25 August 2016

Update for IMB Stakeholders

In 2008, IMB's Board sought a report from PricewaterhouseCoopers Securities Ltd (**PwC Securities**) on the relative contribution Shareholder Members have made to the permanent funding of IMB compared to the contribution made by IMB's other Member classes (**Contributed Funding**).

PwC Securities provided its report to IMB's Directors on 4 September 2008 and this report was made available to Members (**the 2008 Report**). The 2008 Report and the covering Explanatory Memorandum issued by IMB in conjunction with the 2008 report are located under the 2008 Market Announcements on IMB's website.

In 2012 IMB undertook the first of a series of off-market buybacks of ordinary shares on issue (the **Buybacks**). As a result, 2.9 million ordinary shares were bought back and cancelled. A second Buyback was undertaken in 2013 with a further 2.1 million ordinary shares bought back and cancelled.

Following the Buybacks, the Board considered it appropriate to understand the effect of the Buybacks on the allocation of Contributed Funding. The Board commissioned PwC Securities to advise on how Buybacks could be incorporated into the Contributed Funding framework developed in 2008. The results of PwC Securities' review are contained in the report made available to members on 26 June 2014 (**the 2014 Report**). A further Report was commissioned in 2015 to include the 2015 off-market share buyback completed in March 2015 (**the 2015 Report**), which was released to Members on 27 August 2015.

The Board has again commissioned PwC Securities to update their report to include the results for the 2015/16 financial year and to incorporate the merger with Sutherland Credit Union Ltd (included as at 1 July 2016). The Board also asked PwC Securities to provide an assessment as to which of the two potential approaches to allocating Contributed Funding (Approach 1 or Approach 2) identified in the **2014 Report** and the **2015 Report** is more appropriate to the current structure of IMB.

The results of PwC Securities' update are contained in the attached report (**the 2016 Report**).

With regard to the assessment of the more appropriate approach for the current structure of IMB, PwC Securities advise that they consider Approach 2 is the more appropriate approach to consider the allocation of Contributed Funding. The Board have considered this assessment and agree with PwC Securities rationale and conclusion.

Following the release of the 2014 Report, when referring to the contributed funding interest pertaining to Shareholder Members, the Board have referenced a mid-point interest which averaged the interest under Approach 1 and Approach 2. As a result of the Board's view that Approach 2 is the more appropriate approach based on the current operations of IMB and the continuing off-market buyback programme, the Board will now reference only Approach 2. Under Approach 2, the full year dividend for 2015/16 represents 95% of the profit after tax attributed to Shareholder Members.

If you have any questions or comments in relation to these documents, they should be directed to IMB's Company Secretary at (02) 4298 0211 or cosec@imb.com.au.

PRICEWATERHOUSECOOPERS SECURITIES LTD

FINANCIAL SERVICES GUIDE

This Financial Services Guide is dated 19 August 2016

1. About us

PricewaterhouseCoopers Securities Ltd (ABN 54 003 311 617, Australian Financial Services Licence no 244572) ("PwC Securities") has been engaged by IMB Limited ("IMB") to provide a report in the form of a letter of advice in relation to the updating of analysis provided in 2008, 2014 and 2015 on the allocation of Contributed Funding (the "Report") for disclosure on the IMB website.

You have not engaged us directly but have been provided with a copy of the Report as a retail client because of your connection to the matters set out in the Report.

2. This Financial Services Guide

This Financial Services Guide ("FSG") is designed to assist retail clients in their use of any general financial product advice contained in the Report. This FSG contains information about PwC Securities generally, the financial services we are licensed to provide, the remuneration we may receive in connection with the preparation of the Report, and how complaints against us will be dealt with.

3. Financial services we are licensed to provide

Our Australian financial services licence allows us to provide a broad range of services, including providing financial product advice in relation to various financial products such as securities, interests in managed investment schemes, derivatives, superannuation products, foreign exchange contracts, insurance products, life products, managed investment schemes, government debentures, stocks or bonds, and deposit products.

4. General financial product advice

The Report contains only general financial product advice. It was prepared without taking into account your personal objectives, financial situation or needs.

You should consider your own objectives, financial situation and needs when assessing the suitability of the Report to your situation. You may wish to obtain personal financial product advice from the holder of an Australian Financial Services Licence to assist you in this assessment.

PricewaterhouseCoopers Securities Ltd, ACN 003 311 617, ABN 54 003 311 617, Holder of Australian Financial Services Licence No 244572
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5. Fees, commissions and other benefits we may receive

PwC Securities charges fees to produce reports, including this Report. These fees are negotiated and agreed with the entity who engages PwC Securities to provide a report. Fees are charged on an hourly basis or as a fixed amount depending on the terms of the agreement with the person who engages us. In the preparation of this Report and related advice on Contributed Funding our fees are charged on an hourly basis and as at the date of this Report are approximately $65,000.

