



# Capital Markets



## Time for Prospectus NZ?

Should we be aggressively chasing foreign investment dollars, ask **Fran O'Sullivan** and **Tim McCready**

**N**ew Zealand is in a sweet spot. Surely it's time for our sharpest brains to come up with a major campaign to spruik New Zealand as an investment destination and go hard on capital markets?

"I just think the genie is out of the bottle with New Zealand," says Nicholas Ross, country head for UBS New Zealand. "People are just going to keep coming and coming and coming."

"If there was ever a time to be bold and to borrow a bit more this is it," he adds. "Markets are in very good shape, they are very receptive to good proposals and interest rates are very low."

It is a stance shared by a growing number of senior NZ capital markets players and business leaders.

New Zealand arguably remains behind the pace when it comes to applying financial leverage to fully fund the growing infrastructure gap sparked by rocketing net migration.

A Government spooked by a series of major earthquakes is wary of accruing too much debt in case it needs to use its balance sheet in the event of another costly natural disaster or recession. But this appears short-sighted when Trump's America and Brexit have affected international perceptions and this country is increasingly viewed as a safe haven for people and capital.

In today's report, Auckland Chamber of Commerce CEO Michael Barnett points out there are many options for funding the city's growth.

But they all require capital.

Commonwealth Bank's Andrew Woodward says the NZ debt market has shown it has the capacity to complete larger project finance transactions.

Woodward – who is general manager of CBA's NZ operations – points to Transmission Gully and the Puhio-to-Warkworth projects, which attracted support from domestic and offshore banks and investors and competitive outcomes for the NZ Government.

He says the continued success of this style of transaction – as well as funding of significant investment by the likes of Auckland Council and Auckland Airport – will continue to rely on domestic and increasingly international debt markets supporting growth projects, with both having targeted international debt markets to meet their growing funding requirements this year.

Says Woodward: "To aid the further development of the NZ debt market



**Andrew Woodward**

land on the radar, as well as ensuring legislation around areas such as interest withholding tax are competitive versus other jurisdictions, and encourage investment in New Zealand.

"While the domestic debt market can meet requirements up to a certain capacity, foreign capital is expected to play an increasing role to meet the planned infrastructure spend."

Kiwis who have collectively saved more than \$40 billion in KiwiSaver – an average of just under \$15,000 per person – might also question whether investment allocations are structured to deliver sufficient funding for NZ growth (and the needs of savers). Australian research firm Strategic Insight

there continues to be a strong role for Government in outlining a clear pipeline of projects (across a range of asset classes including toll roads, prisons, hospitals, and rail projects), so foreign capital keeps New Zealand on the radar, as well as ensuring legislation around areas such as interest withholding tax are competitive versus other jurisdictions, and encourage investment in New Zealand.

"While the domestic debt market can meet requirements up to a certain capacity, foreign capital is expected to play an increasing role to meet the planned infrastructure spend."

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has released figures showing total KiwiSaver balances hit \$40.651 billion at the end of March; up from \$38.416b at the end of December.

With KiwiSaver poised to turn 10 this year, it is worth asking whether more avenues for investment should be provided onshore.

In its report, *World awash with Money*, Bain & Company looked at capital trends through to 2020. The consultancy firm predicted that for the balance of the decade, markets will generally continue to grapple with an environment of "super-abundance".

It says there has been a power shift from the owners of capital to the growers of good ideas. "In this environment, investors' success will be determined less by how much money they command than by their ability to spot an investment's true creation potential and act on it nimbly. Those that can react with speed and adaptability will be best able to identify the winners, steer clear of bubbles and generate superior returns."

There is an abundance of innovation in New Zealand. Time for that Kiwi prospectus to fund our growth and our ideas.



**No end in sight for golden run of shares – Liam Dann, D3**

## THE NEXT FRONTIER



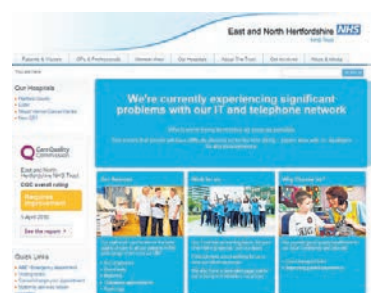
### BLOCKCHAIN TECHNOLOGY

– D18



### CLOUD COMPUTING

– D19



### CYBERSECURITY

– D20

## IPOs experience a cyclical patch

After just three initial public offerings (IPOs) each year in 2015 and 2016, there appears to be a new, and perhaps worrying, normal for the NZX. However, industry players are divided on the outlook.

Immediate expectations for 2017 suggest a few listings is the best we can hope for. This paints a bleak picture when compared with the 12 IPOs on the NZX in 2014 and seven the previous year.

The sustained slump seems to be the result of a combination of increased activity in other sectors of the capital markets and uncertain market conditions.

Chapman Tripp's recent New Zealand Equity Capital Markets Report predicted a continuation of those factors in 2017.

"The uncertain local and global political environment and the mixed performance of a number of recent IPOs is likely to dampen investor appetite," said the report.

"A healthy M&A market, which carries

lower transaction costs for vendors and greater certainty of a successful exit, is another reason likely to keep listings at a lacklustre level."

However, while Chapman Tripp's report dubbed the three listings per year a potential "new normal", industry players are less willing to make such forecasts.

"The rate of listings per year is cyclical," says Henry Chung, Head of Equity Capital Markets at FNZC. "Yes, there were a quarter of the IPOs in 2015/2016 vs 2013/2014 but over those four years there were 27 listings (excluding ETF products) compared with seven from 2009-12.

The rate of new public listings has dropped but industry experts refuse to believe this is a new normal, writes **James Penn**.

"I'm not expecting a material uptick in 2017 but I don't think you can ever say for cyclical activities like listing numbers that there's a 'new normal'."

Brian Gaynor, Head of Investments at Milford Asset Management and columnist for the Weekend Herald, shared similar sentiments. "I hope it is not the 'new normal'. There is no sign of a quick uptick in 2017 and it is far too early to talk about 2018.

"IPO trends are cyclical and one would hope that 2018 and 2019 will be better."

Continued on D11

"It can often be a good path for a company to be incubated by New Zealand private equity prior to listing."

FCNZ's Sam Ricketts,



## CAPITAL MARKETS

# Congestion charge has merit for Auckland

**A**uckland has the vision to be the world's most liveable city. Immigration into New Zealand is at record levels and most newcomers and returnees wish to come to Auckland – so our city must be an attractive destination. However, partly as a result of this inflow, our transport infrastructure is stretched.

In August last year Auckland Mayor Phil Goff noted the productivity losses from congestion alone are estimated at between \$15 billion and \$2b a year. Currently during the morning peak period, some 27 per cent of commuters' time is spent in severe congestion.

Moreover, pressure on our transport system will intensify as the city's population is estimated to grow by almost 50 per cent over the next 30 years, adding a further 700,000 people for a total of 2.2 million residents.

The amount of freight travelling on Auckland's roads is projected to rise by 78 per cent over the same time.

For transport alone, the gap between the 30-year funding requirement identified in Auckland Council's Long-Term Plan and the funding available from current sources is estimated to be \$12b.

The shortfall cannot be financed by borrowing more as the council's debt will reach some \$10b over the next three years. That is because the council is already operating close to the 270 per cent ratio of debt to revenue it needs to operate within to preserve its AA credit rating.

But even if the council was to borrow more, the increased interest burden needs to be serviced now, ahead of the increase in rating revenue arising from future growth. So what additional revenue sources are available to the council to fund, that is pay for, the increased infrastructure spend?

Half of the council's \$3.2b annual operating revenue comes from rates. If the \$400 million average annual shortfall in infrastructure spending identified above was wholly funded from this source alone, it would require a step-up in the annual rates bill of around 25 per cent in the current year.

This is politically unsustainable.

Some form of road pricing could be used, such as a regional petrol tax or congestion charging. However, a regional petrol tax has been ruled out by central government because it is

**Jim McElwain** suggests some ways to bridge the infrastructure funding gap



## Possible new tools to meet Auckland's infrastructure funding shortfall:

- A congestion tolling system
- Public private partnerships (PPPs)
- Value capture models

"administratively unwieldy and prone to leakage", according to the Minister of Finance.

A congestion charge has much to recommend it because it would assist in demand management. Through shifting usage away from peak periods, it defers the need for future investment and buys time for new

and more cost-effective technologies to emerge.

It could also be a means of delivering increased revenue which could fund additional infrastructure. However implementation of congestion pricing might be 10 years away. So what do we do in the interim?

Public private partnerships (PPPs)

have been proposed. PPPs are a long-term contract to deliver a service, where provision of the service requires the construction of a new asset, or enhancement of an existing asset.

Private sources finance the asset, while the Crown/council concerned retains full legal ownership.

For example, a PPP has been used to design, construct, finance, operate and maintain the new 27km Trans-mission Gully highway for 25 years after the five-year construction period. The New Zealand Transport Agency expects the PPP will deliver the project at a lower "whole of life" cost than the public sector could obtain through conventional procurement.

The PPP model also encourages the most advanced technology and innovative approaches from overseas to be brought to this and, potentially, other projects.

Though PPPs are an innovative way to procure infrastructure with significant efficiency benefits, they are not a means of project funding where the loans and interest are repaid by the sponsoring government or local authority.

A form of funding that has found favour with the New Zealand Productivity Commission, in its recently published report on urban planning in New Zealand, is called "value capture". The essence is that landowners are taxed on the uplift in unimproved land values arising from the infrastructure put in place by the council concerned.

It is only fair that a portion of the windfall gains enjoyed by landowners should be retained for the benefit of the community.

The value capture tool has been used to part-fund London's Crossrail railway line, currently under construction. The Greater London Authority is raising £5.2b of the estimated £14.8b project cost from value-capture sources – a third of the total. Auckland Council's Long-Term Plan includes some \$25b in capital expenditure on transport projects over the next 30 years.

Even where only half of this expenditure was amenable to value capture, the potential additional revenue of \$4b would make a material difference to bridging the funding gap.

● **Jim McElwain** is the Executive Director, Institute of Finance Professionals NZ Inc (INFINZ)

## INSIDE



### Michael Pollard

Big deals in the pipeline but they are taking a while to come to market **D4**



### Mark Peterson

The sharemarket continues to be in a healthy state **D8-9**



### Paul Goodwin

wonders whether the pools of capital are going to the right places **D10**



### Ross George

of Direct Capital talks to Tim McCready about the state of NZ's private equity industry **D13**



### Offshore capital

James Penn talks to the founders of two firms about the state of international investment. **D16**

## Get set for 2017 INFINZ Awards

Excellence in 14 categories of financial services will be recognised tonight at the annual INFINZ Awards dinner, being attended by more than 800 guests in the Langham Hotel.

An Emerging Leader Award will be presented for the second time. This is part of the INFINZ Emerging Leaders programme for members in their 30s.

The objective is to assist those with subject matter expertise to move into senior ranks as partners of law or accounting firms, chief financial officers and chief investment officers.

This will also be the second year in which INFINZ has inducted a Distinguished Fellow – in 2016 this accolade went to Sir John Anderson KBE. INFINZ is grateful to all the sponsors of the INFINZ Awards and acknowledges the New Zealand Herald as Media Sponsor and the Herald's The Business as sponsor of the Institutional Banking Innovation Award.

Extended coverage of the Awards



will be provided in The Business on Friday May 26.

### 2017 INFINZ Conference

The annual INFINZ one-day conference, with a theme of "Transform – Shaping Tomorrow Today", will be held in Auckland at the ANZ Viaduct Events Centre on November 2.

Corporate clients, fund managers, bankers, professional services

leaders, chief financial officers, treasurers – wherever they come from in the financial markets ecosystem have this in common: They live in a time of profound change, where tomorrow belongs – not to those equipped for conditions that no longer exist, but to those who are prepared to listen, learn and transform.

