WESTPAC BANKING CORPORATION — THE MERGER & BEYOND

An Address by

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Chief Manager, Merger, Bank of New South Wales to The Securities Institute of Australia, New South Wales Division, March 10, 1982.

Thank you Mr. Chairman.

This is my third appearance before members of the Securities Institute — my first being in Adelaide last August and my second in Melbourne in October.

On both of those occasions I was able to point to the historic nature of events then occurring. For example, in August, we had just concluded the Special General Meeting which effectively brought the merger together by authorising the necessary changes to the Bank's Deed.

In October, when I was in Melbourne, I was able to say that it was an historic occasion because that very day we were seeking listing of the shares being issued to former CBA shareholders.

Today I find myself without dramatic headlines — the merger is now well advanced —

- the CBA is a wholly owned subsidiary of the Wales, the continuing legal entity;
- the Board has been functioning as one since October, the top executive since October and the Third Level (Chief Managers) since January;
- the Proprietors (or shareholders) have given approval to the new name for the merged bank — by 16.7m votes to 4.9m, we will become Westpac Banking Corporation, provided the necessary legislation is enacted;
- by 1st October, if all goes well, we expect to present our new face to the world.

In sum, the merger is well advanced. There are still some loose ends to tidy up — but the excitement and drama are largely behind us.

Nevertheless I welcome the opportunity to speak to you for it seems to me that the full significance of the events of the past two years has yet to be grasped by many in the community.

Indeed we are witnessing some of the most dramatic changes in Australia's economic history — changes which will have consequences for many of us here today for the rest of our working lives.

You may feel it is presumptuous of me to suggest that the Wales/CBA merger is a cause for excitement — it may be the largest merger in Australia's corporate history, but it's not the only merger that's hit the press in the past five years — as you may have noticed.

And yet, the story of this merger demonstrates the outworking of tremendous forces for change, forces that I believe we need to understand if we are to make sense of the events which have already unfolded in the financial system and those yet to unfold.

Let me explain:

Firstly, you should realise that banking is no longer banking — in fact the Bank of New South Wales ceased to be simply a traditional bank in 1956 when it opened its savings bank. That process was swiftly followed by our entry into the finance field, into merchant banking, into investment banking and into development banking via Australian Resources Development Bank.

We are no longer just bankers — we are in financial intermediation — intervening between borrowers of money and lenders, between savers and investors.

Once we saw that, we could also see that we were not alone in the financial intermediation field — and that every other financial intermediator is moving in the direction of his neighbours' pastures.

- *Building societies* want to be banks, they want to issue cheques and deal with companies, and issue insurance.
- *Credit unions* want to provide automatic teller machines and enter Bankcard.

- *Stock brokers* want to be merchant bankers; and merchant bankers want to be stockbrokers (albeit at de-controlled brokerage rates). Even bankers don't want to be excluded from the field if incorporation is permitted.
- *Insurance companies* want to borrow on deposit and some even have set up chains of building societies.
- *Merchant banks* enter the unit trust field with their cash management trusts and compete directly with other intermediaries.
- *Bankers* dabble in general insurance and some in life insurance.
- *Pastoral houses,* like Elders, are moving to become bankers.
- We even see a Canadian bank trying to franchise its operational methods to Australian *credit unions.*

And so on. So whether they realise it or not, the lines between intermediaries are disappearing fast and so are State boundaries.

International

Once you start thinking as a financial intermediator and not a banker, you see another obvious, yet rarely perceived, truth — namely that international boundaries no longer have much meaning in financial intermediation.

The Australian government believed for a long while that, by denying foreigners a banking license, they could insulate Australia from this reality.

The failure of their policy is seen in the fact that at least 77 foreign banks have a major presence here as merchant banks, in the finance field, in money markets, as suitcase bankers, and through their representative offices. (37 of those banks are larger than the Westpac Banking Corporation — 20 of them between 2 and 5 times as large).

In fact, the Campbell Inquiry has discovered that 14 per cent of financial intermediation is controlled by these foreigners — it will help you to get this into perspective if I tell you that, Westpac, Australia's largest banking group, will only conduct about 11 per cent of intermediation.