Directors or employees of PwC Securities, PricewaterhouseCoopers, or other associated entities, may receive partnership distributions, salary or wages from PricewaterhouseCoopers.

6. Associations with issuers of financial products

PwC Securities and its authorised representatives, employees and associates may from time to time have relationships with the issuers of financial products. For example, PricewaterhouseCoopers may be the auditor of, or provide financial services to, the issuer of a financial product and PwC Securities may provide financial services to the issuer of a financial product in the ordinary course of its business. PricewaterhouseCoopers has provided certain consulting services to IMB and PricewaterhouseCoopers Securities previously provided advice in relation to the allocation of Contributed Funding in 2008 and 2014 and 2015.

7. Complaints

If you have a complaint, please raise it with us first, using the contact details listed below. We will endeavour to satisfactorily resolve your complaint in a timely manner. In addition, a copy of our internal complaints handling procedure is available upon request.

If we are not able to resolve your complaint to your satisfaction within 45 days of your written notification, you are entitled to have your matter referred to the Financial Ombudsman Service ("**FOS**"), an external complaints resolution service. FOS can be contacted by calling 1300 780 808. You will not be charged for using the FOS service.

Contact Details

PwC Securities can be contacted by sending a letter to the following address:

Kevin Reeves
Darling Park Tower 2
201 Sussex Street
GPO Box 2650
SYDNEY NSW 1171

The Directors
IMB Limited
253-259 Crown Street
WOLLONGONG NSW 2500

19 August 2016

Dear Directors

Update of previous advice provided by PwC Securities in relation to the allocation of Contribution Funding

1. Introduction

In accordance with our letter of engagement, PwC Securities has been requested to update the analysis previously provided in our report of 4 September 2008 (the 2008 Report) and our reports dated 24 June 2014 (the 2014 Report) and 21 August 2015 (the 2015 Report) in relation to the estimated proportions of Contributed Funding provided by Depositor and Borrower Members (D&B Members) and Shareholder Members of IMB.

There is no statutory requirement for IMB to commission this report, or having obtained the report, to provide it to the D&B Members and the Shareholder Members. The report does not constitute an independent expert report within the terms of ASIC Regulatory Guide 111, but instead represents advice provided to the Directors of IMB in response to a specific request.

The report has been prepared exclusively for the use of the Directors. However, the Directors wish to make the report available to D&B Members, Shareholder Members and other parties. We have consented to this disclosure on the basis that the report is disclosed together with the Update for IMB Stakeholders provided by the Directors, the 2008 Explanatory Memorandum and the 2008 Report.

2. Purpose, scope and limitations

This report (Report) has been requested by the Directors to assist them in updating their assessment of the relative contribution of the D&B Members and the Shareholder Members to the permanent funding of IMB and to consider future dividend policy. Our Report does not cover all matters that will be considered by the Directors in relation to dividend policy and the current and future interests of the D&B Members and the Shareholder Members.

Since the 2015 Report, there have not been any further buybacks. However, the Directors have identified the following events that potentially affect the allocation of Contributed Funding:

- A post-tax profit of $29.6 million will be reported for the financial year to 30 June 2016.

- An interim dividend of 10 cents per share was paid to Shareholder Members on 28 February 2016 and a final dividend of 15 cents per share for the financial year to 30 June 2016 is expected to be paid based on the current Dividend Guideline.

- On 1 July 2016, the business of Sutherland Credit Union (SCU) was transferred to IMB, with the members of SCU becoming D&B Members of IMB.

The Directors have requested that we:

- Incorporate the above events in updated analysis of Contributed Funding at 1 July 2016 (immediately after the transfer of the SCU business).

- To the extent that the 2014 Report and the 2015 Report analysed Contributed Funding based on two approaches (Approach 1 and Approach 2), provide an assessment as to which approach is more appropriate to the current structure of IMB.

In addition, for completeness, this Report also sets out previous analysis in relation to the way the 2012, 2013 and 2015 buybacks have been incorporated in Contributed Funding analysis.

The Report is restricted to the above matters and has been provided to the Directors solely for the purposes of their consideration of the relative contributions of D&B Members and Shareholder Members to the Contributed Funding of IMB.

The Report does not constitute advice to the Directors in relation to the value of ordinary shares in IMB, the price at which future buybacks should occur or whether IMB should undertake buybacks. We have not performed an assessment of the value of IMB, the value of the ordinary shares in IMB, the price at which future buybacks might occur nor the commercial logic of further buybacks.

The Report should not be used, and has not been prepared, as advice to any party that might be considering the sale or purchase of ordinary shares in IMB or considering the commencement or termination of a deposit holding or borrowing relationship that gives rise to membership of IMB. The report should not be relied upon by any party considering such a shareholding, deposit holding or borrowing relationship with IMB.