The event brings together world-



**Jim McElwain** (above) and guests at the 2016 INFINZ Conference.

class speakers, including:

● **Andrew Grant**, Senior Partner, McKinsey, who will speak on the future of our region.

● **Joan Withers**, Governance leader, speaking on environmental, social and corporate governance trends.

● **Matt Whineray**, Chief Investment Officer, NZ Super Fund, on how major investors are responding to climate change and implications for corporate strategy.

● **Carl R. Tannenbaum**, Executive Vice-President and Chief Economist of Northern Trust, a US\$1 trillion fund manager, and former Head of Risk at the Federal Reserve, speaking on geopolitics and the global macro-economy.

● **Paul Newfield**, Chief Investment Officer, H.R.L. Morrison & Co, outlining major investment themes.

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### Capital Markets 2017

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CAPITAL MARKETS

# No end in sight for golden run of shares

Political turmoil and voter unrest has failed to deter equity markets around the world, writes **Liam Dann**

**G**lobal sharemarkets continue to defy gravity. In fact one suspects they've become immune to it.

United States political scandal, nuclear stand-off with North Korea, far-right politicians in Europe – it can all get very grave indeed.

But nothing seems to faze investors. The great post-Global Financial Crisis bull run charges on. It turned eight years old in March.

This begs the question: Have investors learned to cope with political uncertainty? Or have we perhaps always over-played political risk?

The answer is probably a bit of both. Uncertainty can affect sentiment, particularly in the short term.

Markets with the quickest trigger – like currencies – clearly move sharply on political news. You've only got to watch an intraday currency chart on an election day.

But equity markets are less reactive. And as we have seen illustrated through the big political shocks of the past year – Brexit and United States elections – they seldom stay down for long. History shows they slump and recover quickly around political events. And the big crashes of history – 1929, 1987 and 2008 – were sparked by more seemingly random events.

Warren Buffett, a Democrat and a big Hillary Clinton supporter, made the point a year ago.

When asked at the Berkshire Hathaway annual meeting about the risks of a Donald Trump presidency,



Host Liam Dann takes the Economy Hub to the pub.

he shocked some of his politically like-minded supporters by saying he thought his investments would do just fine under either candidate.

He made the point again this month after his latest annual meeting when asked about the Trump influence.

"It's the most important job in the world but it's still over-emphasised in its relevance to stock market fluctuation or even business prosperity."

So, perhaps smart investors have always seen this. But inevitably each new Trump-related outrage brings diminishing degrees of market angst.

Around the recent French elections we saw the market pull back

cautiously in advance.

Institutional investors braced themselves and hedged. When Macron won, markets surged.

There's no doubt a Marine Le Pen victory would have had enormous ramifications for Europe. A Frexit would have cast a shadow over what is actually a slow but steady economic recovery story. But still business and consumers would have carried on with daily life. This perhaps is the big lesson for investors in the shadow of Trump and Brexit.

Headlines may be shocking, people may be unsettled and upset, but the world does not stop.

Strong businesses will retain a core optimism and seek new opportunity

in a changing environment – even as they seek to minimise risk.

So what next? Well, in New Zealand we face our own madcap year of political posturing and potential instability.

The NZX has followed Wall Street on a golden run since 2009. We got ahead of ourselves last year and the market has taken longer than United States to climb back from the Trump slump. But growth has been solid so far this year.

Could a wild card election result end the run? History suggests that the answer is most likely no.

The ruling National Party still holds the box seat, although some polls now suggest it could be close run if opposition parties can stitch together a workable coalition.

Regardless, the prospect of a change in government after three terms is hardly unprecedented. The Kiwi system does throw a bit more chaos into the mix.

MMP means a candidate with a relatively small base of 10 per cent can hold the balance of power. Parties in that space tend to offer up some pretty loopy and economically worrying policies.

But history also suggests that when they do go into coalition the price exacted is typically specific social policies with either National or Labour retaining control of the broader economic direction.

Politics all over the world will continue to be at its most influential when it drives monetary policy.

In the United States the Federal Reserve has looked through fears that

Trump might derail the economy – and the prospect he might supercharge it with tax cuts and spending – to hold a remarkably steady course.

But even with two more hikes scheduled this year, the shift back to more normal interest rate levels remains too slow and too distant to attract investors back to cash deposits in a hurry. Equities have stayed strong.

In New Zealand the OCR looks set to remain on hold for at least a year. Rates are creeping up as banks fight for retail deposits but again there seems to be little pressure bearing down on capital markets. Bad politics could derail the economy but would put downward pressure on rates.

Traditionally the arrival of a Labour Government might herald greater spending and a higher rate track. But this year, in partnership with Greens, Labour has committed to a fiscal responsible set of Budget Responsibility Rules.

So budget surpluses and paying down debt will remain base policies regardless of the outcome in September.

Of course the next crash could always be just around the corner.

After eight years of equity market growth, it seems like common sense to assume we are nearer the end than the beginning of the bull run.

But fears that it would be political turmoil and voter unrest that killed the bull run seem to have been unfounded.

● Liam Dann is the NZ Herald's business editor at large

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## CAPITAL MARKETS

# Buyers are becoming more discerning

**D**espite the strength of corporate balance sheets and the amount of cash washing around, the deal flow so far this year has been slow.

To give you some flavour, 2015 saw a huge number of assets moved, with key deals including Aspire2, Manuka Health, ACG Education, NZ Pharmaceuticals, Macpac, Yealands and Vector's gas transmission asset sale. Interestingly, many of these involved Australian private equity firms.

Last year saw lower deal volumes and transactions reflecting more strategic (as opposed to financial) drivers. Key deals included Solid Energy's asset sales, Nuplex, the proposed Sky/Vodafone and Fairfax NZ/NZME mergers, the sale of UDC and Sistema, and ACC and NZ Super's investment in Kiwibank. Private equity led acquisitions were limited with the most obvious being CHAMP's acquisition of Strait Shipping. There were three IPOs – Tegel, NZ King Salmon and Investore.

And yet, contrary to expectations, 2017 has been slow. The Tower takeover is in-play and reflects another opportunity for the Commerce Commission to flex its muscle. Other key deals have been Todd's sale of Nova Energy, the Oceania IPO, and the proposed sale of Mainland Poultry.

There are a bunch of other decent sized deals in the pipeline but these are taking a long time to come to market.

Market conditions certainly remain conducive for deal activity – we have strong GDP, low interest rates, high employment, and immigration, leaving our companies with strong balance sheets and well poised to make acquisitions.

Additionally, there is a lot of equity capital available – with many of the Australian and New Zealand private equity funds having capital raised in recent years (New Zealand funds alone raised over \$800m in 2016), and quasi-governmental investors (such as ACC and NZ Super) are pursuing opportunities.

In contrast, debt capital is harder to find. The banks are being more selective with their lending. They now have greater capital adequacy pressure as Basel III has pushed them toward long term retail deposits rather than shorter term wholesale funding.

Arguably this year's deal shortfall suggests that the fundamentals and sensitivities underpinning 2016 deal flow will apply again in 2017. They key sensitivity is not to over-pay.

Price inflation seen in the public and private capital markets over recent years has starkly increased this risk. In the last five years, the NZX50 has doubled with private deal values following suit. Low interest rates have kept the weighted average cost of capital down and pushed valuations up. These values are also propped up by demand driven from available capital.

Given these factors, asset quality has become critical with buyers becoming increasingly sensitive to protecting returns and looking for growth.

Also underpinning this sensitivity is a concern that New Zealand economic growth has been partly fuelled by unsustainable migration numbers and the slowing Christchurch rebuild.

Fortunately, international political uncertainties seem to have abated to an extent since Brexit and Trump have bedded in and the French election has left Europe-watchers with greater predictability.

The concern not to over-pay has resulted in a more discerning lens being applied by buyers and institutional investors in both the private and public capital markets.

A high percentage of recent deal volume seems to therefore reflect strategic imperatives and is supported by the synergies that naturally flow to trade buyers.

In the public capital markets, this sensitivity seems to be reflected in the limited number of initial public



There are a bunch of decent sized deals in the pipeline but they are taking a long time to come to market, writes **Michael Pollard**



**Brendan Lindsay sold Sistema for \$660 million..**

## Looking forward – key trends for 2017

**Global economic events – potential volatility:** 2017 promises turbulent times for the world's economies. This should support NZ's reputation as a safe haven

**Private Equity – ready to shop:** Private Equity continues to be seen as a safe pair of hands in troubled times

**A rebalancing of public assets:** Expect a growing willingness on the part of local authorities to dispose of non-core infrastructure assets

**Initial Public Offerings flat:** We expect to see very few companies come to market this year

**Continued innovation in capital raising:** For those companies already listed, we expect greater flexibility in the options available to raise money

**Regulatory development:** In its prolonged investigations of the Z/Chevron, Sky/Vodafone and NZME/Fairfax tie-ups, we have seen the Commerce Commission display renewed zeal.

“An interesting development has been the re-emergence of court-approved schemes of arrangement as an alternative to the classic takeover.

offerings. We have seen only one IPO this year – Oceania, another aged care asset.

The presence of so many aged care businesses, property companies, electricity companies and utilities reinforces the view that our market is largely defensive and yield focused.

It hasn't helped investor confidence that six of the eight technology stocks listed since 2013 are trading below their listing price. Only Vista and Gentrack have delivered.

We now seem to be in a world where three to four IPOs annually is the norm. The years 2013 and 2014 were anomalies with seven and 12 IPOs respectively, and the Crown deserves credit for kickstarting the capital markets with the Mixed Ownership Model process.

We should be concerned, however, with these numbers, given at least nine listed companies have been the subject of takeovers since the beginning

of 2016 – most were successful.

On the subject of takeovers, the most interesting development has been the re-emergence of court-approved schemes of arrangement as an alternative to the classic takeover. Schemes were used in the case of both Nuplex and Tower.

Schemes have been out of favour for years (branded a “sneaky loophole” for takeovers). A new regime with Takeovers Panel support is likely to see them become the preferred structure for public mergers and acquisitions.

On the secondary front, 2017 has seen only one material capital raise, which was Heartland's \$20 million share purchase plan. NPT proposed a large capital raise to part finance its deal with Kiwi Property but this was blocked by Augusta and Salt. It will be worthwhile watching NPT given Augusta's actions and previous bids for NPT.

## Mergers and Acquisitions

2016 saw some significant transactions characterised by strategic deals and some general inertia after a wave of deals in 2015

### Solid Energy

### Kiwibank

### Silver Fern Farms

**NZME/Fairfax** (rejected by Commerce Commission)

**Sky/Vodafone** (rejected by Commerce Commission)

### UDC

### Sistema

### Bell

### NZOG

### Nova Energy

## Capital Markets

While the IPO market remained quiet, the year saw the broad adoption of the AREO through deals such as Restaurant Brands, Sky City and Synlait

### IPOs

Tegel

Investore

Property Managers Group

Oceania Healthcare

NZ King Salmon

### Secondary Capital Raisings (rights offers)

Restaurant Brands

Ike

Synlait

Heartland Bank

SkyCity

Arvida Group

GeoOp

CBL Insurance

Vital Healthcare Property Trust

Sea Dragon

### Block Trades

NZME

Vista

Metro

Xero

Trilogy

Z Energy

Metlifecare

Synlait

An interesting trend in the last couple of years has been the adoption of the accelerated rights entitlement offer (AREO) structure from Australia (used by Sky City, Synlait and Restaurant Brands). Rather than a standard rights issue – which sees all investors having an extended offer period where they consider whether to take up or trade their rights – the AREO requires institutional investors to invest up front, but allows retail investors the normal consideration period.

