

# **SOUTHERN CROSS BUILDING SOCIETY**

**Annual General Meeting 17 September 07**

## **CHAIRMAN'S ADDRESS (Geoff Ricketts)**

A warm welcome to all our Members present. My name is Geoff Ricketts and as Chairman of your Society, I wish to address the matters I would like to comment on in my overview.

### **1. CAPITAL RESTRUCTURE**

The financial year to the 30<sup>th</sup> of June 2007 will, when the history of the Society is written, be recognised as a milestone year for the Society. Members of the Society at the Special Meeting held on the 28<sup>th</sup> of June voted overwhelmingly to capitalise \$40M of the Society's accumulated reserves into its permanent capital base and distribute the resulting ordinary shares by way of bonus issue to members. A further 10 million new ordinary shares of \$1 each were issued for cash to Oceania & Eastern Group who is a new cornerstone shareholder in the Society. The overall result was that as at the 30<sup>th</sup> of June 2007, the Society had 50 million ordinary shares of \$1 on issue. Today, the equity in the Society stands at approximately \$60M. Accordingly, that permanent capital together with about \$10M of terminating shares, means the Society has a capital base of approximately \$70M. The result is that your Society has one of the best capital adequacy ratios in the sector, which provides great security for our depositors.

### **2. HEAD OFFICE BUILDING**

Members may have noted in the Society's accounts that there are two categories of properties referred to. Firstly there is Investment Property which comprises the Society's head office building in Victoria Street and secondly there are properties included in "property, plant and equipment". This latter category relates to four owned branch offices of the Society around the North Island.

The Board has undertaken a strategic review of all these properties and concluded that the branch offices are core to the Society's business and accordingly are best owned by the Society for the medium to long term.

However, In respect of the investment property, being the head office building in Victoria Street, the Board came to the conclusion that this was not core to the Society. The Society occupies only about 10% of the building. Owning investment properties such as the head office is not our core business. The Society was considering the sale of this building provided it could protect its office occupancy, naming rights and signage rights. By coincidence, before the Society had formally decided to sell or list the building for sale, it received an offer to acquire the building for \$19M which is over 15% above the book value of the property of \$16M fixed by independent valuation as at 30 June 2007. As the building is not core to the Society's operations, your Board has accepted that offer and the sale which is now unconditional and will settle on the 31st of October 2007. However, the Board has no current intention of selling its branch offices.

### **3. DIRECTORS' REMUNERATION**

Following the restructuring of the Society, the newly constituted Board reviewed the level of fees payable to Directors for Board and Committee work. The Board has resolved to recommend to Members that Directors be authorised to pay annual Directors fees of \$110,000 in aggregate for the financial year ending 30 June 2008. This compares to the total of fees for Board and Committee attendances paid to Directors for the financial year ended 30 June 2007 of \$283,000 – a reduction of \$173,000 - or around 60%. When the Board is confident the Society is receiving an improved return on capital, it is possible we will come back to you requesting an increase in Directors fees!

#### **4. OPERATING ENVIRONMENT**

Your Board is conscious that depositor confidence can be adversely impacted by the ongoing failures in the finance company sector and indeed the current dislocation in global financial markets.

However, as you know, the Building Society sector is very different to the Finance Company sector – different cultures, different traditions and different sources of funding. They have been servicing the community for decades. Building societies do not issue debentures but rather rely on depositors money and bank lines. Southern Cross Building Society, as I have previously said, has one of the highest equity ratios in the sector following the capital restructuring. In the year to date trading for the first quarter is well above the equivalent period last year and broadly in line with budget. In respect of liquidity, the Society currently has adequate banking lines in place and since 1 July 2007 (the start of our financial year) to today, the level of deposits retained has been around 95%. This demonstrates our depositors have confidence in the Society notwithstanding the market conditions affecting the Finance sector in New Zealand. The Society is managing the challenges well.

You will also be aware there are new compliance requirements arising from the proposed changes to the regulatory environment impacting deposit taking institutions. We view these changes in the regulatory environment as positive and are supportive of them. Indeed, we consider both the market environment and the changing regulatory environment are more likely to provide real opportunities over the medium and long term for the Society to both grow its business organically and participate in, what we perceive to be a likely consolidation in the building society sector.

## **5. CANTERBURY BUILDING SOCIETY AND LOAN AND BUILDING SOCIETY**

On the 16<sup>th</sup> of August 2007, 13% of the shares in Canterbury Building Society and 9% of the shares in Loan and Building Society were offered for sale on the market. Both those societies are long established building societies based in Ashburton and are currently in the process of merging. Your Board took the view that the opportunity to acquire those shareholdings was strategic. Since acquiring the shareholdings, I have had initial discussions with the Chairmen of both Canterbury Building Society and Loan and Building Society and they are supportive and comfortable with Southern Cross as a shareholder. While they are currently preoccupied with their own merger, on completion of that they wish to sit down with us to discuss future opportunities for collaborating together. As I have said in my Annual Report we will, as appropriate, seek to participate in friendly mergers and consolidations with similar likeminded financial institutions so as to develop sufficient scale to become a leading New Zealand controlled first mortgage provider with strong governance and ethical standards supporting a sense of community.