As a condition of our engagement, IMB has indemnified PwC Securities and PwC against any claims, cost damages or expenses that may result from any third party claims arising out of or in relation to the provision of services to IMB or the use or circulation of this Report.

This Report is to be read in conjunction with the attached Financial Services Guide.

3. The share buybacks

IMB has completed three buybacks of ordinary shares in September 2012, November 2013 and March 2015.

The buyback mechanism involves Shareholder Members tendering shares by reference to a nominated discount to a Deemed Market Value. Deemed Market Value is determined by reference to volume weighted trading prices for IMB shares prior to the buyback announcement indexed in the period up to the closing date of the buyback offer in line with movements in the S&P/ASX 200 index. Shares are bought back at a price incorporating the minimum discount required to purchase the number of shares determined by the Directors of IMB to be acquired under the buyback.

The following table summarises the buybacks completed in 2012, 2013 and 2015:

Buyback date	Shares bought back Million	Shares bought back %	Buyback price $	Buyback consideration ($ Mil)
September 2012	2.9	7.3	3.28	9.5
November 2013	2.1	5.8	4.07	8.7
March 2015	3.0	8.6	5.35	16.0

To the extent that buybacks are funded from the balance sheet of IMB, they do not reflect direct transfers of value from D&B Members to Shareholder Members (as would be the case if D&B Members were buying out Shareholder Members using external funds). The buybacks reduce the relative interest of Shareholder Members, but also reduce the value of the overall IMB entity by the amount of the consideration. Therefore, so long as there are continuing Shareholder Members, the pricing of share buybacks will affect the continuing interests in IMB of both D&B Members and Shareholder Members.

4. The 2008 Report on Contributed Funding

In updating the advice set out in the 2008 Report, we note the following points in relation to the methodology set out in that report:

- The allocation of Contributed Funding set out in the 2008 Report was approximate reflecting the fact that it was not based on a legally defined concept and the need to make significant estimates in our analysis to reflect transactions that had occurred over an extended period. During that period, there was no explicit guidance on the assessed interests of D&B Members and Shareholder members in the Contributed Funding of IMB as a continuing entity.

- The methodology identified the value reasonably allocable to Shareholder Members based on the initial subscription for shares in 1989 and subsequent further issues of shares (primarily by way of dividend reinvestment) and retention of profits.

- In the absence of any commercial guidance to D&B Members and Shareholder Members prior to 2008 on their assessed interests in the Contributed Funding of IMB, the assumption was made that retained profits in any year were shared pro rata to their estimated interest in Contributed Funding at the beginning of each year.

- Analysis of Contributed Funding in the 2008 Report was aligned with the shareholder funds of IMB up to 30 June 2008. For the purposes of the allocation, the 2008 Report considered two scenarios where:

    - The economic value of an interest in IMB was considered to be equal to the underlying share of the shareholder funds of IMB (Appendix 2 of the 2008 Report);

    - The economic value of IMB at relevant times was different to the underlying shareholder funds. For the purpose of this it was assumed that the original subscription would have been made at a discount to net asset value per share, but subscriptions in subsequent years would have been made based on the economic value of interests in IMB being up to twice the net asset value (Appendix 3 of the 2008 Report).

- The assumptions made in the analysis in the 2008 Report on the relationship of the economic value of IMB to net asset value was based on very broad estimates of financial sector valuation parameters across an extended period from 1989 to 2005 (when the dividend reinvestment plan ceased).

The analysis in the 2008 Report applying the two scenarios estimated that the interest of the Shareholder Members as at June 2008 was between 40.8% and 46.4% (or 43.6% expressed as an average).

Since there were no further equity subscriptions between June 2008 and June 2012 (the balance sheet date immediately prior to the first share buyback), the above estimated range of 40.8% to 46.4% for the Shareholder Member interest remained unchanged up to June 2012 based on the exact methodology applied in the 2008 Report for the period 1989 to 2008.

5. Allocation of retained profits in the period since the 2008 Report

During the period 1989 to 2008, there was no clear guidance on the exact interests of D&B Members and Shareholder Members in IMB as a continuing entity. For the purposes of the analysis in the 2008 Report, it was assumed that retained profits were shared between D&B Members and Shareholder Members pro rata to their interests at the beginning of each financial year. We consider that this assumption was commercially appropriate given the absence of any explicit guidance and was not inconsistent with the dividend policy over the period 1989 to 2008.