AREO typically reduces underwriting exposure and therefore costs, reduces the price discount compared with traditional rights issues (given reduced risk for institutional investors), and accelerates receipt of the offer proceeds for the issuer.

Trend predictions are always difficult. Appropriately priced quality assets will get sold given the fundamentals. Since the markets are looking for growth and the digital disruption phenomena, tech deals will undoubtedly still contribute to future deal flow despite the failures of recent years. Tech is obviously an international commodity.

Equally, we are expecting to see further recycling of public assets. The Mixed Ownership Model was the catalyst to deeper equity capital markets only a few years ago.

Substantial public assets still remain in the hands of central and local governments without adequate public policy and commercial justification. Whether these assets find a home on the NZX remains unknown.

● *Michael Pollard is head of the corporate and commercial department at Simpson Grierson*





# “Call to action” to back Auckland

**P**art of Auckland's long-term infrastructure deficit has been a lack of leadership and the conditioning of Aucklanders that “someone else will pay” for the fix.

I agree funding is at the heart of the problem. In transport and water infrastructure alone the immediate shortfall is in the range of \$10 billion.

The funding is there. New Zealand and the world are awash with private sector money looking for the opportunity to invest.

The solution depends on how smart we can be to capture some of this money to meet the demand for today and build for tomorrow.

For “game-changer” solutions we need look no further than what deficit-stretched governments and cities around the world are increasingly doing to unlock new investment from the private sector to fund major infrastructure projects that wouldn't otherwise get built.

There are many models and examples we could use. Here are three from transport:

- In Hong Kong, the mass transit system is financed by revenue from property development along corridors. Every train station has a private invested multi-tower complex on top from which substantial revenue is generated through rents and other tools.

- In London, a Special Purpose Vehicle (SPV) Crossrail company is investing \$28b to build 10 new stations, and around 118km of rail line, including 42km of tunnels through central London. Crossrail has a 50:50 shared governance sponsored by the mayor of London and the UK's Secretary of State, will increase London's rail capacity by 10 per cent and be operating in 2019. The consortium delivering Crossrail comprises three world class industry leaders, includ-

Capital markets have a key role to help unlock Auckland's infrastructure investment logjam, says **Michael Barnett**

“An Auckland SPV approach will only succeed if Wellington-Auckland differences can be put aside.

ing Aecom, a firm operating in Auckland. Crossrail includes a station (at Woolwich) proposed and financed by a private developer, and which has commercial activity at the station site complementing the project's public transport and amenity objectives.

- In Denver, Colorado, an SPV has been formed to build a large station using borrowing from central government loan programmes and the private sector.

Common to these examples is the setting up of a special purpose company or SPV embracing all the partners and setting out risks, benefits, funding and most important, detailing where the revenue to ultimately pay for the project will come from. This can take many forms, but increasingly around the world a tool known as “value capture” is used.

For each project or package of projects, an SPV is established to support the leveraging of value capture revenues, especially from property value uplift. This is the main revenue source for all three examples.

In Crossrail “value capture” revenue mechanisms include a business rate, development revenue on “new” ventures attracted by the project's benefits, sale of surplus land and

property and a bundle of “voluntary” contributions from Heathrow Airport, Canary Wharf Group and other developers.

Innovative thinking and receptiveness to consider new ideas are at the heart of “value capture” models. The SPV governance gives all parties critical certainty and accountability of who gets the benefits and how to secure this.

Could an SPV model work for Auckland?

Drawing especially on the Crossrail model, options to form an SPV and use value capture and other tools to generate revenue to pay for the critically-needed accelerated momentum in Auckland's delivery of major infrastructure are being explored.

The idea was signalled some time ago by Government ministers keen for Auckland to suggest a more innovative approach to funding key infrastructure.

But an Auckland SPV approach will only succeed if Wellington-Auckland differences can be put aside. Aucklanders must get beyond thinking that someone else will pay for solving the city's worsening infrastructure problems.

The way New Zealand's local gov-



ernment is structured, Auckland-only ideas such as regional fuel tax, return of GST and/or other tax revenue from Wellington, or giving local government greater control are not going to happen in New Zealand. They are ideas that we can't wait around another five years for a future government to reform local government to make them workable. Central government needs to do more to understand and respond to the critical imperative of Auckland's day-to-day transport impacts on every aspect of city life, including social issues.

But if promoted right an Auckland SPV or multiple SPVs could be a way

for the whole city to get long-term certainty and uplift in the pace of delivery of major infrastructure.

How could an SPV be structured? What “ready to go” projects would it capture? What opportunities will the private sector have? And will other critical supporting clearing steps such as a faster consenting process and overcoming our skills shortages be part of the action?

We await details, possibly in or around the upcoming Budget.

But if reducing traffic congestion and encouraging increased use of public transport is a shared urgent goal of both council and government, an obvious initial Auckland-wide SPV package could comprise the northwest busway in the west, Mill Road in the south, Penlink in the north and private sector-led park-and-ride station upgrades across the city. All have been talked about and sat on plans for years.

At stake isn't just identifying new revenue sources in which Aucklanders can see what the dividend will be in terms of people and goods being able to move around Auckland more easily and with less cost. It's about the success of New Zealand.

These ideas should also not be seen as the end of the “new funding” fix Auckland story. Across the infrastructure board, Auckland has around \$40b of projects with no clear funding path.

We critically need the finance sector to put forward what further new financing mechanisms other cities and government with big infrastructure deficits are increasingly calling on for solutions. Sharing that information might seed new concepts that will help Auckland.

● Michael Barnett is chief executive of the Auckland Chamber of Commerce and chairman of the Auckland Business Forum.



## CAPITAL MARKETS

# Agri-sector is in strong demand

**G**lobally, the mergers and acquisitions (M&A) market remains buoyant and deal terms suggest that it's a good time to be a seller, says global business law firm DLA Piper.

DLA Piper, with more than 4200 lawyers based across Europe, the Americas, Middle East, Africa and Asia-Pacific, produces a unique annual *Global M&A Intelligence* report providing insight into the regional differences in elements of M&A transactions. The latest one, surveying 1000 people, will be published late next month.

The 2016 report, based on data from about 500 M&A deals in Europe, North America and Australia, said though there has been some softening in the market year on year, there is strong competition for good assets, and sellers are generally able to negotiate exits which leave them with limited residual risk.

New Zealand is sharing a slice of this action. The domestic M&A market is presently seller-friendly, with hot competition for solid businesses and other assets, particularly in the agri-sector.

The intelligence report noted that auction processes drive better deal terms for sellers, who are more likely to get a fixed price or locked box deal, a shorter claim period and a lower cap on their liability.

The use of insurance on M&A deals was increasing and it's a global trend – but deal size and the types of buyer and seller still played a big part.

Rachel Taylor, a DLA Piper corporate partner based in Wellington, highlighted four M&A trends that have flowed into the New Zealand market:

- Private equity investment is strong globally and we are seeing an increase in this activity in New Zealand. Sellers get better deal terms when

Sellers are getting better deals from private equity investors, writes **Graham Skellern**



**Rachel Taylor**

private equity is involved. They want to get things done and the closing time between a conditional agreement and selling is as narrow as possible.

- We are seeing more warranty and indemnity insurance in sale and purchase transactions – the buyer insures against warrant and indemnity risk and generally there is no recourse to the seller. The seller is then able to have a clean exit.

- There are fewer takeover offers, and scheme of arrangements through



**Martin Thomson**

the High Court are becoming more common as an alternative. In a scheme of arrangement the board of the target company is more actively negotiating the terms, the board can make a recommendation to the shareholders, and the deal can work more effectively.

It goes back to certainty. Once the board of the target company has agreed to the terms and an appraisal report has been commissioned, the buyer is fairly confident of getting High

Court approval. In the case of listed companies, a scheme of arrangement requires a 'no objection' letter from the Takeovers Panel before it can be sanctioned by the High Court.

- There is a strong flow of Chinese investment into New Zealand despite changes to capital controls in China. A lot of Chinese money is routed through Hong Kong and the Cayman Islands and the true investment is more than the Department of Statistics publishes. (The 2017 M&A Intelligence report will include data and analysis from Asian deals).

Martin Thomson, a DLA Piper corporate partner based in Auckland, says Chinese investment in agri and food businesses is significant. "China has an increasingly affluent population and we produce high-quality food products. There is a lot of opportunity in that market."

"Chinese investment is focused on sourcing quality food products and other primary produce and securing supply back to China."

He says progress has been made on the consenting process involving the Overseas Investment Office (OIO).

"The Shanghai Mailing application (to buy 50 per cent of the shares in Silver Fern Farms) was too long – almost a year."

"It is getting more efficient. Clients expect the process for sensitive land to take three to six months depending on the complexity of the deal – and closer to three months should be the norm."

In competitive sales processes involving large deals requiring OIO consent, sellers are making efforts to speed up the consenting process. Thomson says that, as part of the deal process,

the seller will produce an OIO application form.

"The seller is saying to the buyer 'here's a draft application and we've populated it with everything we can say. Now you undertake to meet a deadline and populate your information'."

"The sale and purchase agreement is signed subject to the OIO consent condition."

"The buyer is required to consult with the seller in respect of communications with the OIO and is bound to accept some reasonable consent conditions (often a material adverse change clause is excluded) – that is quite a change reflecting the increased rigour of the OIO process," Thomson says.

Thomson says there's increased interest from private equity players particularly from Australia because of the strength of the New Zealand economy. "Banks have tightened up on the availability of debt funding and we are likely to see more equity funded deals rather than leverage transactions."

He says there's a wall of baby boomers who have spent their lives building substantial businesses and they have reached the age where they want to wholly or partially sell. "Private equity players are in a position to buy a bunch of these businesses, roll them up and look to complete an initial public offering (IPO)."

DLA Piper applies its global experience in M&A deals to guide New Zealand clients through every stage of a deal – from due diligence and structuring to negotiation and preparation of deal documents, obtaining OIO consent and finally transaction completion and post-merger integration.

“ There are fewer takeover offers and schemes of arrangement through the High Court are becoming more common as an alternative.

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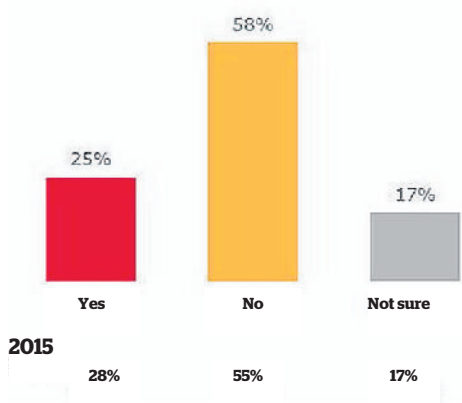
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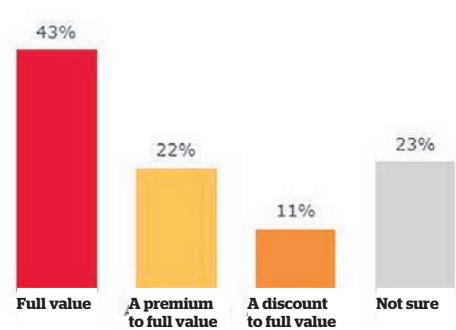
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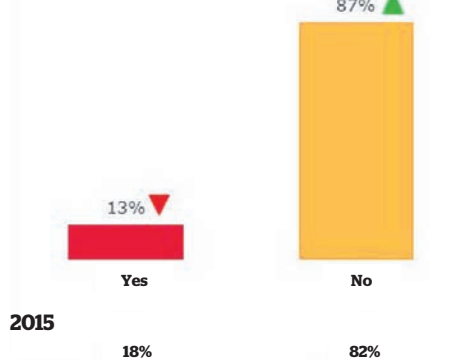
**CAPITAL MARKETS**



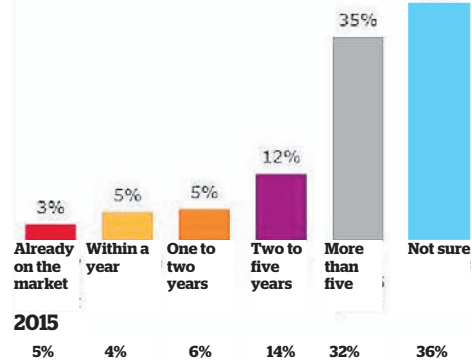
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When do you think you might sell your business?

