

20 February 2008

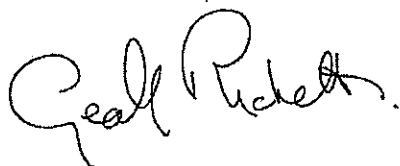
**Interim Report for the six months ended 31 December 2007**

The Society is pleased to report on the six months ended 31 December 2007, being the first half of the Society's financial year to 30 June 2008. Please find attached a report in relation to this period.

The key highlights for the six month period since the Society's capital restructure was undertaken on 28 June 2007, include the following:

- Unaudited pre-tax operating surplus reported under NZ IFRS for the six months ended 31 December 2007 was \$3.1 million – compared to a profit of \$0.1 million in the six months to 31 December 2006.
- "One-time" items contributed a further \$1.9 million of net profit, bringing the total pre-tax surplus for the six months ended 31 December 2007 to \$5.0 million, resulting in a total net profit after tax of \$4.7 million for the six months – compared to \$0.1 million for the six months ended 31 December 2006.
- Sale of non-core head office investment property for \$19 million realising a one-time net gain on sale of approximately \$2.0 million.
- Significant reduction in impaired loans by over \$2.5 million since 30 June 2007.
- Banking facilities increased from a secured \$6 million facility to unsecured facilities of \$80 million provided by two major trading banks as part of a deliberate strategy by the Society to diversify its funding sources.
- A significant increase in the Society's liquidity resulting from the sale of the Society's head office property and new bank facilities.
- Acquisition of strategic shareholdings in CBS Canterbury Building Society and Loan and Building Society (now merged) – in which Southern Cross holds approximately 12% and is the largest shareholder in the merged group.
- Higher equity of \$61.6 million, up 36% from \$45.2 million as at 31 December 2006 resulting in a risk weighted capital adequacy ratio of 16.3% as at 31 December 2007 compared to 10.2% as at 31 December 2006.
- The Society's total assets as at 31 December 2007 were \$459 million - compared to \$481 million as at 31 December 2006. The reduction was largely attributable to a more cautious lending approach being adopted by the Society.

Yours faithfully



**Geoffrey T. Ricketts**  
Chairman

## **CHAIRMAN'S REPORT**

### **For the six months ended 31 December 2007**

The Directors of Southern Cross Building Society are pleased to report a very satisfactory financial result for the six months ended 31 December 2007, reflecting the benefits of the Society's restructuring effected on 28 June 2007.

This result has been achieved in a difficult financial environment arising from the "credit crunch" in financial markets emanating from the difficulties in the USA sub-prime mortgage markets. The impact of the credit crunch has extended to all international financial markets including New Zealand and has particularly affected funding liquidity as investors sought a "safe haven" for their cash. Building societies, such as Southern Cross, have continued to receive good support from members and depositors, no doubt because the sector with its long history and separate regulation, is generally considered a safer investment than finance companies.

Building societies are distinctly different from finance companies. A building society typically has a long established history (Southern Cross is 85 years old this year), has a long established and loyal customer base, is customer and community service orientated, and adopts conservative lending policies, primarily lends only on a first mortgage basis, is separately regulated and operates under the constraints of a Trust Deed to protect depositors. These factors differentiate building societies from the major trading banks and finance companies – and Southern Cross Building Society has all these attributes.

Also, Southern Cross, having been operating for 85 years has previously experienced changes in economic cycles, share market crashes, world wars and depressions. It has survived because of its conservative approach and prudent money management. These practices continue today.

While the Society has been resilient in this uncertain environment, in addition the Board has also been cautious and adopted some conservative strategies in a number of areas:

- In the six months to 31 December 2007 the Society adopted a cautious approach to new lending as a means of ensuring that the Society maintained its conservative liquidity position. The Society also experienced some unexpected loan repayments during the period. Both events meant the Society's total loan portfolio (net of provisions) reduced by less than 6% to \$353 million as at 31 December 2007 from its 30 June 2007 position of \$373 million.
- The Society sold its head office investment property in Auckland for \$19 million, as it only occupied 10% of the building and it was considered non-core to the Society's business. The Society has leased back that part of the building, which it occupies.
- The Society has increased its wholesale committed bank debt facilities from a secured \$6 million facility to unsecured facilities of \$80 million provided by ANZ National Bank and ASB Bank to enable the Society to grow its business. Both banks completed due diligence and the Society was pleased to see the confidence shown by those banks in granting these facilities. The new unsecured bank facilities rank equally with the Society's depositors in terms of security.
- The Society has achieved considerable progress in reducing its impaired loan position by \$2.6 million in the six months ended 31 December 2007 to \$5 million.