For the allocation of retained profits after 2008, there are two potential approaches:

- The methodology applied in the 2008 Report for the period 1989 to 2008 could be replicated. This would mean that Shareholder Members continue to share in retained profits (i.e. after dividends are paid to Shareholder Members) pro rata to their assessed interest in the Contributed Funding of IMB. Given that there have been no share issues subsequent to the 2008 Report; this approach would mean that the interest of the Shareholder Members prior to the first buy back would have been the same as at the date of the 2008 Report. (**Approach 1**)

- Alternatively, it could be considered that, once the respective interests of the D&B Members and Shareholder Members were defined in 2008, annual post-tax profit should be allocated between the D&B Members and Shareholder Members pro rata to their assessed interests in Contributed Funding. To the extent that dividends were paid to Shareholder Members, the dividend would be charged against their share of post-tax profits. This approach would effectively consider D&B Members as being equivalent to Shareholder Members in sharing in the returns generated by IMB, but with none of their share of profit being paid out by way of dividends. To the extent that no dividends were charged against the share of profits allocated to D&B Members, this would mean that the proportional interest of the Shareholder Members in Contributed Funding would dilute over time due to the higher implicit reinvestment by D&B Members. (**Approach 2**)

We set out below an analysis of the impact of buybacks on the allocation of Contributed Funding applying the two approaches.

6. Using Approach 1, buybacks cannot be directly incorporated into the Contributed Funding calculations in the 2008 Report

Buybacks were not addressed in the methodology set out in the 2008 Report as the analysis addressed a period when no buybacks occurred.

The 2008 Report allocated value between D&B Members and Shareholder Members in financial and economic terms using a fixed range of relativities (in the case of dividends reinvested, it was assumed that the economic value of IMB was between 100% and 200% of the balance sheet shareholders' funds of IMB during the period 1989 to 2005). The models did not seek to compare the actual share prices at the date of dividend reinvestments over this period to the economic values implied by the assumed relativities.

The models in Appendix 2 and Appendix 3 of the 2008 Report cannot therefore be simply updated for buybacks (by including the buyback cash consideration paid as a negative subscription) as the buyback price will not align with the different assumptions in the two models (where economic value is assumed to be either 100% or 200% of balance sheet shareholder funds of IMB).

Instead, in the following section, we set out a relatively simple method of calculation to adjust the estimated Shareholder Member interest in Contributed Funding for a buyback that is consistent with the principles in the 2008 Report and Approach 1.

7. Updating the estimated interest of Shareholder Members for buybacks applying Approach 1

The pricing of future buybacks and the number of shares bought back will affect the aggregate financial resources available to IMB. If buybacks are made at a higher price, they will reduce the aggregate economic value of IMB by a greater amount than if the same buyback is made at a lower price. However, once the final price for a buyback has been set by the Directors, the economic value attributed to, and cash paid to, selling Shareholder Members is effectively being provided pro rata by the D&B Members and continuing Shareholder Members.

To the extent that a high price or a low price is paid under the buyback, it will not affect the post buyback allocation of value between D&B Members and continuing Shareholder members as they will effectively “fund” any premium, or receive the “benefit” of any discount, pro rata to their post buyback interests.

Reflecting this logic, the Shareholder Member interest following a buyback (allowing for the fact that the buyback is funded by both D&B Members and Shareholder Members) can be generalised by the following equation:

$$\textbf{SMIpost} = \frac{(\textit{SMIpre} \times \textit{PROPpost})}{(1 - (\textit{SMIpre} \times \textit{PROPbb}))}$$

Where:

SMIpost is the percentage Shareholder Member Interest post buyback

SMIpre is the Shareholder Member interest pre buyback (estimated to be 43.6% immediately prior to the 2012 buyback based on application of the methodology in the 2008 Report)

PROPpost is the proportion of shares pre buyback that remain on issue post the buyback (92.7% in the case of the 2012 buyback)

PROPbb is the proportion of shares bought back (7.3% in the case of the 2012 buyback)

The denominator in the above equation addresses the characteristic of a buyback that it reduces the overall economic value of IMB as well as the relative interest of the Shareholder Members.

Applying this formula to the 2012 buyback, the following estimates for Shareholder Member post buyback interest are derived based on the assumed starting mid-point interest for Shareholder Members of 43.6%:

$$\textbf{SMIpost} = \frac{\textbf{43.6\% x 92.7\%}}{\textbf{(1 – (43.6\% x 7.3\%))}} = \frac{\textbf{40.42\%}}{\textbf{(1 – 0.032)}} = \textbf{41.8\%}$$

Applying the formula to the 2013 buyback, the estimated interest of Shareholder Members would be further reduced in line with the following calculation:

$$\frac{41.8\% \text{ x } 94.2\%}{(1 - (41.8 \text{ x } 5.8\%))} = \frac{39.38\%}{(1 - 0.024)} = 40.3\%$$

Applying the formula to the 2015 buyback, the estimated interest of Shareholder Members would be further reduced in line with the following calculation:

$$\frac{40.3\% \text{ x } 91.4\%}{(1 - (40.3\% \text{ x } 8.6\%))} = \frac{36.83\%}{(1 - 0.035)} = 38.2\%$$

Since no buyback occurred in the financial year to 30 June 2016, the estimated interest of Shareholder Members in Contributed Funding applying Approach 2 remained at 38.2% immediately prior to the SCU transfer of business.