# Get ready for baby boomer sell-off

**N**ew Zealand is gearing up for a “succession wave” as the baby boomer generation looks to retire and hand over the reins of the businesses they have built up over the last 20 or 30 years.

Indeed, over the next decade, we will see one of the largest changes of business ownership in New Zealand’s history as thousands of businesses are put up for sale.

A survey of ASB’s own customer base suggests around one in four ASB customers who are business owners are considering retiring and transitioning out over the next five years.

Combined with strong domestic growth, this “succession wave” is creating a recipe for heightened activity in New Zealand capital markets and will be a key driver for merger and acquisition (M&A) volume.

Although this creates a positive outlook for the New Zealand capital markets, the increase in M&A activity is creating a healthy tension between the public and private equity markets as good businesses that would otherwise list on the NZX are being acquired by private equity investors or trade buyers, often at inflated earnings multiples.

Private equity has been a significant contributor to the New Zealand capital market eco-system and is in part solving the need for both growth capital and buying businesses when owners are looking to retire.

Last year some US\$2.5 billion was raised by private equity firms in Australia and New Zealand, with a further US\$566 million raised this year already.

The private equity market generally involves firms that buy stakes in companies, with the objective of transforming them into better businesses and taking them public or selling them to another company to turn a profit.

The private equity firms use various strategies that add value, such as introducing new skills and capability, improving productivity, introducing governance and reporting frameworks, incentivising management and increasing revenue through developing new growth engines.

Cashed-up private equity firms on both sides of the Tasman have been keen to invest into quality assets, which has been driving demand for good businesses as well as company valuations (although not at the same levels just prior to the Global Financial Crisis).

In recent times private equity firms have often been willing to pay a premium over an equivalent NZX listing price.

Blackstone Group’s purchase of five retirement villages in New Zealand from Lendlease Group is a good example, as is Pacific Equity Partners’ acquisition of Academic Colleges



A positive outlook for New Zealand capital markets is creating tension between the public and private markets, writes **Henry Withers**.



“Over the next decade, New Zealand will see the single largest change in business ownership in its history as the baby boomer generation transitions into retirement.

Group. Both businesses would have received strong support from institutional investors and retail shareholders, but were out-bid by private equity.

This increase in appetite from offshore investors has led the Overseas

Investment Office (OIO) to boost its resourcing. Statistics indicate applications are taking an average of 97 days to be processed from the date they are accepted.

Although this is a significant decrease on previous years, there is still

room for improvement.

A lot of money has been made out of private equity investing, but, as with any investment, there are risks. The demise of Dick Smith in Australia (and to a lesser extent in New Zealand) has tarnished the perception of private equity of late.

Although we are unlikely to see the same level of Initial Public Offerings (IPOs) that were experienced in 2013 and 2014, New Zealand’s public market is still an attractive option for many larger businesses and we anticipate strong secondary capital raising activity to be maintained.

Price earnings ratios are strong, and at 7378.4 (at the time of writing), the NZX50 is steadily climbing back to its high of 7571.1 recorded on September 7 last year, reflecting a

reasonably strong corporate reporting season, strong economic growth and low interest rates.

Those businesses with strong earnings histories and are scalable have performed well on the NZX, and quality New Zealand businesses with a strong domestic footprint and are scalable overseas are being strongly supported.

With an enterprise value of \$585 million, an EBITDA multiple of 13 times and price-earnings ratio of 19 times, Oceania Healthcare is a good example of this. New Zealand’s third-largest residential aged care provider and sixth largest retirement village operator, successfully raised \$200 million in an IPO and dual-listed on the New Zealand and Australian stock exchanges on May 5.

It’s important to note that listing on the NZX does come with added expenses, greater regulatory oversight and enhanced reporting requirements, which doesn’t suit some businesses.

The third exit option which many business owners consider is selling to a competitor or trade buyer. The successful sale of Sistema for \$660m after 34 years to United States-based Newell Brands is an example of the wealth and prosperity being created by many successful privately-owned businesses.

Often trade buyers are willing to pay a premium due to the synergy benefits that can be achieved or global growth potential of New Zealand brands, products or services.

The beneficiary of higher valuations and competitive tension between listing on the NZX, private equity or selling to a trade buyer is the business owner.

Ultimately this also has a multiplier across the economy as the sale proceeds get reinvested in wealth products and spent.

ASB has supported many clients in managing the risks involved in selling their business and also assisted them in developing an inter-generational wealth management strategy with the sale proceeds. Getting good advice from a trusted advisor is critical.

Over the next decade, New Zealand will see the single largest change in business ownership in its history as the baby boomer generation transitions into retirement.

ASB is focused on supporting both companies and business owners to achieve their ambitions, and has established a specialist Capital Solutions team to connect people, ideas and capital to help ensure business owners maximise the value and ensure a successful transition.

Companies that have clear strategies and can demonstrate a strong competitive advantage and sustainable earnings growth will be the most sought-after by investors and trade buyers.

● *Henry Withers is ASB’s General Manager Corporate Banking*



## CAPITAL MARKETS

# Sharemarket continues

NZX in a healthy state but is also looking at ways to improve its services to customers, writes **Mark Peterson**

**T**he combined equity and debt market capitalisation of companies listed on the NZX has doubled over the past 10 years, recently peaking at more than \$150 billion.

This signifies that the growth track of New Zealand's capital markets is strong, and our market continues to perform well relative to international peers. Our listed companies have delivered healthy dividends and share price increases, and as such local investors have received strong returns.

The continued strength of New Zealand's economy, relative to other countries, and the introduction of the Financial Markets Conduct Act (FMCA), which has made it easier for listed companies to raise capital, are positive features of our capital markets.

This has had a particularly significant impact on NZX's debt market, which has doubled in size over the past 18 months. The global popularity of NZX's dairy derivatives market has also been a recent highlight, reinforcing its long-term growth potential.

#### Trends in NZ's equity market

Since 2006, total equity market capitalisation has grown from \$65b to more than \$126b, a compound annual growth rate of 6.6 per cent. Over the same period the average daily value of equity transactions increased by 23 per cent to more than \$175 million.

The last three years have seen an acceleration of this growth, with increases in total market capitalisation of 10 per cent and daily value traded of 11 per cent respectively per annum.

Progress made in New Zealand to create stronger and deeper capital markets is graphically illustrated by the increase in the ratio of equity market capitalisation to Gross Domestic Product, which peaked at 50.1 per cent in July 2016 (see chart on opposite page). This is a significant milestone given the ratio was as low as 25 per cent in February 2009 and by mid-2012 had still only risen to 27.6 per cent.

In addition, our benchmark index, the S&P/NZX 50 Gross Index, reached a new milestone of 7571 points on September 7, 2016. To give that context, the index was at 2715 at the end of 2008 following the Global Financial Crisis (GFC) and had only returned to pre-GFC levels of around 4000 by the end of 2012.

The subsequent five years have delivered exceptional returns, both in absolute terms and relative to international markets.

Bloomberg numbers show the five-year return of the S&P/NZX 50 index



to the end of 2016 was 110.1 per cent, which equates to a compound annual growth rate over the same period of 16 per cent a year.

That's a very healthy performance compared with major international market indices, including the Australian S&P/ASX 200 Accumulation Index (annualised return of 6.7 per cent over the same five-year period), the UK FTSE 100 Total Return Index (6.7 per cent), and the USA S&P 500 Total Return Index (17.4 per cent).

The S&P/NZX 50 has continued to outperform international markets in recent times, with the index solidly in positive territory – up 8.8 per cent for the year to December 31, 2016.

The first quarter of 2017 saw this trend continue – with the index up 6.6 per cent year to date (see comparison on opposite page).

#### NZX's appetite for debt

The recent appetite for New Zealand's debt market has been a key feature of market health, with growth driven by the listing of corporate bonds, and structured and hybrid debt securities.

Total debt market capitalisation



NZX is now home to the fastest-growing derivatives market for global dairy ingredients.

has grown from \$7b in 2006 to more than \$25b in 2016, a compound annual growth rate of 13 per cent.

The total number of listed debt securities increased by 20.9 per cent in the first quarter of 2017, and follows 20.2 per cent growth in 2016. This emphasises that the NZDX continues to meet the needs of the market extremely well, while highlighting its attractiveness and accessibility as a capital raising option following the implementation of the FMCA.

#### Dairy derivatives development

In 2010, NZX launched a range of futures and options dedicated to exported dairy ingredients, and more recently New Zealand dollar liquid milk contracts.

NZX is now home to the fastest growing derivatives market for global

dairy ingredients (see graphic opposite).

Last month, overall volume on NZX's dairy derivatives market climbed 268 per cent on the previous corresponding period, and reached a new record for open interest of over 50,000 contracts.

That comes on the back of new highs reached a month earlier when the market experienced its busiest ever first quarter in futures, with total volume traded up 130 per cent on the corresponding period.

The success of this market reflects New Zealand's importance in the global dairy supply chain. Not only does it create new global opportunities, but with the launch of liquid milk contracts it also provides local dairy farmers with the opportunity to better manage their risk, which has a

direct effect on the health of New Zealand's economy.

#### Creating a holistic picture

The trends stated above capture the development and strength of New Zealand's capital markets, while reinforcing NZX's view that it is important to view market health in the context of long term trends across asset classes, not short term selected statistics to suit news cycles.

These statistics help to create a holistic picture of the critical role stock exchanges play in funding growth for listed companies, which in turn creates jobs for the economy and wealth for investors.

This also fuels the growth of investment funds, which are critical to supporting the future superannuation needs of all New Zealanders.

Though global and local economic cycles have provided a tail wind for our markets over recent years, co-ordinated market development efforts have played a crucial role in allowing them to flourish.

One of the tangible outputs of this was the development of the FMCA. The Government's share offer programme was also a significant contributor. Both initiatives came out of the Capital Markets Development Task Force, which developed a series of recommendations to broaden and deepen our markets ecosystem and benefit the New Zealand economy.

The impact of the Task Force's initiatives are still highly visible today. Their efforts have added to the quality of investment options and products available on our markets, improved liquidity, and most importantly encouraged more people to invest.

#### Market engagement

As a licensed market operator, NZX serves at the centre of New Zealand's capital markets. The team at NZX have a responsibility to proactively engage with the market to address the needs of our customers, who include investors, companies, market participants, and other industry participants. Educating companies about the benefits of listing is also a key focus for NZX in 2017.

Last week we published an updated NZX Corporate Governance Code, which represents a significant step forward for New Zealand's corporate governance reporting requirements, with the recommendations reflecting internationally accepted practices. The Code brings together the industry's views to establish a framework around

continued on D9

## Head of Listings

NZX sits at the heart of New Zealand's financial markets, building and operating capital, risk and commodity markets and the infrastructure required to support them. Our aim is to make a meaningful difference to wealth creation for our shareholders and the individuals, businesses and economies in which we operate. We support this by providing high-quality information, data and tools to further enhance business decision making.

Following a year of repositioning, we are now focussed on developing and expanding our offering within the listed product arena across New Zealand and Australian issuers. Our vision is to create an even more vibrant, listed market, that expands as the market evolves.

