

Members Equity Bank Limited

ABN: 56 070 887 679

Interim Financial Statements

For the half-year ended 31 December 2017

Directors' report for the half-year ended 31 December 2017

The directors of Members Equity Bank Limited (the Company) submit herewith the interim financial statements of the Group (being the Company and its subsidiaries) for the half-year ended 31 December 2017, and the independent auditor's review report thereon.

Directors

The directors of Members Equity Bank Limited at any time during or since the end of the half-year and at the date of this report are:

K Hodgson	Chairman since January 2016 and Director since January 2012
C Bart AO	Director since July 2016
C Christian	Director since November 2012
G Combet AM	Director since November 2014
J Milne	Director since November 2012
J Nesbitt	Director since February 2017
E Rubin	Director since October 2016

Principal activities

The principal activities of the Group comprised of:

- provision of banking services under a banking licence;
- funding, management, and servicing of residential and consumer lending portfolios; and
- carrying out associated funding activities for off balance sheet portfolios.

There were no significant changes during the period in the nature of the activities of the Group.

Dividends

No dividends have been paid or declared since the start of the financial half-year (2016: \$nil). The directors do not recommend the payment of a dividend with respect to the half-year ended 31 December 2017.

Review of operations and results

Statutory profit for the half-year ended 31 December 2017 was \$46.4 million compared to \$29.3 million for the half-year ended 31 December 2016.

Subsequent events

There have been no matters or circumstances which have arisen since the end of the financial half-year which significantly affect the operations of the Group, the results of those operations, or the state of affairs of the Group in subsequent years.

Significant items

In November 2017, the Group issued \$200 million of perpetual Capital Notes which are callable in November 2022. The notes form part of equity on the balance sheet.

There are a number of significant items which are included in the Group's statutory profit for the financial period but have been excluded from the Group's underlying profit for the financial period. The following table reconciles the Group's statutory profit with the Group's underlying profit. All amounts are after tax.

	31 Dec 2017 \$'m	31 Dec 2016 \$'m
Underlying earnings	51.0	40.4
• loss on sale of commercial loans and asset finance portfolios	-	(5.7)
• realised and unrealised gains / (losses) on hedging instruments	0.6	(3.0)
• IT partnership costs (1)	0.1	(2.4)
• Systems and processes (2)	(3.1)	-
• ULTRACS decommissioning (3)	(2.2)	-
Statutory profit for the half-year	46.4	29.3

(1) One-off transition costs to consolidate multiple service providers for IT infrastructure, application solution and support services.

(2) Systems and processes costs represents the cost of improving the customer experience and driving productivity benefits in the Company's operations.

(3) ULTRACS decommissioning represents the cost to decommission the legacy core banking system.

Rounding off of amounts

The Company is a company of the kind referred to in *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191*, dated 24 March 2016, and in accordance with that Instrument amounts in the interim financial statements are rounded off to the nearest thousand dollars, unless otherwise indicated.

Directors' report for the half-year ended 31 December 2017

Corporate Governance

The Board has received the relevant assurances required from the Chief Executive Officer and the Chief Financial Officer in respect of the half-year financial report for the period ended 31 December 2017.

The directors of the Company have responsibility for the integrity of external reporting. Further details of the role of the Board and the Audit and Governance Committee are available in the Corporate Governance Statement on the Company's website at mebank.com.au.

Auditor independence

The auditor's independence declaration is included on page 3 of the interim financial statements.

Signed in accordance with a resolution of the directors.

On behalf of the directors



Director
Brisbane, 14 March 2018

14 March 2018

The Board of Directors
Members Equity Bank Limited
Level 28, 360 Elizabeth Street
MELBOURNE VIC 3000

Dear Board Members

Members Equity Bank Limited

I am pleased to provide the following declaration of independence to the directors of Members Equity Bank Limited (the Bank).

As lead audit partner for the review of the Interim Financial Statements of the Bank for the half-year ended 31 December 2017, I declare that to the best of my knowledge and belief, there have been no contraventions of:

- (i) the auditor independence requirements of the Australian Accounting Standards in relation to the review; and
- (ii) any applicable code of professional conduct in relation to the review.