The Society continued to receive strong support from depositors during the period. The level of its deposits at 31 December 2007 remained at approximately 90% of the level of deposits as at 30 June 2007. This reflects the fact that the Society continues to experience high levels of re-investment by depositors and is successfully attracting deposits from new depositors. Your Board considers this a satisfactory outcome, given the relative uncertainty and volatility in financial markets and relative to rates of investment being reported by other financial institutions in the industry. The Society's liquidity and funding position has been significantly strengthened by the additional bank debt facilities - which formed part of a deliberate strategy to diversify the Society's funding base. For the first six weeks since 31 December 2007, the

Society has seen an encouraging lift in deposit inflows resulting in a net growth in deposit levels.

As at 31 December 2007, the Society reported a very strong liquidity position with a liquidity ratio (defined as liquid assets as a percentage of total tangible assets minus reserves) of approximately 40% – compared to a ratio as at 31 December 2006 of 22% and a minimum liquidity ratio required under the Society's Trust Deed of 15%. Consequently, the Society is in a very strong position relative to its financial covenants, and will cautiously grow its lending portfolio.

The Society's unaudited pre-tax operating surplus reported under NZ IFRS for the six months ended 31 December 2007 was \$3.1 million – compared to a profit of \$0.1 million in the six months to 31 December 2006.

In addition, "one-time" items contributed a further \$1.9 million of net profits (after taking into account some non-recurring costs), bringing the total pre-tax surplus for the six months ended 31 December 2007 to \$5.0 million, resulting in a total net profit after tax of \$4.7 million for the six months to 31 December 2007.

The Society had total assets as at 31 December 2007 of \$459 million - compared to \$494 million as at 30 June 2007. The reduction was largely attributable to the Society adopting a more cautious lending approach during a period of uncertainty and volatility in financial markets in the six months ended 31 December 2007. This resulted in loan advances (net of provisions) of \$353 million as at 31 December 2007 – compared to \$373 million as at 30 June 2007.

The Society's equity position has improved significantly with shareholders' funds of \$61.6 million as at 31 December 2007 – up \$16.4 million or 36% on the comparable position as at 31 December 2006. The Society's balance sheet continues to be one of the strongest in the building society sector and the Society's equity ratio as at 31 December 2007 was 13.4% compared to 11.6% as at 30 June 2007. According to the 2007 "KPMG Financial Institution Performance Survey", Southern Cross Building Society had the highest equity ratio of the five largest building societies in New Zealand. The Society's capital adequacy ratio (a measure of capital to risk weighted assets) was 16.3% as at 31 December 2007 compared to 10.2% as at 31 December 2006 - and compares to a minimum capital adequacy requirement of 8% applying to the trading banks in New Zealand as required by the Reserve Bank of New Zealand.

As at 31 December 2007 the Society had 50.25 million ordinary shares and 16.967 million share options on issue. Accordingly, the undiluted net asset backing per ordinary share at that date was \$1.23 and \$1.17 per share on a fully diluted basis (determined on an NZ IFRS basis).

### **NZ IFRS Adoption**

The Society has adopted New Zealand International Financial Reporting Standards (NZ IFRS) with effect from 1 July 2007. Accordingly, the financial figures referred to in this report are reported on an NZ IFRS basis. The Society will in due course report its unaudited detailed financial statements showing the NZ IFRS transition adjustments made in order to comply with the new accounting standards. As part of the transition to NZ IFRS, the Society's equity as at 30 June 2007 was reduced by \$0.7 million to \$57.2 million from \$57.9 million reported under previous Generally Accepted Accounting Practice. This reduction arose primarily due to the establishment of a Collective Provision for doubtful debts as part of the transition to NZ IFRS and as a conservative approach to recognising possible impairment losses on loans not already specifically provided against. This treatment is widely adopted by all the trading banks in New Zealand and Australia. As at 31 December 2007, the Society's Collective Provision was \$1.8 million. Additionally, under NZ IFRS, the Society is required to consolidate the Southern Cross Building Society Superannuation Scheme (a defined benefit superannuation scheme). This had the effect of increasing the Society's equity position at the date of transition to NZ IFRS (1 July 2006) by \$0.9 million based on the last triennial valuation undertaken for the Scheme as at 31 March 2005.