To achieve this, we are recruiting a Head of Listing to support the growth of the NZX markets. In this role, you will report to the CEO and your responsibilities will include:

- Developing commercial relationships with both existing and prospective clients across equity, fixed income and fund markets
- Growing the issuer population of the NZX Market
- Creating awareness of NZX added value products and services within New Zealand and offshore

You will be recognised for your network of senior stakeholder relationships and strong understanding of listed markets including equity, debt and funds. Of course, you will be a proven leader, that operates with the upmost integrity, who has a track record of executing on sales and marketing strategies. Operating in an open, transparent, team environment that supports creative approaches to maximising opportunities and overcoming challenges will be a strong motivator for you.



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For a confidential conversation regarding this role,  
please contact Clayton Badland or Rebecca Jamieson  
from Korn Ferry Futurestep on (09) 309 4900.





## CAPITAL MARKETS

# its strong performance

continued from D8

corporate governance practices that is intended to better protect the interests of and provide long term value to shareholders, while seeking to reduce the cost of capital for issuers. Its overall aim is to increase confidence and drive greater market participation.

We will soon deliver the outcome of a review of our Participant Rules, which seeks to strike an appropriate balance between enhancing NZX's supervision and surveillance capabilities, and managing the compliance burdens for participants.

Market engagement in both reviews exceeded expectations, reflecting the industry's commitment to and need for effective regulatory infrastructure, and NZX's key leadership role in the markets.

NZX will this year begin the first substantial review of its listing rules since 2003, which will build upon this engagement. Effective listing rules are core to promoting integrity and participation in our markets.

The review will consider the current settings for smaller listed companies and assess our market structure to determine how we might list a wider range of financial products.

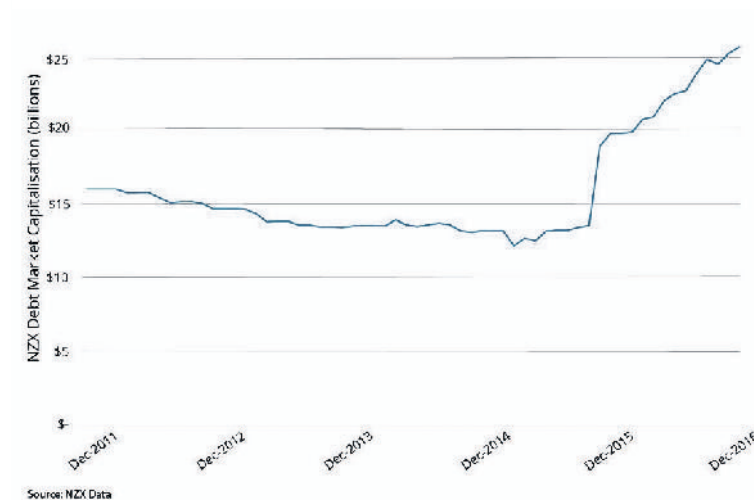
NZX is committed to creating a collaborative culture at the core of our markets ecosystem, because we understand our market's success depends on a range of stakeholders, and the architecture of our capital markets must meet the needs of all our customers.

● Mark Peterson is chief executive, NZX

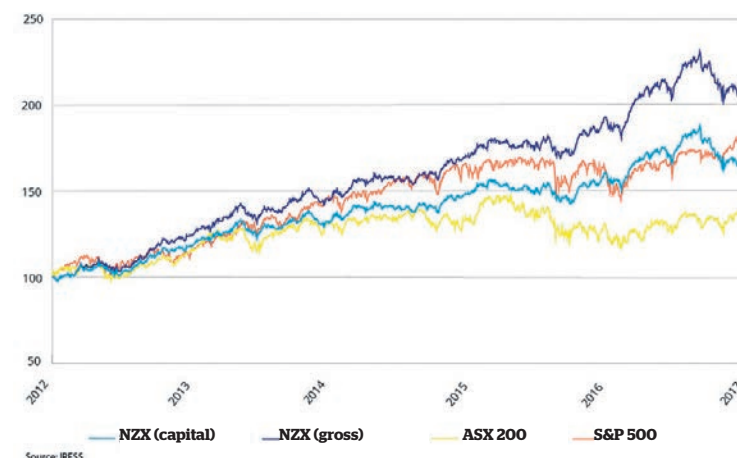
## NZX Trading Values - on and off market



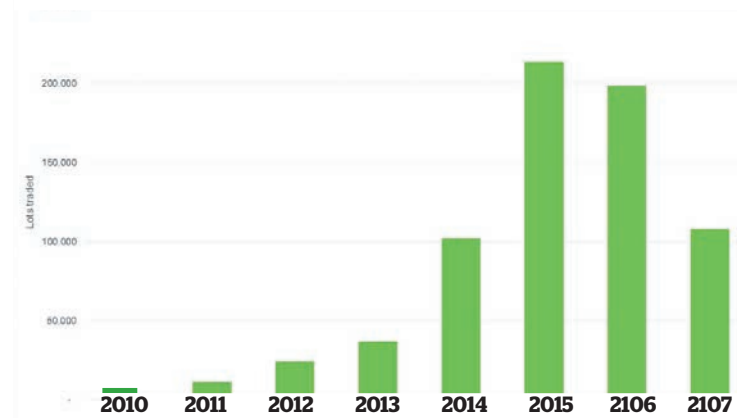
## NZ Debt Market Capitalisation



## S&P/NZX 50 Performance compared to S&P ASX/200 and S&P 500 indices



## Dairy Derivatives - trading volume since launch



# Revised NZX stance on diverse governance

Some of New Zealand's biggest businesses will now have a comprehensive, measurable diversity policy to follow.

As part of the NZX's new Corporate Governance Code, NZX-listed companies are recommended to make their diversity policy and objectives public, and explain their attitudes and goals to achieving better diversity in the workplace.

These goals should be measurable and progress tracked. This includes reporting on the number of men and women on the board, at senior management level, and across the entire organisation.

If an organisation doesn't have a diversity policy, the new corporate governance code requires them to explain why not.

These changes will lead directly to more listed companies establishing display metrics – including gender, but also hopefully extending to address areas such as equal pay and flexible working arrangements.

Joan Withers, chair of Mighty River Power and The Warehouse, believes these changes will lead directly to more listed companies establishing diversity metrics.

"This includes gender, but also hopefully extending to areas such as equal pay and flexible working arrangements," Withers says.

"Measurable objectives lead to greater diversity; greater diversity leads to better business outcomes – delivering to the bottom line through improved productivity, profitability and performance; better growth, innovation and customer service; and an enviable 'employer of choice' reputational standing."

The revised code aligns to Australia's ASX's diversity policy regime, which has a similar 'if not, why not' requirement.

Since those reporting requirements were introduced in Australia, the number of women on boards increased by 47 per cent (from 15 per cent in 2012 to 22 per cent in 2015),



and the number of women in senior management positions increased by 30 per cent (from 20 per cent in 2012 to 26 per cent in 2015). Now, 99 per cent of ASX200 companies have a diversity policy in place.

A combination of reporting and voluntary target setting saw the number of women on UK's FTSE100 boards increase by 52 per cent over four years (from 12.5 per cent in 2011 to 26 per cent in 2015).

The changes are not a quota and won't force companies to have a specific number of women on boards.

Withers, who is also vice-chair of Global Women, is against the concept of quotas because she thinks they are demeaning.

"All of the women that I work with around the board table are there because of their all-round directorial competence. They can hack it with any of the male directors that are sitting around those same tables."

"The changes are saying that we need to be utilising – as a nation – the whole talent pool that we have got."

Withers notes she has never been in a position where a board she is sitting on hasn't been able to find skilled women across all areas.

Hamish Macdonald, General Counsel and Head of Policy at the NZX, says that the NZX Code sets out a series of recommendations, such as diversity, that listed companies are recommended to follow.

"Our role as a licensed market operator is to act as a standard setter but it is up to companies and the industry as a whole to progress change," he says.

"Naturally, the aim of the NZX Code is to improve governance standards, particularly for listed companies which are smaller in size or at an earlier stage of development."

Many of New Zealand's top listed companies will already be meeting the practices outlined in the NZX code.

"We hope the updated NZX Code leads to improved corporate governance, but ultimately it is up to shareholders to decide if they are comfortable with a company's governance practices based on the disclosure triggered by NZX's rules," Macdonald says.

### New rules for CEO transparency

The NZX's Corporate Governance Code, released last week, represents a significant step forward for corporate governance reporting requirements in New Zealand.

The NZX Code has eight parts, covering principles that reflect internationally accepted corporate governance practices intended to protect the interests of and provide long term value to shareholders while also seeking to reduce the cost of capital for issuers.

Principles include ethical behaviour, board composition and performance, board committees, reporting

“All of the women that I work with around the board table are there because of their all-round directorial competence. They can hack it with any of the male directors that are sitting around those same tables.”

Joan Withers, Chair The Warehouse and Mighty River Power

and disclosure, remuneration, risk management, auditors, and shareholder rights and regulations.

Each principle contains specific recommendations and explanatory commentary that NZX-listed issuers are encouraged to adopt. It's been more than 13 years since the NZX Code was reviewed.

The remuneration principle requires the pay of directors and executives to be transparent, fair, and reasonable, and includes the following recommendations:

● An issuer should recommend director remuneration to shareholders for approval in a transparent manner. Actual director remuneration should be clearly disclosed in the issuer's annual report.

● An issuer should have a remuneration policy for directors and officers, which outlines the relative weightings of remuneration components and relevant performance criteria.

● An issuer should disclose the remuneration arrangements in place for the CEO in its annual report. This should include disclosure of the base salary, short term and long term incentives, and the performance criteria used to determine performance-based payments.

Companies that do not comply with the recommendations will have to justify their decision. Currently, companies only have to report on the number of people who earn over

\$100,000 within salary bands of \$10,000 above that threshold – and it is not always the case that the chief executive is the top earner.

Hamish Macdonald, General Counsel and Head of Policy at the NZX, says the code recommendations were designed to drive increased transparency for shareholders.

"Sound corporate governance practices can lead to a lower cost of capital and higher valuations for New Zealand listed companies. The streamlined NZX Code will result in greater transparency for investors and hopefully drive increased confidence in our capital markets."

The NZX Code was subject to extensive market consultation – more than 80 submissions were received throughout the consultation process from major governance groups, issuers, corporate firms and investors in New Zealand and overseas.

"The extensive engagement NZX received as part of this review reflects the industry's desire for strong corporate governance and the key leadership role NZX plays in encouraging these improved practices," Macdonald says.

The updated NZX Code takes effect from October 1, 2017 so it must be reported against for reporting periods ending December 31, 2017 and beyond. The NZX encourages issuers to adopt the recommendations on a voluntary basis earlier if they wish.

– Tim McCready



## CAPITAL MARKETS

# Valuing foreign investment



**F**oreign investment into New Zealand remains a hot topic and a significant amount of today's focus is, rightly enough, on our property market.

However, the importance of foreign direct investment (FDI) on our tradeable sector cannot be ignored. How we attract it, and on what basis, are both issues worthy of debate, as is how to support New Zealand business looking to invest offshore to capture greater economic rents for our capital providers.

Like it or not, we are reliant on offshore capital to fund a domestic savings shortfall. While we have certainly improved, for many years we have made a conscious decision to spend for today rather than invest for tomorrow.

That has played out in a high stock of overseas investment in New Zealand. Out of a total investment into New Zealand of \$397 billion, FDI stands at \$111 billion.

FDI is a vital source of capital for business to help open up new markets, drive greater productivity and provide critical technological innovation. Unless we see a miraculous uplift in national savings, a failure to import foreign capital would see lower investment and growth. Imagine where we would be without the \$111 billion invested to date.