Yours sincerely



DELOITTE TOUCHE TOHMATSU



Mark Stretton
Partner
Chartered Accountants

Independent Auditor's Review Report to the Members of Members Equity Bank Limited

We have reviewed the accompanying Interim Financial Statements of Members Equity Bank Limited, which comprises the condensed consolidated statement of financial position as at 31 December 2017, and the condensed consolidated statement of profit or loss and other comprehensive income, the condensed consolidated statement of cash flows and the condensed consolidated statement of changes in equity for the half year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the end of the half-year or from time to time during the half-year as set out on pages 5 to 15.

Directors' Responsibility for the Interim Financial Statements

The directors of the company are responsible for the preparation of the Interim Financial Statements that gives a true and fair view in accordance with Australian Accounting Standards and for such internal control as the directors determine is necessary to enable the preparation of the Interim Financial Statements that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express a conclusion on the Interim Financial Statements based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the Interim Financial Statements is not in accordance with Australian Accounting Standards including: giving a true and fair view of the Members Equity Bank Limited's financial position as at 31 December 2017 and its performance for the half-year ended on that date. As the auditor of Members Equity Bank Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the review of the annual financial report.

A review of an Interim Financial Statements consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, which is not an audit, nothing has come to our attention that causes us to believe that the 31 December 2017 Interim Financial Statements of Members Equity Bank Limited do not present fairly, in all material respects, the bank's financial position as at 31 December 2017 and of its financial performance for the period ended on that date in accordance with Australian Accounting Standards.

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

M Stretton

Mark Stretton
Partner
Chartered Accountants

Melbourne, 14 March 2018

Directors' declaration

The directors declare that:

- (a) in the directors' opinion, there are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable; and
- (b) in the directors' opinion, the attached interim financial statements and notes thereto comply with accounting standards and present a true and fair view of the financial position and performance of the consolidated entity.

Signed in accordance with a resolution of the directors.

On behalf of the directors



Director

Brisbane, 14 March 2018

**Condensed consolidated statement of profit or loss and other comprehensive income
for the half-year ended 31 December 2017**

	Notes	Consolidated half-year ended	
		31 Dec 2017 \$'000	31 Dec 2016 \$'000
Interest and similar income		620,177	581,044
Interest and similar expense		(423,388)	(418,694)
Net interest income		196,789	162,350
Funds management fee income		1,575	3,714
Other operating income		13,139	21,077
Total net operating income		211,503	187,141
Expenses			
Operating expenses		121,989	117,203
Impairment losses		5,545	7,972
Project expenses		17,589	11,967
Loss on sale of commercial loans and asset finance portfolios		-	8,040
Total operating expenses		145,123	145,182
Profit before income tax		66,380	41,959
Income tax expense	4	19,999	12,617
Profit for the period		46,381	29,342
Other comprehensive income			
Items that will not be reclassified subsequently to profit or loss		-	-
Items that may be reclassified subsequently to profit or loss			
Net fair value gain / (loss) on available-for-sale financial assets, net of tax		1,402	(4,690)
Cash flow hedges - effective portion of changes in fair values, net of tax		10,524	37,407
Total comprehensive income for the period		58,307	62,059

Notes to the financial statements are included on pages 11 to 15.

**Condensed consolidated statement of financial position
as at 31 December 2017**

	Consolidated	
	31 Dec 2017	30 Jun 2017
	\$'000	\$'000
Assets		
Cash and cash equivalents	444,669	312,646
Investments	2,975,774	2,981,442
Derivatives	12,257	11,331
Trade and other receivables	8,087	6,005
Loans and advances	23,521,463	22,503,585
Plant and equipment	8,003	8,330
Intangible assets	94,972	89,336
Deferred tax assets	9,375	14,557
Other assets	11,093	8,969
Total assets	27,085,693	25,936,201
Liabilities		
Deposits and other borrowings	25,355,652	24,410,231
Derivatives	12,659	26,927
Trade and other payables	19,174	25,721
Current tax liabilities	4,968	949
Provisions	23,485	26,482
Subordinated debt	300,431	333,236
Total liabilities	25,716,369	24,823,546
Net assets	1,369,324	1,112,655
Equity		
Issued capital	1,006,283	807,921
Reserves	20,223	6,792
Retained earnings	342,818	297,942
Total equity	1,369,324	1,112,655
Book value per share	\$ 123.97	\$ 100.73

Notes to the financial statements are included on pages 11 to 15.

