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Adelaide Bank Limited today reported net profit after tax of \$41.48 million for the first half ended December 2005, a 21 percent increase compared with the previous corresponding period. Loans under management grew at an annualised rate of 22.2 percent to \$21.1 billion in a competitive environment with weaker housing lending. What factors contributed to this growth?

MD Barry Fitzpatrick

The Bank has benefited from its strategy of increasingly diversifying its lending, with higher contributions from Margin and Business Lending more than offsetting the slow-down in the housing market. The pre-tax profit contribution from these two segments increased to 34 percent in the latest half from 21 percent in the half year ended December 2004. The slow-down in the housing market saw our profit contribution from residential lending reduce in the latest half by 12 percent year on year to 41 percent.

Our average business loan book rose by 49 percent to \$2.0 billion, boosted by the development of our Portfolio Funding business. Growth in Margin Lending was accelerated by our June 2005 acquisition of the margin lending business of Goldman Sachs JBWere with our average margin loan book growing by 88.2 percent to \$2.8 billion.

While we were integrating the Goldman Sachs JBWere margin lending business, we freed up balance sheet lending capacity by securitising a greater proportion of

our margin loans. At the end of December, securitised margin loans represented 72 percent of the total of \$2.9 billion, up from 50 percent at the end of June 2005.

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This is the first time you've reported under Australian International Financial Reporting Standards (AIFRS). What were the major adjustments to the accounts compared with the previous AGAAP standards?

CFO Frank Lupoi

The major adjustments relate to the recognition of securitised assets on the balance sheet, plus the reclassification of our reset preference shares from equity to debt. Also, goodwill is no longer amortised, but is subject to an impairment test, and the general provision for doubtful debts has been replaced by a collective impairment provision.

The balance sheet recognition of securitised assets lifted our total assets to \$21.1 billion compared with total assets reported under AGAAP of \$13.4 billion at June 30. As the margins on securitised assets are lower than those on other loans, our reported overall margins have been diluted. This is purely a change in reporting classifications and our margin profitability has not changed.

The change to collective impairment provisioning is the only item with a significant impact on the cash EPS calculation. If we'd reported the latest result under the previous accounting standards our cash EPS growth would have been 12 percent rather than 13 percent.

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While your share of national mortgage loans grew by 2 basis points (excluding the purchased portfolio), your share of national mortgage loan approvals fell to 3.1 percent in the 5 months to end November compared with 3.8 percent in FY05. What caused the reversal in your mortgage approval market share and what are the implications for future profit growth?

MD Barry Fitzpatrick

Our mortgage approvals fell in a housing loan market that was intensely competitive while the rate of growth in approvals was slowing. To avoid unprofitable growth, we've been selective in choosing the areas in which we compete.

We're confident of returning to growing our mortgage loan approvals at a rate faster than the market. Our management is committed to regaining our market share of approvals and is finalising a strategy that will simplify the product range sold through brokers and strengthen the products offered through the Bank's major mortgage manager relationships. We'll also continue to introduce innovative products and strengthen our loan retention process.

We'll continue to improve the profitability of this business segment, despite reduced volumes in the short term, by removing costs from the mortgage loan approval process. Despite the short-term decrease in profit we'll continue to

invest in our Residential Lending business and continue to provision conservatively, which also contributed to the decrease in profit in the first half.

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Your Business Lending book grew by 29 percent in the December half compared with the June half and with system growth of 8 percent in the December half. How have you achieved this above market growth rate and in which markets are you growing your business lending?

MD Barry Fitzpatrick

Our Business Lending book comprises both Business Banking and Portfolio Funding. Growth in the traditional business banking book was modest at \$100 million, that's up 8 percent compared with the June 2005 half, as we're cautious in lending to projects outside South Australia and we're ever-vigilant about credit quality. We're concentrating on lending to the aged care sector and rural and equipment finance where we have an established track record.

The growth in Portfolio Funding was the strongest in our loan book, more than doubling year on year to \$627 million at the end of December 2005, partly as a result of some of the deals that were in the pipeline in June 2005 coming to fruition.

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Who are your Portfolio Funding customers and how do margins compare with those of your other lending categories?

MD Barry Fitzpatrick

Portfolio Funding is the financing of loans, leases and receivables that are originated, credit approved and managed by our partners. Our customers are a range of specialist financiers and we're applying the skills developed in our relationship management and securitisation areas to provide them with innovative financing solutions.