Surprisingly to some, China has not been as dominant in New Zealand as is often made out.

It is responsible for a lot of our export growth after the 2008 Free Trade Agreement. However, the majority of our FDI originates from the United States, Canada, Europe and Australia.

Our FDI is also broad based. Agribusiness, energy and power as well as the financial services sector remain leading areas. So while we have done well to date in attracting \$111 billion of other countries savings to fund our growth, there is plenty more to do.

We are in catch-up mode with infrastructure and the growing list of investment projects to alleviate

New Zealand has significant pools of capital but **Paul Goodwin** wonders whether the capital is going to the right places

bottlenecks associated with a growing population means that our challenge to attract capital remains.

For example, Tourism Industry Aotearoa recently released a report outlining infrastructure gaps that need addressing to support growth. This includes significant investment needed to build more visitor accommodation and capacity of our airports.

A funding gap remains despite our domestic savings performance slowly changing. Domestically we now have significant pools of capital available to help fund our future - whether it be KiwiSaver, Sovereign Wealth, infrastructure funds, or Iwi.

With significant capital pools locally, is it time to challenge our current investment settings? Are the settings right to ensure capital is being funnelled into the right parts of our economy to drive productivity and income growth (not household credit), and at the same time allow New Zealand capital to capture some of the rents associated with productivity improvements?

Part of the challenge of attracting capital is connecting providers of capital with investment opportunities - addressing the supply side of the equation. New Zealand Trade and Enterprise plays a role abroad but rightly has been focused more on trade flows.

Advisors and intermediaries, like ANZ, also have an important role in connecting parties. It is vital that we all take a NZ Inc approach offshore, but also at home, making sure the

value of foreign capital is well understood.

Investors have a choice where to invest so we are lucky to live in a country with a safe and stable political and legal environment, and a relative ease of doing business.

The bigger challenge for investors is identifying businesses or investment opportunities of sufficient scale given our relatively small size. It is great to see Finance Minister Steven Joyce announce \$11 billion of infrastructure investment. However it is estimated only \$1 billion will be investible for the private sector.

To support the supply side challenge, is it time to see the National Infrastructure Unit expanded into a central procurement agency to assist in unlocking the capital markets and ensuring consistency in approach from the public sector - both local and central?

Is there an opportunity for us to learn from models employed by other markets, including Canada and

mains a challenge. Progress is being made but timelines can range from three to six months based on complexity, albeit the OIO targets 50 days for most applications.

There is a balance needed between attracting overseas investors and protecting New Zealand's interests. The feedback we get from our clients is a more timely process would be welcomed.

What is more thought provoking is whether our current investment criteria for foreign capital remain valid. Though New Zealand has liberal foreign investment rules, the OIO has stringent tests.

Purchasers must demonstrate financial commitment, business acumen, be of good character and show investment benefits to New Zealand. At face value that seems fine, but is it really delivering the outcomes we desire judged by today's societal expectations?

With the amount of capital available locally, is there a way to ensure

foreign capital is attracted to drive productivity but in a way that allows domestic capital to participate and enjoy some of the fruits of that additional capital being applied to our productive assets?

Is it time to drive partnership or co-

investment models to require domestic capital to partner alongside foreign capital?

With domestic capital struggling to find the right opportunities to invest in at home, KiwiSaver funds (expected by the NZ Treasury to amount to \$20 billion by 2020) are flowing into passive funds offshore.

Though this is good for New Zealand, in that we gain exposure to a diversified range of economies, the ability to support the tradeable sector at home is adversely impacted.

What sort of structural support can be provided to local funds that face liquidity restrictions to allow investment in local businesses?

The other side of the coin is offshore direct investment relative to the \$111 billion we have attracted from offshore. Our savings record has meant that we have only invested roughly a third of that amount offshore, \$35 billion.

This part of our contribution to global capital flows is too often ignored. This is partly because there are not many great examples of New Zealand companies going offshore and adding value. Frequently it has been a recipe for how to shrink your balance sheet.

As a consequence, our returns on foreign investment have tended to be less than what foreigners get on their New Zealand investments.

If New Zealand offshore direct investment returns had matched those that foreign (direct) investors had seen in New Zealand between 2000 and 2016 we'd be \$29.5 billion richer. That's an eye-watering difference we need to look at addressing, both in relation to inbound and outbound capital.

Access to capital is fundamental to our long term prosperity. It is just as important an imperative as trade flows, but with a longer term impact. We need to attract capital to our productive businesses from both local sources and from offshore, perhaps in a way where both local and foreign providers of capital can benefit from ownership.

At the same time we must find ways to improve our offshore investment returns. As with inward investment, the opportunity around partnering or co-investing to de-risk global markets may be a sensible way to achieve this.

● Paul Goodwin is Managing Director Institutional, ANZ



Is it time to drive partnership or co-investment models to require domestic capital to partner alongside foreign capital?

the United Kingdom, where central procurement teams procure all major public projects engaging with domestic and global partners and suppliers - with outcomes being more private investment, lower cost projects and higher performing solutions?

In relation to FDI, the Overseas Investment Office (OIO) process re-



## CAPITAL MARKETS

# Quality local assets are in demand

**N**ew Zealand's capital markets are in a buoyant and positive state reflecting the strength of New Zealand's economy.

Local and offshore buyers are on the hunt for quality New Zealand assets especially those with a potential growth angle into Asia. New Zealand businesses are also looking at opportunities to expand domestically and offshore via acquisition.

In some industries, such as media and telecommunications, a rapidly evolving environment is forcing parties to adapt, including via acquisitions and divestments. All buyers currently have confidence about their ability to finance strategic acquisitions.

Indeed it is a pretty good time to be a vendor of a quality New Zealand asset.

Private equity funds throughout the world (both here in New Zealand, Australia, Asia, Europe and the United States) currently have lots of cash to invest and are needing to "pay up" to acquire desirable assets. Multiples being paid on deals are, in some cases, back to pre-Global Financial Crisis heights.

New Zealand has long been a hunting ground by foreigners (whether private equity or other foreign investors) for assets to acquire. New Zealand assets and businesses – particularly those in our agri and food sector – are seen as particularly attractive right now.

New Zealand is seen internationally as clean and green – our distance from market is in many cases a positive – and food and food-related products here are seen as coming from a pure place far



Despite global uncertainty our capital markets are in a healthy state, write  
**Cathy Quinn and Silvana Schenone**

away from polluters. With a growing emphasis by many consumers on knowing the source of products and on sustainability, products produced in New Zealand can demand a price premium.

Consumers around the world but particularly in Asia are very focused on food safety.

The current multiples vendors can achieve in private treaty sale processes are probably a factor in some New Zealand businesses opting for this method to realise their investment, rather than listing on the NZX.

For example, we do act for and know a number of owners of quality New Zealand businesses who

simply do not want the publicity and regulation associated with an NZX listing.

There have been a paucity of new listings on NZX so far this year.

Another dynamic in the market in 2017 is the Commerce Commission's recent decision to decline the Sky/Vodafone and the Fairfax/NZME deals. Those contemplating mergers are clearly on notice that the Commerce Commission process is not a rubber stamp.

As New Zealand markets have become more concentrated, additional merger activity becomes more difficult from a regulatory perspective.

Our expectation is that these

recent decisions will result in market players being more cautious about what mergers they seek to transact.

Spending a year, or close to it, putting together a merger and then to have it fail is a huge cost to those entities involved.

It's not just the costs of advisers, it's the management distraction which is unavoidable during the process.

Likewise, the Inland Revenue and other regulators in the context of global efforts to control money laundering and financing of terrorism are also increasing their focus on M&A transactions.

While taxation and structuring issues will often be front and centre of transactions, the days of 'inventive' tax structuring are probably over.

For many years, market participants were critical of the Overseas Investment Office (OIO) – its processes and time taken to read decisions. The Government responded earlier this year by increasing the resources of the Office and bringing in some new faces.

The OIO itself has also responded with reviewing its processes and looking to assist parties to effect obtaining approval more quickly. Our view is that all of these changes

have been positive and participants in the market now need to give the OIO the opportunity to deliver.

However, as we head into an election there will be concern that the approval process will slow down and that Ministers may seek to defer making decisions during the election process.

Obviously the length of time needed to form any new government post-election and appoint new Ministers also has the potential to slow commercial deals from being completed.

This is a key business risk for those seeking to effect a transaction – as in the current market it is common for a deal to be subject to a "material adverse change" clause, allowing the buyer to walk away if a "material adverse change" arises before the money is paid.

The longer the time between signing a deal and completing it, the greater the risk that such an event will occur.

Despite a backdrop of global political and economic uncertainty, our capital markets are in a healthy state – as evidenced by the extent of merger activity, the number of parties chasing deals and the multiples vendors are receiving.

At the same time market participants seem more disciplined than at the height of the last boom in 2006 – financiers are not being foolish in the levels of debt they will provide.

That all bodes well for a continuing period of positive activity.

● *Cathy Quinn and Silvana Schenone are Partners Corporate and Commercial with MinterEllisonRuddWatts*

“With a growing emphasis by many consumers on knowing the source of products and on sustainability, products produced in New Zealand can demand a price premium.”

## IPOs experiencing cyclical patch

Continued from D1

Macroeconomic factors have played a role in the decline in IPO numbers.

For example, persistently low interest rates have enabled private equity firms to offer larger sums to buy companies from owners looking to exit than those owners might receive if they list publicly.

Sistema was one of these companies. Academic Colleges Group and Brew Group (formerly Bell Tea & Coffee Company) both exited for sums of over \$100 million to an Australian private equity company and a Dutch beverage company respectively.

Though this may be concerning for the NZX, it is not necessarily a negative.

Sam Ricketts, Head of Investment Banking at FNZC, observes, "It can often be a good path for a company to be incubated by New Zealand private equity prior to listing."

He points to NZ King Salmon in which Direct Capital first acquired a stake in 2008, and after eight years of involvement listed the company. While still in its infancy as a public company, the signs are positive with a trading price of \$1.35 now a significant increase from the original listing of \$1.12.

"Private equity investment in these instances assisted in maturing the company prior to listing," explains Ricketts. "It's much easier for companies to have a hiccup when it does not have continuous disclosure obligations and the associated instant market reactions to share price."

The suppressed number of listings is compounded by a number of delistings. Many of these are also the result of M&A activity and Ricketts believes that should be viewed positively too.

"Like the uptick in the listing cycle seen through 2013 to 2015, M&A is also cyclical and public market M&A

activity shows that there's higher value owners in a private setting and rewards shareholders with takeover premiums," says Ricketts.

"Ultimately in takeover contexts, shareholders have the decision as to whether it proceeds – through accepting the offer or voting on the scheme of arrangement."

However, Rachel Dunne, partner at Chapman Tripp, says a vibrant public market is important for the economy more broadly.

"It's important for the New Zealand economy to have a strong capital market so KiwiSaver funds and the like can invest in New Zealand listed companies," says Dunne.

"If there is a continued decline in the level of IPOs, investors are likely to look overseas for investment opportunities, which may create a vicious cycle as investment funds head offshore and making the NZX even less attractive to list on."

While the impact of these figures on NZX's own performance will have been offset by an increased number of debt instrument listings in 2016, the performance of their smaller markets continues to disappoint.

The NXT market, which targets companies in the \$10 million to \$100 million range, still contains just four companies almost two years after its launch. It's precursor for small to medium-sized companies, the NZAX, is now closed for new listings.

"It may be that New Zealand's capital markets are just too small to sustain them," says the Chapman Tripp report. "Especially given the early success in New Zealand of the equity crowdfunding model which provides smaller issuers with a way to raise capital from the public without having to list."