**Condensed consolidated statement of changes in equity
for the half-year ended 31 December 2017**

	Consolidated					Total \$'000
	Issued capital \$'000	Retained earnings \$'000	General reserve for credit losses \$'000	Investment revaluation reserve \$'000	Cash flow hedge reserve \$'000	
Balance as at 1 July 2016	767,922	235,211	18,332	3,235	(58,748)	965,952
Issue of share capital	-	-	-	-	-	-
Issue of capital notes	-	-	-	-	-	-
Transfer to/(from) general reserve for credit losses	-	3,169	(3,169)	-	-	-
Other comprehensive income for the period	-	-	-	(4,690)	37,407	32,717
Profit for the period	-	29,342	-	-	-	29,342
Balance as at 31 December 2016	767,922	267,722	15,163	(1,455)	(21,341)	1,028,011
Balance as at 1 July 2017	807,921	297,942	17,457	2,722	(13,387)	1,112,655
Issue of share capital	-	-	-	-	-	-
Issue of capital notes*	198,362	-	-	-	-	198,362
Transfer to/(from) general reserve for credit losses	-	(1,505)	1,505	-	-	-
Other comprehensive income for the period	-	-	-	1,402	10,524	11,926
Profit for the period	-	46,381	-	-	-	46,381
Balance as at 31 December 2017	1,006,283	342,818	18,962	4,124	(2,863)	1,369,324

*\$200 million net of transaction costs

Notes to the financial statements are included on pages 11 to 15.

**Condensed consolidated statement of cash flows
for the half-year ended 31 December 2017**

	Consolidated	
	31 Dec 2017	31 Dec 2016
	\$'000	\$'000
Cash flows from operating activities		
Profit before tax	66,380	41,959
Adjustments for:		
Change in operating assets	(1,031,113)	(1,405,021)
Change in operating liabilities	932,671	1,372,906
Non-cash items included in profit before tax	28,155	44,138
Income tax payments	(15,915)	(15,436)
Net cash (used in) / from operating activities	<u>(19,822)</u>	<u>38,546</u>
Cash flows from investing activities		
Purchase of plant and equipment	(903)	(710)
Purchase of intangible assets	(14,252)	(9,692)
Net cash used in investing activities	<u>(15,155)</u>	<u>(10,402)</u>
Cash flows from financing activities		
Redemption of subordinated debt	(33,000)	-
Proceeds from issue of capital notes	200,000	-
Net cash provided by financing activities	<u>167,000</u>	<u>-</u>
Net increase in cash	132,023	28,144
Cash and cash equivalents at the beginning of the period	312,646	440,054
Cash and cash equivalents at the end of the period	<u>444,669</u>	<u>468,198</u>

Notes to the financial statements are included on pages 11 to 15.

Condensed notes to the financial statements for the half-year ended 31 December 2017

1 General information

The interim financial statements of Members Equity Bank Limited (the Company) and its subsidiaries (collectively, the Group) for the half-year ended 31 December 2017 were authorised for issue in accordance with a resolution of the directors made on 14 March 2018.

The Company is a limited company, incorporated and domiciled in Australia. The Group's principal activities are:

- provision of banking services under a banking licence;
- funding, management, and servicing of residential and consumer lending portfolios; and
- carrying out associated funding activities for off balance sheet portfolios.

2 Basis of preparation

The interim financial statements are general purpose financial reports prepared in accordance with *AASB 134 'Interim Financial Reporting'*. Compliance with AASB 134 ensures compliance with International Financial Reporting Standard *IAS 34 'Interim Financial Reporting'*. The interim financial statements do not include notes of the type normally included in an annual financial report and should be read in conjunction with the most recent annual financial report.

The interim financial statements have been prepared on the basis of historical cost, unless the application of fair value measurement is required by relevant accounting standards. Cost is based on the fair values of the consideration given in exchange for assets. All amounts are presented in Australian dollars, unless otherwise stated.

The Company is a company of the kind referred to in *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191*, dated 24 March 2016, and in accordance with that Instrument amounts in the interim financial statements are rounded off to the nearest thousand dollars, unless otherwise indicated.

3 Significant accounting policies

The accounting policies and methods of computation adopted in the preparation of the interim financial statements are consistent with those adopted and disclosed in the Company's annual financial report for the financial year ended 30 June 2017.

Application of new and revised accounting standards

The Group has adopted all of the new and revised accounting standards that are relevant to its operations and effective for the half-year. None of the new and revised standards had a material impact on the Group.

AASB 2016-1 Amendments to Australian Accounting Standards – Recognition of Deferred Tax Assets for Unrealised Losses – Amends AASB 112 Income Taxes to clarify the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. It does not change the underlying principles for the recognition of deferred tax assets.