So blind are we about this internationalisation of banking, that we overlook that the Australian banks are themselves international banks. For example, the Wales itself was the first foreign bank into London, in 1853; we have been in New Zealand since 1861, in Fiji since 1901, in PNG since 1910. Today Westpac is represented in 14 countries, we have 5,000 employees overseas and we derive 19 per cent of our banking profits outside Australia's shores.

Summary

These then are the realities

— we are no longer in banking, we are in financial intermediation.

— financial intermediation is no longer national but international.

— and even at home every other financial intermediary is stealing the melons out of our patch and the sheep out of our pasture.

Technology

One factor which will hasten this process of sheep stealing is *technology* — computers enable credit unions to have automatic teller machines, building societies to have on-line pass book updating, merchant banks to efficiently mobilise the savings of the people in cash management trusts.

Even more extensive technological changes are in store — the video information systems such as Prestel, Telidon, videotex and related systems have the *potential* to dramatically alter the way in which Australians shop and do their banking. In theory at least, the supermarket and the local bank branch could be made obsolete by such technology.

Economic Situation

Overhanging all of this is the uncertain economic situation — the stability of the 1960s gave way to the uncertain 1970s, now we face the horrendous 1980s.

The world waits with bated breath to see the success or failure of Thatcherism and Reaganomics.

And despite these varying attempts to solve stagflation, conditions appear to be worsening worldwide.

Talk of resources boom notwithstanding, Australia will be hard pressed to avoid this general world malaise. Indeed that so called 'Boom' is proving to be of doubtful validity — as the results of some of our major miners and companies have shown in recent weeks.

And yesterday, the Prime Minister has acknowledged the seriousness of the situation.

Application

Except for the recession, all these threats were evident in 1968/69 when the Wales and CBA first had merger discussions. They did not disappear when these negotiations broke off — in fact they became more apparent throughout the 1970s.

By 1977 we in the Wales were engaged on an extensive appraisal of our environment and our internal strengths and weaknesses. We could see that we had become a large, static, inward-looking organisation, dependent on procedures and bureaucracy. Yet we were operating in a turbulent environment, with our domestic markets under threat at both the wholesale and retail ends and with a pressing need to escape the straightjacket of Australian monetary controls by a vigorous overseas expansion.

By March 1978, to meet these threats, we had decided on a major internal reorganisation and unfreezing exercise. With the aid of an outside consultant, we shifted power from the bureaucracy to the line, we delegated responsibility closer to the action, we set ourselves a market orientation, dedicating ourselves to improvement of our service to customers.

The process took two years to accomplish (we were a large bureaucracy) and at the end of it we had an organisation with greatly improved flexibility to deal with the turbulent environment already unfolding.

I will be happy to talk more about that process in question time if it interests you.

Campbell Inquiry

But of course, while we carried out this re-appraisal and re-organisation, others were not sitting still.

In mid 1978, the banking industry itself was looking at the decline of its role in the affairs of the nation. So it was that the ANZ and the Wales were instrumental in the establishment of the Banking Industry Special Committee whose report was, we believe, one of the catalysts which led to the establishment of the Campbell Committee a few months later, in January 1979.

So within a few months of our own strategy review, the whole financial system was undertaking a similar examination of itself and its role in the future.

Before long, every institution of any size had a Corporate Planner — and every Corporate Planner soon had a Mergers and Acquisitions Section.

Back at the Wales we had already carried out one strategy review about the time that the Campbell Inquiry was established in January 1979. A year later, in January 1980, we were ready for a much more comprehensive examination, with the benefit of the evidence given to the Inquiry and with our new top team about to take office.

Over the next few months, an exhaustive strategy review was undertaken, involving in the end some 81 people and by July 1980, we had distilled our thinking down to three alternative scenarios.

On the 20th of that month, we took the decision to adopt one of those scenarios — to merge with The Commercial Bank of Australia Limited and on the terms (ex price) which you now know.

In August we engaged David Block & Associates and our legal advisers Allen, Allen & Hemsley; in September we set up a merger section; in October (in response to another bidder) we commenced buying CBA shares; by November we were ready to move. In January we increased our capital. We had detailed submissions prepared to all the necessary authorities and opinion leaders.