In appendix A to this Report we set out an indicative analysis of the way that future Shareholder Member interest would decrease from the levels implied by Approach 1 in a hypothetical scenario where future buybacks were made at a rate of 4 million shares in future years (with all outstanding shares being repurchased in the final year of a buyback programme).

8. Movements in the interest of Shareholder Members since 2008 applying Approach 2

Approach 2 is based on the premise that post-tax profit is allocated to D&B Members and Shareholder Members in line with their assessed interests in Contributed Funding post 2008. Applying that approach, dividends paid to Shareholder Members are charged against their notional share of profit after tax (with the remaining amount of undistributed profit effectively being the contribution to retained profits).

To the extent that no dividends are payable to D&B Members, Approach 2 implies that the interest of Shareholder Members declined in the period after 2008 as their notional contribution to retained earnings was considerably less than that notionally provided by D&B Members.

There is no definitive way of modelling how the relative interest of Shareholder Members in Contributed Funding would decline over time in line with applying Approach 2. However, in appendix B, we have developed a relatively simple analysis of the period 2009 to 30 June 2016 which we consider provides a commercial estimate of how the Shareholder Member interest has changed over time based on Approach 2.

The simplified analysis is based on the following assumptions and approximations:

- The interest of the Shareholder Members at 30 June 2008 was 43.6% in line with the 2008 Report.

- The relative interests of D&B Members and Shareholder Members at 30 June 2008 are recorded by assuming each group held a notional number of shares in IMB in line with the assessed interests in Contributed Funding at that date. Based on the fact that the Shareholder Members actually held 39.9 million shares representing an assessed 43.6% interest, this would imply that the total number of notional shares was around 91.5 million (39.9 million/0.436). The balance of notional shares attributable to D&B Members would be around 51.6 million.

- Subsequent to 30 June 2008, profit after tax is allocated to the D&B Members and Shareholder Members pro rata to their assessed interest in Contributed Funding at the beginning of the financial period (i.e. the Shareholder Members are allocated 43.6% of profit after tax in the year to 30 June 2009).

- The dividend payable to Shareholder Members in respect of each financial period subsequent to 2008 is charged against their share of the profit after tax in that period. Any amount of profit after tax attributable to Shareholder Members that was not distributed is used to acquire notional shares in IMB.

- The retained profits arising from the allocation of post-tax profit to D&B Members (to whom no dividends are paid) are assumed to be used to acquire notional shares on behalf of the D&B Member interest.

- The number of notional shares allocated to the retained profits provided by the Shareholder Members and D&B Members is based on the value of the shares issued. As a broad proxy for that value, we have used the average IMB share price during the period in which the retained profits were generated. This assumption is approximate. Specifically, it assumes traded prices for IMB shares are an appropriate reflection of the value of shares on an ongoing basis. In practice, we note that over the past four years, the IMB share price has increased strongly as reflected in the current yield on the shares being below that for the listed Australian banks. The IMB share price has increased over the past eighteen months when share prices for the major banks have typically declined. Analysing the strength of the IMB share price, we note that the market in IMB shares is thin. Whilst there is no conclusive evidence of this, IMB's share price may, among other factors, be influenced by expectations of further buybacks as well as speculation as to future dividends and operational performance. Additionally, the above basis of allocation does not recognise the fact that – over time – the number of notional shares increases above the actual number of shares on issue. Both these approximations potentially result in a higher value being attributed to notional shares and hence a smaller number of notional shares being allocated to D&B Members in respect of their significant share of retained profits. However, the potential impact of these approximations on the assessment of the proportional interests of D&B Members and Shareholder Members at 1 July 2016 is not material.

- At the end of each period, the relative interest of the D&B Members and Shareholder Members is recalculated based on the estimated number of notional shares held by each grouping following the assumed issue of notional shares.

- Using Approach 2, the impact of the buybacks is reflected by reducing the number of notional shares allocable to Shareholder Members pro rata to the proportion of actual shares bought back. For example, if 5% of the actual shares were bought back, it would be assumed that 5% of the notional shares held by the Shareholder Members immediately prior to the buyback were bought back. This method of adjustment gives a consistent relative result to the calculation applied under Approach 1.