AASB 2016-2 Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 107 – Amends AASB 107 Statement of Cash Flows to require entities preparing financial statements in accordance with Tier 1 reporting requirements to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

AASB 1048 Interpretation of Standards – A new principal version of AASB 1048 providing an up-to-date listing of Australian Interpretations. This service standard ensures there is no difference between the status of interpretations in the hierarchy between IAS 8 Accounting Policies, changes in Accounting Estimates and Errors and AASB 108 Accounting Policies, changes in Accounting Estimates and Errors.

Condensed notes to the financial statements for the half-year ended 31 December 2017

3 Significant accounting policies (continued)

At the date of approval of the financial statements, the Standards and Interpretations listed below were in issue but not yet effective. The Group is currently assessing the impact of the following Standards and Interpretations.

Standard/Interpretation	Effective for annual reporting periods beginning on or after	Expected to be initially applied in the financial year ending
AASB 9 Financial Instruments, AASB 2010-7 Amendments to Australian Accounting Standards arising from AASB 9 (December 2010), AASB 2014-1 Amendments to Australian Accounting Standards (Part E – Financial Instruments), AASB 2014-7 Amendments to Australian Accounting Standards Arising From AASB 9 (December 2014)	1 January 2018	30 June 2019
AASB 15 Revenue from Contracts with Customers, AASB 2014-5 Amendments to Australian Accounting Standards arising from AASB 15, AASB 2015-8 Amendments to Australian Accounting Standards – Effective Date of AASB 15, and AASB 2016-3 Amendments to Australian Accounting Standards - Clarification to AASB 15	1 January 2018	30 June 2019
Interpretation 22 Foreign Currency Transactions and Advance Consideration	1 January 2018	30 June 2019
AASB 16 Leases	1 January 2019	30 June 2020

4 Income tax

The Group calculates the period income tax expense using the tax rate that would be applicable to the expected total annual earnings. The major components of income tax expense in the interim statement of profit or loss are:

	Consolidated half-year ended	
	31 Dec 2017 \$'000	31 Dec 2016 \$'000
Income taxes		
Current income tax expense	19,228	14,643
Adjustment recognised in the current year in relation to the current tax of prior years	-	-
Deferred income tax expense/(income) related to origination and reversal of deferred taxes	771	(2,026)
Income tax expense recognised in statement of profit or loss	19,999	12,617

The Group has reviewed the disclosure of prior half-year comparatives. As a result, \$14 million of deferred income tax has been reclassified to current income tax expense. Income tax expense recognised in the statement of profit and loss for the prior half-year remains unchanged as does the current tax liability.

5 Investment in controlled entities

During the half-year ended 31 December 2017, the Group formed two additional trusts, SMHL Series Securitisation Fund 2017-1 and SMHL Series Private Placement Fund 2017-2 as part of its securitisation program, which settled on 21 September 2017 and 25 January 2018 respectively. The trusts were formed in Australia, and the Group holds 100% of the residual income units of the trusts.

6 Deposits and other borrowings

In November 2017, the Group issued \$300 million of 3 year medium term notes with a maturity date of 9 November 2020.

Condensed notes to the financial statements for the half-year ended 31 December 2017

7 Regulatory capital

Subordinated debt

On 19 December 2017, the Group redeemed \$33 million of subordinated debt, with approval from the Australian Prudential Regulation Authority (APRA).

Issued capital

In November 2017, the Group issued \$200 million of perpetual Capital Notes. With prior written approval from the APRA, the Group has the right but not an obligation to redeem the Capital Notes. Unless a Tax Event or a Regulatory Event occurs, the Group will only have a right to redeem the Capital Notes on or after 28 November 2022. The Capital Notes contain a provision for write-off in the event of non-viability. A non-viability trigger event will occur if APRA provides a written notice to the Group that the write-off is necessary or a determination by APRA that without a public sector injection of capital, the Group would become non-viable. This issuance supported the Group's Tier 1 capital position as an eligible Additional Tier 1 capital instrument.