I hope you can see from all this that the Wales did not enter this merger, as some have suggested, as a panic reaction to the ANZ's move. We had laid our plans long before that time; we fully expected others to be doing the same, and all that happened was that we were able to have all the protagonists in the field and with the base prices set *before* we commenced discussions.

The Terms of the Merger

Before I talk about price, I should touch briefly on the other conditions of the merger.

As I have said these were all set by mid 1980 — we decided then that we would offer a change of name, we would offer seats on the board to all CBA non-executive directors and their Chief Executive; we would retain all their executive; we would retain a significant Southern Region headquarters; we would neither retrench staff nor change their conditions of service.

Our motivation was simple — we were looking after people in a people industry.

There are other ways of putting two large organisations together but in the long run we believe we will benefit by entering in a true merger, uniting our joint staff behind a new corporate identity rather than enduring the thirty years of bad taste that a ruthless takeover would have engendered. We hope to mobilise goodwill rather than incur hostility.

Our intentions towards our customers are clear — we have not acquired 700 new outlets to walk away from our personal and small business customers as some would have you believe. If we had wanted to do that, we would have sold all our branches, as the Bankers Trust did in the U.S.

Besides, does it make sense to concentrate on big customers when that is precisely the area which is most vulnerable to competition from merchant banks, foreign bank representatives, suitcase bankers, the Australian Bank and future imitators?

We will certainly continue to be leaders in that corporate field and will be better able to meet its needs with our bigger base — but we are mindful that the bulk of our lending is in the under $1m category and over half is under $100,000, controlled interest rates notwithstanding.

We have a long term commitment to the *rural sector* and we will not be walking away from that.

We also have a long term commitment to *small business* — and the Wales and CBA are the only two banks with departments specifically set up to deal with small business problems.

We intend to continue our *branch network* — 43 per cent of Australians choose their banker on no other criterion than convenience of location.

Price

And so to price.

- There is no question that we paid more than we thought we would need to pay when we did our feasibility study in July/August of 1980.

  But given the competing forces at work and the limited number of options open, it was inevitable that an auction would have taken place.

  And don't forget that the base price had been set by the ANZ and by the NBA in their frantic efforts to forestall us.

- Secondly, as the CBA's chairman stated at the time, the CBA's 1980 profit results were depressed. They had absorbed heavy computer costs, the CBA Centre was a liability since it was not then fully let and General Credits' results were depressed. All these were seen as short term problems. By May 1981 before the merger, it was apparent that the CBA and CBC which had reported flat results in their December half year results, would both record strong profit growth in June similar to that being published for the March balancing banks.

  The CBA's flat profits of $39m in June 1980 were already on the move up — they reached $45½m in June 1981 after the merger was announced and Potter Partners, in the offer booklet, predicted $50m in the year to 30/9/81.

- There was also a substantial capital realisation programme in train. The figure realised in the end from Marac, Henry Jones IXL, CBA Centre, The TV Company in NZ and so on was $40m or nearly 50¢ per share.

  Put another way, they could have had a further bonus issue from capital profit. Given all this the price was not excessive.

  Moreover, in world terms, the price was realistic — witness the Merrill Lynch study of UK acquistion of US banks. We fit in the middle on "times earnings/assets/market price".

What have Westpac Proprietors gained?

1. A better bank with a much better spread of representation.

   The Wales held less than 10 per cent of total deposit market in Victoria, South Australia, Tasmania and New Zealand. In one move, we have improved that markedly — lowest market share will be 14 per cent in South Australia; all others exceed 18 per cent, the highest being 30 per cent.

2. We have strengthened every other area of financial intermediation — merchant banking, where we will be No. 1, finance business where we will have a quarter of the market, travel business where we'll be No. 2, unit trusts and investment services, where we'll be a leader among non-life companies.

3. We will thus be in a strong position to provide diversified financial services to a bigger customer base through a much bigger network — plus 700 branches and agencies to over 2000.

4. We will immediately augment our Automatic Teller Network — and open the whole network to CBA customers in May.

5. We will achieve economies in administration — spreading the same overheads over more branches and staff.

   Already savings are coming from (for example) amalgamating Bankcard Administration, with

Travel and others to follow. London and Tokyo are due at the end of March, New York a bit later, New Zealand is well advanced.

6. We will share technological skills and resources and design new systems together.
7. We will gain an augmentation of skills in every area — like most industries we face a shortage of skills in relation to the problems which face us.