- The 2012 and 2013 buybacks were made after the payment of the final dividend for the respective financial years and hence the notional interests of D&B Members and Shareholder Members at the end of the financial year, adjusted for the declared dividend, are the relevant basis to estimate the impact of those buybacks. However, the 2015 buyback was made after the payment of the 2015 financial year interim dividend and, hence, we have assessed the impact of the 2015 buyback based on notional interests at 31 December 2014.

An analysis of the movement in the Shareholder Member interest over the period from 2008 to 30 June 2016 (incorporating the assumed payment of the 2016 final dividend) applying the above assumptions is set out in appendix B. After allowance for the payment of the 2016 final dividend, but before the SCU merger, the interest of Shareholder Members as at 30 June 2016 under Approach 2 was 27.4%.

The extent to which Shareholder Member interest will decline in future applying Approach 2 would depend on the level of future buybacks, the future post-tax profits generated by IMB, the prevailing share price (to the extent it would affect the level of notional reinvestment by D&B Members and Shareholder Members) and dividends paid to Shareholder Members.

9. Incorporating the SCU transfer of business on 1 July 2016 in the Contributed Funding analysis

We have adjusted the interests of D&B Members and Shareholder Members at 30 June 2016 to reflect the Contributed Funding injected by the incoming SCU members on 1 July 2016.

The net funds injected by the SCU members equal the balance sheet equity of SCU at 30 June 2016 are expected to be in the order of $13 million (representing the net amount of its portfolio of banking assets and liabilities). As such, the injection is akin to the balance sheet equity of IMB and greater in economic value than a simple cash injection into IMB.

Therefore, to allocate Contributed Funding to the incoming SCU members, we have attributed a share of the IMB Contributed Funding pro rata to the balance sheet equity of SCU and IMB as at 30 June 2016. This allocation under Approach 1 and Approach 2 is summarised in the following tables:

Approach 1	D&B Members	SM Members	Total
Interest in IMB CF at 30 June 2016	61.8%	38.2%	100%
Implied attributable IMB balance sheet equity at 30 June 2016 (net of final dividend)	$187.8m	$116.0m	$303.8m
Equity injected by SCU members	$13.0m		$13.0m
Implied balance sheet equity on 1 July 2016	$200.8m	$116.0m	$316.8m
Implied interest in Contributed Funding	63.4%	36.6%	100%

Approach 2	D&B Members	SM Members	Total
Interest in IMB CF at 30 June 2016	72.6%	27.4%	100%
Implied attributable IMB balance sheet equity at 30 June 2016 (net of final dividend)	$220.7m	$83.1m	$303.8m
Equity injected by SCU members	$13.0m		$13.0m
Implied balance sheet equity on 1 July 2016	$233.7m	$83.1m	$316.8m
Implied interest in Contributed Funding	73.8%	26.2%	100%

As set out in the tables, the injection by SCU members will form a component of the continuing D&B Member interest as they will become D&B Members of IMB.

In making the above allocation, we note that the return currently being achieved on balance sheet equity by SCU is significantly below that achieved by IMB. In the financial year to 30 June 2016, SCU is expected to report a relatively small profit after tax on pre-merger balance sheet equity in the order of $13 million. Arguably the earnings of IMB will be marginally "diluted" by the merger. However, in this context, we note:

- IMB management anticipate significant improvements in the financial performance of the current operations of SCU following the acquisition as synergies are achieved. IMB management consider that within 4 years of the merger, the SCU operations will generate a return on balance sheet equity equivalent to the current IMB business.

- SCU is small relative to IMB (with SCU balance sheet equity representing less than 5% of the IMB balance sheet equity post-merger) and as such any adjustment for differential performance in initial periods would be immaterial.

Therefore, in the context of merger with SCU, we consider allocation of Contributed Funding to incoming SCU members based on balance sheet equity contributed relative to the IMB balance sheet equity is an appropriate method of reflecting the SCU transfer of business in the Contributed Funding analysis.

10. The alignment of Approach 1 and Approach 2 with the current circumstances of IMB

The Directors have requested that we consider which of Approach 1 and Approach 2 is more appropriate in addressing the proportions of Contributed Funding attributable to the D&B Members and Shareholder Members at 1 July 2016 based on the current circumstances of IMB.

In the period up to 2008, we consider that Approach 1 was appropriate based on the circumstances of IMB, the lack of guidance on the relative interests of D&B Members and Shareholder Members and the dividend policy adopted in the period 1989 to 2008 when there were no buybacks of Shareholder Member interests. This assessment is reflected in the fact that, even where Approach 2 is adopted subsequent to 2008, we have used Contributed Funding interests at 2008 based on Approach 1 as the starting point.

In 2008, the Directors commissioned the 2008 Report and made the decision to consider future dividend policy having regard to the relative interests of Shareholder Members and D&B Members in Contributed Funding. This reflected the view that the Shareholder Members and D&B Members were providing defined notional proportions of the aggregate member equity of IMB. This notional separation was reemphasised in May 2012 with the release by the Directors of the IMB Capital Structure Review and the subsequent commencement of the buyback programme in September 2012 whereby funds were utilised to buy back Shareholder Member interests.