8 Financial instruments

(a) Categories of financial instruments

	Consolidated	
	31 Dec 2017	30 Jun 2017
	\$'000	\$'000
Financial assets		
Cash and cash equivalents	444,669	312,646
Investments		
Available-for-sale financial assets	1,926,922	1,888,292
Held for trading financial assets	1,048,852	1,093,150
Derivatives		
Designated hedge accounting relationship	5,787	2,353
Held for trading	6,470	8,978
Trade and other receivables	8,087	6,005
Loans and advances	23,521,463	22,503,585
Financial liabilities		
Derivatives		
Designated hedge accounting relationship	12,659	26,677
Held for trading	-	250
Amortised cost:		
Deposits and other borrowings	25,355,652	24,410,231
Trade and other payables	19,174	25,721
Subordinated debt	300,431	333,236

(b) Fair value of financial instruments

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable; and
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

**Condensed notes to the financial statements
for the half-year ended 31 December 2017**

8 Financial instruments (continued)

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

	Consolidated			Total
	Level 1	Level 2	Level 3	
	\$'000	\$'000	\$'000	\$'000
31 December 2017				
<i>Assets</i>				
<u>Investments</u>				
Available-for-sale financial assets:				
Treasury notes and semi-government securities	-	423,561	-	423,561
Bank bills	-	323,249	-	323,249
Corporate fixed rate notes	-	-	-	-
Corporate floating rate notes	-	1,029,641	-	1,029,641
Mortgage backed securities	-	150,471	-	150,471
Held for trading financial assets:				
Government Securities	-	1,048,852	-	1,048,852
	-	2,975,774	-	2,975,774
<u>Derivatives</u>				
Designated hedge accounting relationship	-	5,787	-	5,787
Held for trading	-	6,470	-	6,470
	-	12,257	-	12,257
<i>Liabilities</i>				
<u>Derivatives</u>				
Designated hedge accounting relationship	-	12,659	-	12,659
Held for trading	-	-	-	-
	-	12,659	-	12,659
30 June 2017				
<i>Assets</i>				
<u>Investments</u>				
Available-for-sale financial assets:				
Treasury notes and semi-government securities	-	493,690	-	493,690
Bank bills	-	235,359	-	235,359
Corporate fixed rate notes	-	-	-	-
Corporate floating rate notes	-	1,060,009	-	1,060,009
Mortgage backed securities	-	99,234	-	99,234
Held for trading financial assets:				
Government Securities	-	1,093,150	-	1,093,150
	-	2,981,442	-	2,981,442
<u>Derivatives</u>				
Designated hedge accounting relationship	-	2,353	-	2,353
Held for trading	-	8,978	-	8,978
	-	11,331	-	11,331
<i>Liabilities</i>				
<u>Derivatives</u>				
Designated hedge accounting relationship	-	26,677	-	26,677
Held for trading	-	250	-	250
	-	26,927	-	26,927

The Group does not have any financial instruments recorded at level 3 fair value and there were no transfers between levels 1, 2, and 3 during the half-year.

Condensed notes to the financial statements for the half-year ended 31 December 2017

8 Financial instruments (continued)

Except as detailed in the following table, the carrying amounts of financial assets and financial liabilities in the financial statements approximate their fair values:

	Book Value \$'000	Consolidated			Total \$'000
		Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	
31 December 2017					
<u>Financial assets</u>					
Net loans and advances (i)	23,521,463	-	-	23,525,542	23,525,542
<u>Financial liabilities</u>					
Deposits and other borrowings:					
- Medium term notes (ii)	1,205,600	-	1,208,887	-	1,208,887
Subordinated debt (ii)	300,431	-	304,835	-	304,835
30 June 2017					
<u>Financial assets</u>					
Net loans and advances (i)	22,503,585	-	-	22,528,765	22,528,765
<u>Financial liabilities</u>					
Deposits and other borrowings:					
- Medium term notes (ii)	1,255,855	-	1,257,612	-	1,257,612
Subordinated debt (ii)	333,236	-	337,191	-	337,191

Methodologies and assumptions used to determine the fair value of financial assets and liabilities not carried at fair value

- (i) The fair value of fixed rate loans is estimated by reference to current market rates offered on similar loans. The Group has reviewed the disclosure in relation to the classification of the fair value hierarchy for loans and advances, and has determined that it should be classified as level 3 fair value. The inputs used to determine the fair value of loans and advances are unobservable.
- (ii) The fair values of medium term notes and subordinated debt are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and dealer quotes for similar instruments.

9 Segment information

The Group operates as one segment and therefore no separate segment reporting is provided.

10 Subsequent events

There have been no matters or circumstances which have arisen since the end of the financial half-year which significantly affect the operations of the Group, the results of those operations, or the state of affairs of the Group in subsequent years.