Currently the margins are attractive compared with other areas of the business and we see Portfolio Lending growing substantially in the years ahead as part of Business Lending generally. It is not our strategy, however, to be an all-purpose lender to business in all Australian markets.

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Margin Lending of \$2.9 billion accounted for 14 percent of your net loans and advances at end December 2005. What will be the impact on the growth of the portfolio and its credit quality if the equity market's growth rate slows?

MD Barry Fitzpatrick

The major risks in Margin Lending are operational rather than credit. We have well established procedures to mitigate operational risks and the level of losses continues at a low level.

There have been three major stock market corrections since we purchased Leveraged Equities. In each case, while there were significant increases in margin calls, there were no significant losses in the portfolio.

The Bank is confident of being able to achieve significant growth in the portfolio even if growth in equity markets slows, as we continue to focus on increasing our presence in the financial planner market.

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While your net interest margin on non-securitised loans grew by 4 basis points to 2.22 percent, net interest margin on total assets under management of 1.18 percent was a decrease of 6 basis points compared with the previous December half. Can you explain the decrease and do you continue to expect margins for the full year to June to fall by up to 15 basis points?

CFO Frank Lupoi

Competition in housing finance coupled with the repricing of our older Lo-Doc loans combined to reduce margins. We believe the current competitive pricing environment in the housing and deposit sectors is here to stay and margins will continue to ease over the year.

We're satisfied with the profitability of securitisation and as we increase our levels of securitisation, our all-inclusive margin will continue to decline. We stand by our prediction of a fall of between 10 and 15 basis points over the year in the all-inclusive margin.

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In the December 2005 half year, operating costs were 17.1 percent higher than in the previous corresponding half, with staff, occupancy and technology expenses substantially higher. What will be the trend over the balance of FY06?

CFO Frank Lupoi

The first half of the year traditionally has a higher cost base due to accounting for bonus payments and salary increases. Including depreciation, the cost to income ratio fell year on year to 54.6 percent from 55.4 percent and we're confident that this trend will continue in the full year results.

Increases in staff costs of 21 percent arose partly as a result of adding 81 people with the Goldman Sachs JB Were acquisition, expansion of our Portfolio Funding business and staff increases in Information Services and Corporate Risk Management.

We're committed to a growth strategy and this requires increased investment in improving our technology base. In the December half year we finalised a range of product improvements and our desktop systems have been fully upgraded. We're also continuing to invest in our risk management areas. We're disciplined, however, in our cost management and continue to ensure that costs don't grow faster than revenue.

The timing of large items of expenditure makes half-year comparisons difficult. We're expecting the increase in operating costs over the full year to be well below 10 percent.

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Your non-securitised residential performing loans past due 90 days rose by 12 basis points compared with the June 2005 half year to 0.78 percent of the residential portfolio. Does this increase reflect deterioration in credit quality assessment arising from the use of third party loan originators?

CFO Frank Lupoi

The ratings agencies and insurers are reporting a general increase in the level of arrears. We're focused on this trend and we're confident there are no underlying credit issues both from a channel perspective or a product perspective.

Our past due 90 days figure includes only 11 residential loans, with a loan-to-valuation ratio of over 85 percent, which are not subject to lender's mortgage insurance. That's a total of \$5.2 million in a portfolio of \$16 billion. Our historical experience of loan losses indicates that the Bank is unlikely to incur significant losses as a result of the increase in our loan arrears.

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Your capital adequacy ratios are the lowest of all the listed Australian banks with Tier 1 capital at 6.7 percent and the overall ratio at 11.3 percent. What are the implications for your ability to sustain the Bank's growth?

MD Barry Fitzpatrick

We've traditionally managed our capital to provide the best outcome for our shareholders, with capital raised only when required to support growth in the business. The Bank has well established securitisation programs and uses these, together with other instruments and the dividend reinvestment program, to manage its capital base within board-approved limits.

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Cash EPS grew by 13 percent to 40.24 cents in the first half. In December you reiterated your target of growth in cash EPS of more than 10 percent per annum over the next three years. What level of confidence do you have in meeting this guidance for the current year?

MD Barry Fitzpatrick

As I mentioned earlier, the growth in EPS on a comparable basis was 12 percent. The Bank remains committed to its target of an annual increase in cash EPS of more than 10 percent per annum over the next three years. We're confident of achieving this target in the current financial year.

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Thank you Barry and Frank.

For more information about Adelaide Bank, please view www.adelaidebank.com.au.

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