Once D&B Members and Shareholder Members are considered to have notionally separate interests in the aggregate member equity of IMB, there is a strong argument that post-tax profits should be split in line with the respective interests of the two member groups before the deduction of dividends (as under Approach 2). This reflects the fact that dividends paid to Shareholder Members reduce retained profits and this logically results in the dilution of their continuing interest relative to D&B Members (who effectively reinvest all post-tax profit attributable them). If Approach 1 is applied, whereby retained profits after the payment of dividends are split in line with Contributed Funding interests, the Shareholder Members are effectively receiving all dividends paid while receiving a pro rata share of retained profits after the deduction of those dividends.

However, there are situations where Approach 2 may not be appropriate to a hybrid mutual structure. Specifically, Approach 2 might be less appropriate where mutual members receive significant benefits that are expensed before the reported profit of the entity. Examples of such “above the line” benefits received by mutual members in some other mutual organisations include rebates of pool profits to supplier members based on volumes provided for processing (for example in some agricultural co-operatives) or selling products to members at subsidised prices or providing subsidised member services (for example in some mutual professional indemnity entities). In such situations, rebates or product discounts may be set at a level such that reported profit is restricted to the amount required to maintain adequate levels of capital. Applying Approach 2 to a hybrid structure in such a situation, mutual members would be receiving all rebates plus being allocated a pro rata share of operating profits after the payment of those rebates (or provision of subsidised services).

To confirm whether Approach 2 is appropriate to IMB, we have considered if there is evidence whether the mutual structure of IMB is depressing the post-tax returns in which D&B Members and Shareholder Members share below industry levels.

Reviewing returns generated by IMB on balance sheet equity over the period since 2008 shows that IMB has generated an average return on capital employed in excess of the listed regional banks (where there are no mutual interests) and approaching some of the four large listed banks. This analysis, set out below, supports the view that the mutual structure of IMB has not depressed the post-tax returns shared by D&B Members and Shareholder Members under Approach 2.

ROE	Westpac	ANZ	Commonwealth Bank	NAB	Bendigo	MyState	Bank of Queensland	Auswide	IMB
30-Jun-08	19.8%	12.5%	18.3%	14.7%	6.0%	10.1%	8.2%	13.0%	11.3%
30-Jun-09	9.4%	9.1%	15.0%	6.8%	2.7%	8.3%	6.7%	11.3%	11.4%
30-Jun-10	15.8%	13.2%	15.9%	10.8%	6.3%	8.7%	7.6%	13.9%	13.2%
30-Jun-11	16.0%	14.1%	17.1%	12.4%	8.6%	10.8%	6.2%	11.6%	12.9%
30-Jun-12	12.8%	13.7%	16.9%	9.3%	4.6%	8.5%	-0.6%	8.9%	11.5%
30-Jun-13	14.2%	13.8%	16.7%	11.5%	7.9%	10.2%	6.6%	1.3%	10.4%
30-Jun-14	15.3%	14.8%	17.5%	11.1%	7.5%	10.4%	7.8%	7.2%	10.2%
30-Jun-15	14.9%	13.1%	17.1%	11.4%	8.6%	11.1%	9.2%	6.6%	11.2%
30-Dec-15	12.8%	9.7%	15.4%	n/a	8.3%	10.2%	9.7%	6.0%	9.3%
Average	**14.6%**	**12.7%**	**16.7%**	**11.0%**	**6.7%**	**9.8%**	**6.8%**	**8.9%**	**11.3%**

Notes: (1) Westpac, ANZ and NAB have financial year ends at 30 September
(2) Bank of Queensland has a financial year end at 31 August
(3) Final period represents six months result annualised

Sources: Capital IQ

Based on the above analysis, we consider that IMB's profit is an appropriate measure of the aggregate returns generated by IMB on Contributed Funding provided by D&B Members and Shareholder Members. Therefore, based on the current operations of IMB and the continuing buyback programme, we consider that Approach 2 is the more appropriate approach to consider the allocation of Contributed Funding.

11. Conclusion

In this advice, we have addressed the potential movement in the notional interest of Shareholder Members in the Contributed Funding of IMB from the time of our 2008 Report up to 1 July 2016 under Approach 1 and Approach 2.

If the methodology applied in the 2008 Report to allocate retained profits in the period 1989 to 2008 is rolled forward (Approach 1), the assessed Shareholder Member interest of 43.6% prior to the 2012 buyback would be reduced to around 36.6% as at 1 July 2016.