## **6. SOCIETY'S SHAREHOLDERS**

You will recall that the outgoing Board, in recommending the restructuring proposal to Members, requested the incoming Board to facilitate the sale of any shares for any Members wishing to sell. They had concerns that some Members were elderly, and may need the cash. In the event, about 80% of Members have decided to keep their shares and 20% to sell.

As requested by the retiring Board, the Society has facilitated the placement of those shares and accompanying options at their issue price to habitual investors in the investment community. I am pleased to report that the Society received strong demand in excess of the number of shares offered for sale by Members. This clearly reflects the

confidence of investors in the value of the Society and its strategy. This has resulted in good institutional support from new Members such as the Accident Compensation Corporation, Elevation Capital, Aspiring Asset Management, and other habitual investors who are now on the register and we welcome their support and involvement.

From the selling Members' perspective this facility has been a bonus to many of them – let me read from one letter:

## **7. FORMER DIRECTORS**

In concluding, it is appropriate for me to recognise the contribution over many years of the retiring directors and in particular the Chairman, Mr Howard Sexton. A special thanks to him and the other retiring directors of the Society for their contributions.

I will now pass to Bob Smith, Chief Executive to address you.

## **C E O ADDRESS (Bob Smith)**

Firstly, welcome to you all and it is a pleasure to be talking to you at my first AGM.

I am really excited about taking up the position of CEO and revitalising the Southern Cross brand, but at the same time maintaining its trusted status in the market.

The core business of Southern Cross of taking deposits and lending on first mortgages will remain the same but there are a number of opportunities around this that Southern Cross can take advantage of. Examples of this are Internet banking and reselling insurance services.

I would like to take this opportunity to thank the staff of Southern Cross for embracing me into the Society and look forward to working with them in the exciting times ahead.

The current financial market uncertainty has prompted a number of enquiries from depositors that has provided me with a unique opportunity to interact with our depositor base I otherwise would not have had.

What has struck me out of this interaction is the loyalty of the depositor base and the very good relationship that our branches and agencies have with them. This highlights the difference between ourselves and finance companies, who do not have branch networks and a banking type relationship with their customers.

As a result of this we have enjoyed a retention rate of depositor maturities in excess of 90% during these trying times, and indeed up until recent events the Society was experiencing growth in its depositor base. This retention ratio is excellent when compared with the market commentary that Finance Companies, which we are not, are experiencing re-investment ratios of between 20% and 50%.

Our liquidity is governed by our Trust Deed which requires that at any time we must have in excess of 15% of our total assets invested in Treasury investment with a credit rating of AA- or better.

Recently the Securities Commission sought confirmation from all Non Bank Deposit takers that they continued to be in compliance with their Trust Deed. The Directors of Southern Cross have provided the Commission with that assurance as at 4 September and that position remains today.

As the market stabilises we anticipate a change in the market place for deposit taking with long established and trusted organisations, such as Southern Cross receiving increased deposits that might have otherwise gone to Finance Companies. Also we will source funding from alternative sources such as wholesale bank lines.

In the medium to longer term the impact of the current market volatility should provide increased opportunities for Southern Cross, as we believe the market will have to consolidate.

I would like to touch on the financial results and position of the Society for the year ended 30 June 2007, details of which are described in detail in the Annual Report sent to Members.

The key highlights from a trading perspective were:

- Some margin compression as a consequence of competitive market conditions – this has since been addressed as the Society regularly reviews its lending and funding margins and will endeavour to grow its net interest margin.
- Bad debts for the year were significantly higher than 2006 as the Society provisioned against impaired loans. These loans are currently being addressed and the Society is confident about the quality of its lending portfolio.
- We incurred one time / non-recurring costs of \$1.6m in relation to the capital restructure.
- On a like with like basis, adjusting for the on-time items in 2006, additional bad debt provision incurred in 2007 and non-recurring adjustments relating to the terminating shares in 2006, the net profit before tax in 2007 would have been approximately \$4m – compared to \$6.8m in 2006.

Turning to the financial position of the Society:-

- The capital restructure has significantly strengthened the balance sheet until equity at 30 June 2007 of approximately \$58m of which \$50.6m is permanent capital – this compared to there being no permanent capital in 2006.

- This capital base provides a platform for the Society to raise further equity and debt funding to support growth.

Turning to the outlook for the Society, it is expected the trading results will improve significantly relative to 2007 as the Society is focusing on initiatives such as more active interest rate management, costs control and improved balance sheet efficiency.

Looking forward for the coming year the operational priorities for the Society are:-

- The decentralisation of decision making out to the branches – enabling us to provide even better customer service.
- New Products & Services – while staying within the same conservative guidelines there are a number of new products and services we can offer to not only our existing customers but that will enable us to grow our customer base.
- Supporting the friendly mergers and acquisitions activities outlined by the Chairman.

Once again thank you for coming and I look forward to seeing you again next year.