



For whom the merger bell tolls

BY ROB STOCK Last updated 05:00 07/02/2010

In the blue corner, the conservative directors of sleepy South Island building society CBS Canterbury. In the red corner, a cabal of Auckland investors with an eye for opportunity.

Chris Swasbrook, wearing red, has come out swinging. Criticising the CBS management for "inertia and the lack of any clear strategic direction", the Elevation Capital fund manager has lost patience and is demanding a better deal for shareholders.

"The current returns to shareholders are currently unacceptable and we have yet to see clear evidence on how profitability can be restored," he said.

Sparked by a report in the Sunday Star-Times that Australian community bank Bendigo had registered trademarks for "New Zealand Community Bank", Swasbrook fears Ashburton-based CBS Canterbury, formed from the merger of the Canterbury Building Society and Loan and Building Society in early 2008, risks being gazumped from overseas.

"What concerns us is that the opportunity that we see for CBS in creating a New Zealand-owned bank servicing numerous communities within New Zealand looks set to be taken away from us, by an Australian corporation, due to the board's inertia and reluctance to engage in meaningful merger discussions to begin to create requisite scale to better compete in the market," Swasbrook said.

The merger Swasbrook has in mind is with the unlisted Southern Cross Building Society and his outburst appears designed to get CBS Canterbury's shareholders, predominantly loyal elderly Cantabrians, to start asking questions of their board, which he believes has to change as it lacks the experience and skill set to grow the business.

Swasbrook, who has a stake in both companies, has a clear end game.

He envisions CBS Canterbury, with its loan book of almost \$500 million mainly residential mortgages, combining with Southern Cross to create a listed company with \$100m of equity and \$1 billion of loans.

The result would "rerate" the value of his investments upwards and the combined entity could raise more capital to expand further – perhaps using the Bendigo Bank model of providing banking services through branches opened by and owned by local communities.

CBS shares currently trade on the NZAX secondary board at around \$3, down from highs of \$6 in 2006, valuing it at about \$36m, despite having net assets of just over \$50m or \$4 a share.

Southern Cross shares are trading at just 45c on a grey market run by sharebroker Forsyth Barr, a huge discount to their net asset backing of \$1.03 a share, and valuing it at just over \$23m.

Swasbrook insists that "setting the first domino falling" with a merger of the two companies could potentially knock others over, prompting other building societies like the fiercely independent mutuals Napier, Hastings and Wairarapa to join up, and perhaps even SBS, the country's only mutual bank.

CBS Canterbury's chairman Gary Leech would not outline the longer term strategy for the society, but said the board continued to discuss some key ideas: seeking a banking licence, becoming "Canterbury's bank", expanding into other regions, in addition to the idea of a merger with Southern Cross.

"Nothing's off the table in terms of our strategy for the future," Leech said. "But we are a tad conservative and I think that has served us well.

"We don't aspire to be like the big four banks. We believe we have a prominent part to play in the next tier of finance in New Zealand and the communities in which we are. If we were to move to being a bank it would be quite different from the main banking groups," he said, professing admiration for the Bendigo Bank community banking model.

"If we didn't have an aspiration to get a banking licence, then I agree we might be failing," he said, but "we are still in the middle of putting together a merger. The financial crisis put speed bumps in front of us. We haven't bedded down the current merger. To have tried to put another merger together in the middle of the financial crisis would have been suicidal. It would have been dangerous."

Swasbrook and Southern Cross chief executive Bob Smith say CBS Canterbury would need greater scale to cope with the demands of being a bank, and that could provide a catalyst for its board to sell the idea of a merger to its smaller shareholders.

But Smith said it was up to CBS to take the initiative. "We do believe consolidation would be a good thing for the industry, but it is really a CBS decision. It is not our decision."

He remained hopeful though.

"I believe we will see some moves this year. The direction is now becoming clearer as to the environment and I think there is a great opportunity for healthy locally owned banks."

The decision really does lie with the predominantly South Island shareholders – any merger would have to be approved by 75% of CBS Canterbury's shareholders, but no shareholder can vote more than 10% of the company's stock. Most of them got their shares for free when the two societies listed on the NZAX, says Swasbrook. They are not natural shareholders, see their shares as a bonus, do not understand their value or the return they should be getting, says Swasbrook.

CBS Canterbury has no plans to begin that discussion just yet, though Leech said the board would consider a response to Swasbrook's criticism.

"CBS is not blinded by parochialism or has blinkers on to the real world," Leech said, arguing CBS's profitability problems had been the results not of bad debts, but wild interest rate fluctuations during the financial crisis.

He said CBS would remain conservative as that was the best long-term strategy. He also recalled the troubles that led to Southern Cross taking a shareholding. It acquired the stake from Property Finance Group, a listed finance company part-owned by private investment consortium Oceania & Eastern, which owns 28% of Southern Cross.

The implication is clear. North Island money does not always know what's good for it, by contrast to a steadier South Island outlook.

"We have done pretty damn well through the financial crisis," said Leech.

THE MAJOR PLAYERS

SOUTHERN CROSS BUILDING SOCIETY

Founded in 1923 60 North Island agencies It has equity of \$52m, \$276m of loans and \$358m of deposits. In June 2007 it was converted into a shareheld society in a carpetbagging orchestrated by private investment company Oceania & Eastern. The shares are not listed.

CBS CANTERBURY

Created by the merger of Canterbury Building Society and Loan & Building Society in February 2008 CBS was founded in 1875 as the Ashburton Permanent Building and Investment Society. It listed on the NZAX alternative sharemarket in July 2004. Loan & Building Society was founded in 1893. In November 2003 it listed on the NZAX. CBS Canterbury has equity of \$50.6m, a \$439m book of mainly home loans, and

\$466m of deposits. It has branches in Ashburton, Rangiora and the Christchurch suburbs of Riccarton and Sydenham.

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