## **Dividends**

The Directors have determined not to pay an interim dividend to Members given that the six-month period from 30 June 2007 was very much a transition period implementing the restructuring approved by Members at the end of June 2007. As outlined in the Society's annual report for the year ended 30 June 2007, the Board envisages that an appropriate dividend policy will be adopted by the Society that will result in dividend payments being made to shareholders in future years.

## **Share Trading Facility**

Following requests by some Members to establish a facility to enable shares and options in the Society to be traded, the Society asked Forsyth Barr, one of New Zealand's largest independently owned investment houses, to implement a share trading facility. This facility is now operating and enables shareholders in the Society to freely trade their ordinary shares and options in the Society. Details concerning the last traded prices of ordinary shares and options as advised to the Society by Forsyth Barr, as well as ongoing information about the Society, will be regularly posted on the Society's website at [www.buildingsociety.co.nz](http://www.buildingsociety.co.nz). Since the share trading facility was established, the Society's ordinary shares and share options have traded in the range of \$1.03 to \$1.10 and \$0.10 to \$0.15 respectively.

## **Staff Acknowledgement**

The Directors wish to acknowledge our staff and management. Considerable progress has been achieved in the short period of six months since the Society's capital restructure was effected. The Society will continue to regard excellent customer service as a key priority and the efforts of the staff at the Society's branches are greatly appreciated.

## **Outlook**

Your Board comments as follows:

- In respect of the outlook for trading for the balance of the year to 30 June 2008, subject to no further material disruption in global credit markets, the Board expects that the Society will continue to trade profitably in the second half and report satisfactory year on year earnings growth.
- In line with previous comments, the Board continues to be of the view that further consolidation in the Building Society and Savings Sector is likely to occur. This reflects the changed market conditions, the new regulatory environment that has been foreshadowed by government, the change to new accounting standards under NZ IFRS, and the pending need for credit ratings for Non-Bank Deposit Takers who wish to raise deposits from the public. All these factors point to a need for greater scale and your directors will pursue those consolidation opportunities, which they are of the view, are in the best interests of Members.
- Otherwise, on a day-to-day operating basis, the Board will seek to grow the Society's total assets under management. The Society is well positioned given its strong liquidity position and capital strength to cautiously pursue this growth.

**Geoffrey T. Ricketts**  
**Chairman**  
**20 February 2008**

## Summary of Financial Performance & Financial Position

The figures summarised in the tables below have been prepared in accordance with NZ IFRS and are unaudited.

### Summarised Financial Performance

Period ended \$000's	31-Dec-07 6 months	30-Jun-07 12 months	31-Dec-06 6 months
Total interest income	21,881	38,715	19,602
Total interest expense	16,535	30,333	16,611
Net interest margin	5,346	8,382	2,991
Other income	1,402	2,832	1,402
Bad debts recovered / (bad debts)	172	(1,315)	(790)
Total gross margin	6,920	9,899	3,603
Expenses	3,834	7,118	3,546
Net profit before tax (NPBT) before One Time Items	3,086	2,781	57
One time items	1,900	1,272	
Net profit before tax (NPBT) before after One Time Items	4,986	4,053	57
Tax / (Tax Credit)	291	1,286	(11)
Net profit after tax (NPAT)	4,695	2,767	68

### Summarised Financial Position

As at \$000's	31-Dec-07	30-Jun-07	31-Dec-06
Cash & investments	91,849	103,051	106,485
Loan advances	352,834	373,044	360,515
Fixed assets	6,484	6,242	5,195
Deferred tax	3,896	2,241	5,442
Other assets	3,719	9,478	3,718
<b>Total Assets</b>	<b>458,782</b>	<b>494,056</b>	<b>481,355</b>
Deposits	382,831	423,653	418,642
Terminating shares	9,374	10,097	14,372
Other liabilities	4,989	3,096	3,101
<b>Total Liabilities</b>	<b>397,194</b>	<b>436,846</b>	<b>436,115</b>
<b>Net Assets</b>	<b>61,588</b>	<b>57,210</b>	<b>45,240</b>
Number of shares	50,250	50,500	n/a
Number of options	16,967	16,667	n/a
NTA undiluted	\$ 1.23	\$ 1.13	n/a
NTA diluted	\$ 1.17	\$ 1.10	n/a

Note: The Society has recently diversified its funding base and the figures above do not include the committed bank facilities of \$80 million available to the Society - which form part of the Society's "liquidity ratio". As at 31 December 2007, none of the bank facilities had been utilised.