While Simeon Burnett, CEO of New Zealand crowdfunding platform Snowball Effect, doesn't see their operations as directly related to the struggles of the NZX, the company's



Direct Capital took a stake in NZ King Salmon prior to listing.

“It's important for the New Zealand economy to have a strong capital market so KiwiSaver funds and the like can invest in New Zealand listed companies.”

Rachel Dunne.

growth will definitely be something to watch at the small to medium-sized end of the market.

"At this stage we don't have our own secondary market, so don't provide liquidity for investors," says Burnett. "However, for companies who wish to go through a listing process we do provide broad access to retail investors."

"We have over 12,500 in our investor audience, and have a very simple process for those who wish to invest. This eliminates barriers for the public to invest in companies, and helps increase shareholder numbers which should improve liquidity," he says.

Ultimately, observers are split on how much the NZX can and should be doing to arrest the decline in listed companies. "The main reason we have so few IPOs is that the regulations are too tough to encourage smaller companies to list – the NZX does little to encourage companies to list," argues Gaynor.

However, Dunne says "to a certain extent, the level of IPOs will always be outside of the control of NZX (or any other stock exchange operator around the world), but there are some useful steps that NZX could take."

These steps include expanding the existing NZX50 index, creating sector-specific indices (such as a Primary Industries or Tourism index), and encouraging more ASX-listed companies to take advantage of rules which make it easy for them to dual-list on the Australian and New Zealand exchanges.

James Lee, CEO at FNZC, agrees an expansion of the NZX50 may be prudent: "Most recent IPOs have been in the small cap space and have not been large enough to make the S&P NZX50, making them more of a challenge from a fund relevance and liquidity perspective. Expanding the S&P NZX50 to 60 constituents may marginally assist small cap IPOs (less than \$300m)."



## CAPITAL MARKETS



# Making it a bigger deal

There's still a big gap in the market for traditional venture capital, with long lead-ins, writes **James Penn**

**T**he average transaction value in New Zealand's venture and early stage capital sectors more than doubled from 2015 to 2016, according to a recently released report. However, concerns about the fragility of the sector remain.

The New Zealand Private Equity and Venture Capital Monitor, published by EY and NZVCA, paints a rosy picture for the venture and early stage sector, with growth of 47.7 per cent in the value of deals – which don't include angel investments – compared with 2015.

Interestingly, despite this growth in total investment value, the number of transactions has declined. This has resulted in the average transaction value growing from \$906,000 in 2015 to \$1.85 million in 2016, suggesting a maturing of the sector.

A similar, albeit more moderate, story can be observed for angel investments. A recent report by the New Zealand Venture Investment Fund (NZVIF) stated that while the number of investments by angel groups and funds decreased 15 per cent, the total value of investment increased by 13 per cent, reaching \$69 million in 2016.

Willingness to invest larger sums in each individual company is indicative of investors having more confidence that those companies have strong, often international, growth potential.

However, this means that the sector is highly focused on growth capital – for companies that have already generated a significant level of revenue.

“A big gap remains in the market for more traditional venture capital targeted at businesses that have long lead times and deep intellectual property,” says Colin McKinnon, Executive Director of NZVCA. “We don't have a New Zealand fund in the market at the moment that would be likely to invest in (say) Rocket Lab or 8i while they remain pre-revenue.”

Managing Partner of Movac, Phil McCaw, sees fragility in the early



Colin McKinnon

stage capital sector, arguing that New Zealand needs at least a couple more significant funds around the \$150 million mark. Movac for its part recently raised \$110 million for its Fund 4, and has already made a significant investment from that fund in retail software developer Vend.

“My vision for the venture industry is to see that we've got three or four long term sustainable funds that are \$150 million type funds,” says McCaw. “We've got to find a way to lift this industry to get to that position.”

Engender Technologies, a Kiwi company that has developed laser technology to sort livestock sperm by sex, is illustrative of the benefits that come from these growth-focused capital sources.

After closing a \$4.5 million capital raise – led by Kiwi venture investment firm Pacific Capital – in June last year, Engender has started growing its footprint globally. To date in 2017, Engender has announced a \$1



Phil McCaw

**2x**

increase in value of venture capital transactions from 2015 to 2016

**\$1.85m**

average transaction value in 2016, up from \$906,000 in 2015

**15%**

decrease in number of investments by angel groups and funds

**13%**

increase in total value of investments

million deal with Asia's largest animal genetics company and has been named one of the five most innovative Agtech start-ups at Agfunder Global Innovation Awards.

The positive headline figures are also reflected in a flurry of activity among old and new specialised funds. In March this year, for example, NZVIF announced its 17th partnership for its seed co-investment fund with ArcAngels, a group of private individuals focused on investing in female-led start-ups.

Meanwhile, the NZ Super Fund broadened its scope of investments

over the past year, with investment in funds that target a spectrum of companies, from early to late growth.

“New capital commitments for funds including Movac and Global from Day One were complemented by on-going fundraising by Punakaiki Fund,” says McKinnon, “Crowdfunding platforms Snowball Effect and Equitise, and the public listing of Powerhouse Ventures also raised capital.”

McCaw says “I'm more confident than I've ever been. There's more cash in the market and there's more opportunity, and I don't see those

things changing in the next few years.”

Despite this dynamism, there remains work to be done to foster a deep early stage and venture capital market that can satisfy the needs of rapidly scalable ventures.

Public funds and institutional investors need to play a greater role. While the Super Fund has taken a step in this direction, it has taken some time and the industry would welcome other funds following suit.

“KiwiSaver is nowhere to be seen in venture or private equity which is disappointing. International investors prioritise larger markets,” explains McKinnon.

“Creating a framework that incentivises the early-stage growth market until a long-term track-record is developed should be considered. The industry is close, but not quite there yet.”

McCaw also sees a need for policy change in this regard, noting the success of recent Australian policy changes and the subsequent growth in their sector.

“If we want a growth economy that grows from entrepreneurship, you've actually got to put in place a policy framework that supports it across the spectrum,” says McCaw. “And I think there's an absence of policy at the moment in the venture and growth capital class that is not enabling the scaling of funds.”

And the age-old question of returns still remains. Yet again, there was an absence of divestment within the venture and early stage capital sector in 2016.

According to the Capital Monitor, just one of the past six years has seen any divestment, and that was a mere \$400,000. However, McCaw says this is the nature of the beast and the early stage capital sector is always expected to have long pay-off timelines.

“It is still a developing story. Around the world, that's a story that takes 20 years to create, across a couple of fund iterations,” says McCaw. “But it's coming.”

“You can kind of justify the growth that's incurring inside of these companies, because there really is some really fast revenue growth occurring – so there's definite signs that the industry is investing in things that are creating long term value.”

“The rate of return at the moment in terms of cash back is not fast enough,” accepts McCaw. “But it's getting faster.”



KiwiSaver is nowhere to be seen in venture or private equity which is disappointing.

Colin McKinnon



## CAPITAL MARKETS

# Direct Capital spurs private equity market

Late last year, Direct Capital raised its fifth private equity fund in New Zealand. Since it began in 1994, the firm has raised \$1.2 billion, with its latest \$375 million fund coming almost exclusively from existing investors in just two months.

**Herald: Direct Capital's first fund was raised in 1994 – 23 years on, what has changed most in the New Zealand private equity industry?**

**Ross George:** When Direct Capital began, private equity was a very established industry offshore, but it didn't exist in New Zealand in a formal sense. We had to go out and explain who we were and what we wanted to do with investors, advisors, and private companies. Now Ryman Healthcare, Scales and NZ King Salmon are on the sharemarket – people know they came from private equity, and the private company market is well regarded by investors. One of the most positive changes has been the New Zealand Stock Exchange. When we started 23 years ago, you couldn't necessarily invest in companies and then list them – the stock exchange said they were too small. Around the world, all successful markets mirror their economies and their company stock base. The stock exchange here has now grown substantially by appealing to a broader set of companies, and it means you can keep them here in New Zealand.

**Herald: You've just finished raising your fifth fund in the last quarter of last year. How did it go?**

**Ross George:** We had a two-month window, and we were easily able to raise it. We wanted to cap it at \$375 million, but could have raised significantly more. Over 23 years we

**Tim McCreedy** talks to Direct Capital's managing director, Ross George about the firm's latest capital raising, lessons from past investments, and the state of NZ's private equity industry



have performed very well for investors. The feedback we receive is that we don't take inappropriate risk, and that our performance has been consistent and very good relative to other categories. We are in the fortunate position of being able to go back to our existing investors and raise capital. That's real recognition of our performance and just how big the private company opportunity is.

**Herald: What is unique about the private equity industry in New Zealand?**

**Ross George:** In New Zealand, you can find yourself investing in the top five companies within a sector. We have managed to invest in Ryman Healthcare – the biggest in its industry, Scales – the second biggest

apple producer in the country, and King Salmon – the largest salmon producer. In Australia, you're more likely to invest in the top 15. Economically, New Zealand is doing very well, and there are a lot of good opportunities. But it's a double-edged sword. We're not the only ones that have noticed New Zealand is going well – the global corporates have noticed too. There is now a real desire to be here. Also, private company owners in New Zealand tend to be older than offshore. In our size bracket, that's a real feature. As owners near retirement age, they might want to sell down but remain a 20 per cent shareholder, or change their role but stay on the board. We can work with them to understand how they want to change their life – because more often than not they

“ We're not the only ones that have noticed New Zealand is going well – the global corporates have noticed too.

Ross George

don't want to stop working abruptly.

**Herald: Direct Capital's investments have been across many different sectors – from technology and e-commerce to forestry and pharmaceuticals. Are there any particular areas you're targeting for this fund?**

**Ross George:** You can't just choose an industry in New Zealand and invest in it. There are some areas such as food and primary industries that dominate in New Zealand and that we get a lot of recognition for. These will always be a cornerstone of our funds, but we try to follow big long term trends. Food for Asia is a big trend that we think will suit us into the future. In the short term, New Zealand has done well economically over the last decade, and there has

been a lot of money spent on infrastructure. Although we're not an infrastructure investor ourselves, we do invest in companies that provide services into the industry.

**Herald: NZ King Salmon was one of your most recent exits, listing on the NZX and ASX last year. What was it that appealed to you about the company?**

**Ross George:** NZ King Salmon is a company with good insights into how to run a primary industry. When we did due diligence on the company, we liked that it had its own hatchery, farms, processing plant, brand, and export operation. If you put that in the context of other primary industries, it has every step covered. It is a real pleasure to turn up in London and see Ora King salmon on the menu, and you think that started from the production of an egg by the one company. When we came to listing it, that was a really appealing thing. The main comment from the institutions is that this is how a lot of other primary industries should be organised. NZ King Salmon has been a stellar performer for a long time. It produces a premium product that doesn't have a commodity price attached to it, and can sell every kilogram of salmon it produces. The issue now is how it continues to grow. It's a very large employer in Marlborough, and because it is a year-round employer it's a sought-after place to work. The only problem is that it can't grow its production enough. The government and regional councils talk about growing employment, but there has got to be enabling tools and legislation to allow them to do it.

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## CAPITAL MARKETS

# Venturing closer to maturity

Richard Dellabarca, chief executive of the NZ Venture Investment Fund, has completed a strategic review of the industry and provided growth options to Government, reports **Tim McCreedy**.

Last year, then Economic Development Minister Steven Joyce announced a review of New Zealand Venture Investment Fund's structure, reiterating the Government's ambition for the fund to become self-sustaining.

Soon after the announcement, Richard Dellabarca was appointed chief executive of NZVIF in mid-2016 – a move that indicated the industry was maturing.

Dellabarca, an investment banker, had spent 14 years offshore in a variety of leadership roles in venture-backed companies, capital markets, financial services and technology-related opportunities.

He brings a private sector investment perspective, but given his experience as an entrepreneur he understands what is required to build globally scalable companies.

