues -- with three issues during 2004-05 -- saw funding from securitisation increase from $5.2 billion to $7.9 billion.
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Capital

Capital Adequacy stood at 11.06 per cent at the end of 2004-05, with Tier 1 Capital at 6.31 per cent.

This compared with Capital Adequacy of 11.42 per cent at the end of 2003-04, with Tier 1 Capital at 7.20 per cent.

The Tier I ratio was affected by the requirement to deduct capitalised payments to loan originators from eligible Tier I capital.

From July 1, 2005 the Bank was required to deduct a further $42 million from its eligible Tier I capital for capitalised payments under Australian Prudential Regulatory Authority (APRA) requirements.

Costs

During 2004-05 the Bank's operating costs increased by 17 per cent, from $129.4 million to $151.5 million, reflecting the Bank's strong growth, additional compliance costs and increased technology expenditure.

Staff costs grew by 14 per cent year on year, with the increase resulting from the final year of the Bank's Enterprise Bargaining Agreement (EBA), plus an increase in the overall FTE staff numbers. A new EBA has been agreed for 2005-07.

FTE staff numbers rose from 1,079 to 1,174 over 2004-05, due to increased lending activity, compliance and technology demands.

Mr Fitzpatrick said: "The 17 per cent increase in operating expenses was both controlled and measured. Importantly, this increase was considerably lower than the rate of growth in loans under management and the growth in operating income.

"This ensures continuing improvement in the Bank's cost to assets and cost to income ratios – two key measures for the Bank.

"The operating expenses to operating income ratio was further reduced over the year – dropping from to 55.08 per cent to 53.64 per cent – well ahead of the target set in 2002 to reduce this key ratio to 55 per cent by the end of 2004-05.

"At the same time the cost to assets ratio was also further reduced – falling from 0.93 per cent at June 30, 2004 to 0.82 per cent at June 30, 2005.

"This further consolidates the Bank's position at the leading edge of performance for Australian retail banks."

Margin

Net interest income rose by $35.5 million over 2004-05, with gains from increased volumes slightly offset by a 0.04 per cent reduction in the interest margin.

The Bank's net interest margin reduced from 2.23 per cent to 2.19 per cent on a year-on-year basis. The outcome for the second half was in line with that of the first half.

The margin on mortgage loans fell over the year, but was virtually offset by movements in the yield curve and increases in the level of free funds.

Strategic Direction

Detailing the Bank's strategic direction for the future Mr. Fitzpatrick said: "In recent years the Bank has clearly defined its strategies for future growth and careful execution of those strategies was the key to the Bank's performance in 2004-05.

"During the second half of last financial year the Board and Executive of Adelaide Bank revisited our strategic direction and clearly defined the path ahead until at least 2008.

"The previous Plan identified six Critical Strategic Issues to measure our success -- earnings quality, asset quality, efficiency of operations, liquidity management, capital management and customer and partner satisfaction.

"In the new Plan we have added a seventh issue –risk management. This recognises the need to ensure the Bank retains a clear focus on managing all risks within a common framework.

"We have established goals in each Critical Strategic Issue to ensure progress can be tracked over the course of our Plan.

"Execution is the key to success.

"Adelaide Bank strategies are built around developing strong working partnerships and the success of these strategies can be seen by the increase experienced in market share.

“These strategies have held Adelaide Bank in good stead for several years and they will continue to form the basis for the Bank’s growth in the immediate future, while achieving prime objectives in the areas of costs, credit quality, shareholder returns and profits.”

Looking Forward

Summarising the 2004-05 results, Mr. Fitzpatrick said: “This is Adelaide Bank’s best performance – and we have more than delivered on our promises to shareholders and the market.

“We targeted a return on equity (ROE) of 15 per cent – and posted an ROE of 18.7 per cent which was six per cent higher than the 17.6 per cent for 2003-04.

“We aimed to generate an increase in earnings per share of greater than 10 per cent and achieved an increase of 15.4 per cent – with fully diluted cash earning per share up from 67.63 cents to 78.03 cents.

“We said we would reduce the operating expenses to operating income ratio to 55 per cent and achieved a level of 53.6 per cent.

Mr Fitzpatrick said the three key targets over the next three years were:

- Growth in cash earnings per share of more than 10 per cent per annum.
- A cost to income ratio of 46 per cent by June 30, 2008.
- Asset quality that ranks in the top quartile of Australian retail banks.

“Our aim is to capture five per cent of the national mortgage approval market, while targeting specific areas of growth in our business banking operations and further growing our retail deposit taking operations and margin lending businesses.

“Achieving these targets will further reward our shareholders with strong profit growth.”

**Further comment can be obtained from Mr. Fitzpatrick at Adelaide Bank.
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