However, if Approach 2 is applied, a significantly lower measure of the Shareholder Member interest in Contributed Funding of 26.2% at 1 July 2016 is derived.

Based on the estimated interest of the Shareholder Members of 28.2% at the beginning of the financial year to 30 June 2016 under Approach 2, the expected dividends of 25 cents per share in relation to that financial year represent approximately 95% of the profit after tax attributed to Shareholder Members.

At the request of the Directors, we have considered which of Approach 1 and Approach 2 is more appropriate to the current structure of IMB. As discussed in section 10, we consider that Approach 2 is more appropriate to the current circumstances where a mutual organisation is making a commercial return on capital employed.

Yours faithfully

K. D. Reeves

Kevin Reeves
Authorised Representative

Appendix A

Approach 1: Simulation of mechanism to update allocation of Contributed Funding (CF) for buybacks

Year	Opening Shares (million)	Buyback Shares (million)	Closing Shares (million)	Opening SM interest in CF (%)	Closing SM interest in CF (%)
2012	39.9	2.9	37.0	43.6%	41.8%
2013	37.0	2.1	34.9	41.8%	40.3%
2014	34.9	0.0	34.9	40.3%	40.3%
2015	34.9	3.0	31.9	40.3%	38.2%
2016	31.9	0.0	31.9	38.2%	38.2%
SCU acquisition					36.6%
	31.9	4.0	27.9	36.6%	33.6%
	27.9	4.0	23.9	33.6%	30.2%
	23.9	4.0	19.9	30.2%	26.5%
	19.9	4.0	15.9	26.5%	22.4%
	15.9	4.0	11.9	22.4%	17.7%
	11.9	4.0	7.9	17.7%	12.5%
	7.9	4.0	3.9	12.5%	6.6%
	3.9	3.9	0.0	6.6%	0.0%

Notes

- Highlighted hypothetical data for buy backs in future periods is included for demonstration purposes only
- Opening 2012 financial year Shareholder Member (SM) position reflects mid point of estimated range at 30 June 2012 based on methodology in 2008 Report
- Buybacks to date shown in financial year in which they occurred
- SCU incoming D&B members allocated interest in aggregate IMB Contributed Funding pro rata to net balance sheet equity contributed

Appendix B
Approach 2: Implied movement in Shareholder Member (SM) interest in Contributed Funding (CF) 2009 to 2016

Year	Profit after Tax (PAT)	SM share of PAT	Dividend Declared	SM retained Profit	D&B share of PAT retained	Average share price re notional reinvestment	Notional shares allocated to SM	Notional shares allocated to D&B	SM notional shares c/f	SM notional shares bought back	SM notional shares post BB	D&B notional shares	Total notional shares	SM interest post buyback
	$,000	$,000	$,000	$,000	$,000	$	,000	,000	,000	,000	,000	,000	,000	
2008									39,912		39,912	51,629	91,541	43.6%
2009	22,850	9,963	9,379	584	12,887	2.83	206	4,554	40,118		40,118	56,183	96,301	41.7%
2010	29,071	12,111	11,573	538	16,960	3.10	173	5,471	40,292		40,292	61,654	101,946	39.5%
2011	31,018	12,259	9,977	2,282	18,759	3.98	573	4,713	40,865		40,865	66,367	107,233	38.1%
2012	30,148	11,489	9,978	1,511	18,659	3.74	404	4,989	41,269	(3,007)	38,262	71,357	109,619	34.9%
2013	28,510	9,951	9,250	701	18,559	3.58	196	5,184	38,458	(2,226)	36,232	76,540	112,772	32.1%
2014	29,069	9,339	8,716	623	19,730	4.72	132	4,180	36,364		36,364	80,720	117,085	31.1%
2015 H1	14,546	4,518	3,486	1,032	10,028	5.05	204	1,986	36,568	(3,144)	33,424	82,706	116,131	28.8%
2015 H2	17,953	5,167	4,781	386	12,786	5.25	74	2,435	33,498		33,498	85,142	118,640	28.2%
2016	29,600	8,358	7,968	390	21,242	5.33	73	3,985	33,571		33,571	89,127	122,698	27.4%
SCU merger								5,250	33,571		33,571	94,378	127,949	26.2%

Notes

- Buybacks allocated to financial year or half year immediately prior to the buyback occurring
- The 2012 buyback represented 7.3% of outstanding ordinary shares. Notional shares attributed to Shareholder Members reduced in line with that proportion.
- The 2013 buyback represented 5.8% of outstanding ordinary shares. Notional shares attributed to Shareholder Members reduced in line with that proportion.
- The 2015 buyback represented 8.6% of outstanding ordinary shares. Notional shares attributed to Shareholder members reduced in line with that proportion
- SCU incoming D&B members allocated notional shares based on balance sheet equity contributed pro rata to IMB balance sheet equity