   Nowhere is this more evident than in overseas representation, where we are having an immediate release of resources at a time when we are expanding (in Houston, Chicago etc.).
8. We will have greater stability of staff and improvement in our age distribution to enable us to better service our customers.

In Stock Market Terms

1. Before we moved, the Wales established a new dividend rate — 24 cents per share in 1981 which was up 33⅓ per cent on 1980 and 103 per cent since 1977.

   Our shareholders have benefitted in dividend terms even if we do not raise this for a year or two (and I am not foreshadowing anything).
2. We expected our shares to fall in capital value terms to around $3.00. In fact they have been lower as a result of the falling stock market.

   The all ordinaries index has fallen by 32½ per cent since our merger was announced. If the Wales price had fallen as fast, it would have been $2.30 yesterday. In fact it was $2.56, a drop of 25 per cent.

   So the dilution has occurred with a share price fall *smaller* than that of the market as a whole. Will Australia's leading financial institution remain with a yield of 9.4 per cent forever? We would hope not.

   So if we are right, once conditions return to normality our shareholders will gain a lift in capital value — despite having purchased a large income earning asset.

Other Benefits of the Merger

1. We have *invested the long term capital raised* in 1979 in long term income earning assets — and not in short term loans.

   This is the appropriate use of the capital.

   It has gone into office premises, branches, computers etc. — which are all earning income at the outset (not like other new investments which could take time to be income earning).

   Moreover, it its a *diversification into an industry we know* — it is not into fields where we have no proven skills.
2. Westpac's *gearing will improve from around 18:1 to 20:1* — the Wales was too highly capitalised at around 6 per cent relative both to Australian banks and to the overseas banks which will come here officially shortly — and which will thus be able to undercut us.
3. We have taken the *higher profits of the recent past* and *invested them into the future* — our e.p.s. *in theory* fell from 70¢ to around 54¢ on an amalgamated basis (but of course the Banks were not amalgamated at that time).

   But, even at 54¢ the e.p.s. stabilises at the level of the past three years.

Sources for Increased Earnings

In all we will have a much bigger organisation:

- balanced in the geographical spread of its business
- strengthened in the weak markets of the constituent banks
- with a bigger presence in international markets

and carrying on 11 per cent of total financial intermediation in Australia.

The key point is the strategic nature of the move.

It was a once-in-a-lifetime opportunity to position ourselves for the future — in an era which is likely to be more competitive irrespective of the outcome of the Campbell Committee.

The best analogy I have heard of that Inquiry is that it is like a snapshot of a moving train — the forces for change were operating before the Committee was formed, indeed it was formed in response to the pressures for change.

These forces have continued to cause change even while the Committee was sitting
— think of

- the licensing of the Australian Bank
- tap and tender system
- cash management trust
- deregulation of Trading Bank deposit interest rates
- promises of deposit insurance to building societies
- relaxation of controls on capital outflow
- changes in permitted banks' holdings in merchant banks to 60 per cent

- attempts by permanent building societies to merge across boundaries
- the State Bank's claim to have Lender of Last Resort and its plan to open in Canberra.

And change will go on occurring irrespective of what the Government does with that Report.

The train was moving at high speed — and will continue to move even faster, irrespective of the photographer. The forces for change are too powerful.

What again were those forces?

- competition in all areas of financial intermediation;
- the blurring and removal of barriers between different classes of institutions;
- the virtual removal of state and international boundaries;
- the new technology with its potential to open our markets even further to competition to change; and
- a world economy in disarray.

Finally, this round of mergers is to be the last in Australia — the Federal Treasurer has said so.

— If we had failed to position ourselves we ran the risk of becoming a second rate institution with all that would mean for staff morale, for the ability to attract and hold good people;

— and to have a significant voice nationally and internationally;

— placing at risk the opportunity to win that new business which is always attracted to the big man if he's also the best.

As I have said, it was a once-in-a-lifetime chance to position ourselves for the future, with a partner uniquely suited to our needs.

In the process, we have gained a bigger, more robust organisation, more able to cope with adversity and to gain acceptance as a leader in all areas of intermediation: to become a fully diversified financial institution, capable of satisfying the financial needs of the many communities in which we operate.