"Really good Venture Capital funds (VCs) are looking to build businesses. Investment is an important skill to have, but their greatest skill is in building companies," he says.

"It helps to have gone through the journey of building a global company, or a company with global aspirations, in order to understand what is needed."

When Dellabarca joined NZVIF, he was given a blank piece of paper and the mandate to go away and undertake an independent strategic review. He has spent the last year speaking with stakeholders – around 140 organisations and 230 individuals.

Dellabarca says he is encouraged with the significant amount of investable opportunities in New Zealand, noting that founders and teams tend to be aspirational and motivated, and companies aim to be global from day one.

The review noted a growing amount of angel investment – \$69 million in the last year, and more than \$400 million since figures have been tracked – in addition to the significant investment into universities and Crown Research Institutes.

There is money available in New Zealand to fund proof-of-concept in early stage companies.

But a shortage of funds was identified for opportunities requiring \$5-20 million in early stage growth capital.

In addition, Dellabarca noted that in the Silicon Valley or the UK, "you generally see funds syndicating with two or three investors when raising Series A & B investment."

"Yet over here, we have only Movac and Global from Day One (GDI) investing locally in growth capital, severely limiting the opportunity to syndicate investments or fully fund early stage growth companies through to maturity – and ultimately a successful realisation of the investment."

Although eight Venture Capital funds were originally established in New Zealand, the average fund size was only NZ\$45 million compared with a global average of approximately US\$300 million.

Dellabarca explains there is a good reason for global fund sizes given the amount of money a company generally requires through to an investment realisation.

"They will tend to invest in, say, 15-18 companies at \$5-10 million each, and then keep money aside for further follow-on investment in companies that are succeeding."

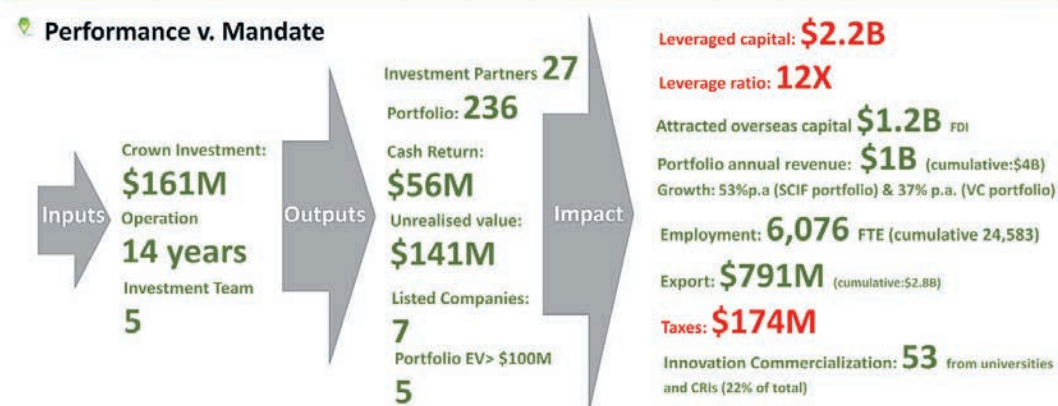
"This allows for better funds management practice, managing downside while optimising on upside opportunities," he says.

"These historic sub-scale New Zealand funds tended to invest in a range of companies, but then either didn't have capacity to fund them through to success and, therefore undercapitalised them, or had later stage

## Substantial Capital Gap.....



## 2002 – 2016: NZVIF



### Performance v. Traditional Fund Metrics

	Buyout		No Buyout	
NZVIF	0.97x	-0.41%	1.18x	2.54%
	% Return	1 Year	3 Year	5 Year
US Venture Capital	23%	21%	18%	11%



Hopefully in 15 years we won't need a NZVIF in any guise, and instead there will be several self-sustaining funds of scale.

Richard Dellabarca

investors dilute them down when they couldn't follow on with the investment.

"The consequence was that many of these funds didn't generate appropriate returns for their investors," Dellabarca says.

While offshore corporates and financial institutions have had an interest in allocating money into New Zealand technology innovation, they

have not been able to find a platform to put the money in.

As many of these institutions manage multibillion-dollar funds, the smallest investment they are willing to make is \$50-\$100 million.

"With an average fund size of \$45 million, their mandate will often preclude them from being more than 10-20 per cent of a fund," says Dellabarca.

### Power of NZVIF

● The NZ Venture Investment Fund (NZVIF) was established by the Labour Government in 2002 to build a vibrant early stage investment market in New Zealand by investing alongside private venture capital funds into high-growth companies.

NZVIF currently has \$245 million of funds under management which it invests through two vehicles:

● a \$195 million venture capital fund of funds, partnering with private New Zealand venture capital funds to support the development of innovative companies from start-up through to growth (investing on a two-to-one basis).

● a \$50 million Seed Co-Investment Fund (SCIF) established in 2005 to encourage angel investment and fill the investment gap for entrepreneurs needing capital to get their business underway (investing on a one-to-one basis).

Since its inception, NZVIF has formed 27 investment partners (16 angel and 11 venture capital partners) and invested in a portfolio of 236 companies. NZVIF has helped stimulate \$2.2 billion in leveraged capital, \$1.2 billion in attracted overseas capital, employment of 6076 FTEs and \$174 million in taxes.

"By definition you need a \$300 million to \$400 million fund to take these cheques."

"We just haven't set up a fund of scale to allow foreign investors to come in and access innovation."

NZVIF have presented a number of options to Economic Development Minister Simon Bridges that aim to make the fund self-sustainable.

Although Dellabarca is unable to divulge the details on those options, he says the fund-of-funds model with its hefty fees on fees structure is no longer viable.

The results of the strategic review provide a clue that early stage expansion capital for growth companies is New Zealand's choke point, and is a gap NZVIF would like to address if a model that works can be established.

"There is an unmet need. You could argue about the specific number but the current deal flow suggests an annual demand of \$200-\$300 million," says Dellabarca.

"If you assume our current VCs invest over five years, holding back 30 per cent for follow-on investment (the traditional venture capital investing model), then you have approximately \$20-\$25 million invested per year, versus a demand of up to \$300 million per year."

"But whatever the number is, it is substantially larger than available capital. The aspirational goal is to have that need met in some way or another."

Considering the future, Dellabarca says that he would like to see more money in the angel space. NZVIF is currently the second largest angel investor in New Zealand, and he hopes that in time it won't be needed.

He has the same goal for the venture capital space.

"Hopefully in 15 years we won't need a NZVIF in any guise, and instead there will be several self-sustaining funds of scale," he says.

"We don't have government intervention in private equity."

"You would hope that ultimately the same will happen in the venture capital space."



# HOW WE'RE SEEING IT

“Ongoing cross-border activity reflects that New Zealand is an attractive place for overseas corporates and investors to deploy capital, given our strong domestic economy and relative stability in a time of geopolitical uncertainty.

— **Jonathan Wilde, Director, Investment Banking, Deutsche Craigs**

## Jeremy Williamson, Director, Investment Banking, Deutsche Craigs

Overall, New Zealand companies are performing well, highlighted in the latest reporting season where 62 per cent of companies upgraded their FY17 earnings, which compares favourably to Australia where 54 per cent upgraded.

Despite this, average earnings growth for 2017 slipped 30 points to 5.8 per cent, potentially pointing to a slowdown in the earnings cycle and looming margin pressure.

While the tone of most executives we talk to is upbeat, some with domestic-orientated business are beginning to wonder whether this may be as good as it gets in the medium term.

In terms of deal volume, we are more bullish on the IPO market looking forward this year. This is a turnaround from this time last year when just about any equity capital markets practitioner would have acknowledged the cupboard was looking bare.

The investor demand side of the equation has always been there and has, if anything, got stronger, driven by strong fund inflows and a tilt towards stocks that deliver both growth and yield.

The key change we are seeing is that vendors with quality assets are now more willing to bring these to public markets and we think that is good for both institutional and retail investors alike.



## Jonathan Wilde, Director, Investment Banking, Deutsche Craigs

2016 represented another strong year of merger and acquisition (M&A) activity in New Zealand, albeit slightly lower than 2015, and we expect this momentum to continue into 2017.

Domestic fund raising activity is at near record levels, with more than \$1 billion in new capital committed by New Zealand private equity funds in 2016. This is anticipated to help drive ongoing transaction volumes, particularly in the mid-market space.

Whilst it is a recurring theme, cross-border M&A activity is expected to continue, including increased attention from Australian private equity funds looking across the Tasman and inbound activity from China (despite capital controls) likely to remain.

Interestingly, the latter has evolved from a traditional focus on agriculture to a more diversified sector approach, which we saw with our involvement on the announced sale of UDC Finance to HNA Group for \$660 million.

Ongoing cross-border activity reflects that New Zealand is an attractive place for overseas corporates and investors to deploy capital, given our strong domestic economy and relative stability in a time of geopolitical uncertainty.

It also highlights the role of the Overseas Investment Office (OIO) and the need to make the OIO application process as efficient as possible.



## David McCallum, Director, Investment Banking, Deutsche Craigs

2016 was a very strong year for issuance with corporates raising in the vicinity of \$2.4 billion from the public debt markets – the highest since 2009.

One notable aspect of last year's issuance (which has continued this year) is that every issuer was able to take advantage of the regulatory changes – either the same quoted class exclusion or the simplified product disclosure statement – implemented by MBIE through the Financial Markets Conduct Act (FMCA) to encourage capital markets activity. Without doubt this has been a great success that is benefitting issuers (through better volume and pricing outcomes) and also investors.

Retail investors in particular have benefited from gaining access to a number of high quality investment opportunities that would undoubtedly have been denied them under the old regulatory regime.

Moreover, we expect to see a number of new issuers who have seen the benefits of the new rules and will enter the market this year.

In terms of current activity, while the first few months have been relatively quiet, we expect activity to pick up over the next few months. Recent announcements by Genesis Energy and Goodman Property Trust are a sign of things to come.



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## CAPITAL MARKETS

# Face the fear of missing out

New Zealand companies often have to look offshore to access the funds and networks they need to scale internationally. Two of them, Booktrack and Vend, have attracted much-needed capital. **James Penn** asked their founders about the state of international investment for high-growth Kiwi companies.

Aucklander **Paul Cameron** founded Booktrack along with his brother Mark Cameron in 2011. Booktrack's technology allows soundtracks to be added to e-books to create an immersive reading experience. Since launching they have secured investment from some of Silicon Valley's most high profile figures, including PayPal co-founder Peter Thiel, and Mark D'Arcy, a Vice-President at Facebook.

**Vaughan Rowsell** is the founder of Vend, a rapidly-growing retail software company. Thiel has also invested in Rowsell's company, and in December Vend raised \$13 million in capital to fund their international growth. That raising included investors such as Square Peg Capital, Movac, and Sam Morgan's Jasmine Investments.

**Herald: When you sought capital investment in the United States, what were the drivers of that decision?**

**Paul Cameron:** To help build networks in our target market. Local investors opened up their networks to us and this enabled Booktrack to accelerate our business in the United States.

**Vaughan Rowsell:** As a SaaS (software as a service) company with a global footprint, we looked to the United States for capital, in particular Silicon Valley, because there is a deep capital pool looking to fund exactly our profile of business. We spoke to many Silicon Valley venture capitalists and ended up being funded by the overseas investment arm of one of the great Valley investors, Valar Ventures, which actively looked for New Zealand businesses to fund.

**Herald: What challenges have you faced when raising capital in the United States as a New Zealand company?**

**Vaughan Rowsell:** The biggest challenge is that United States venture capitalists (VCs) are not used to working with the risk profile of New Zealand companies – we are a 12-hour flight away, speak differently, have a non-American culture towards sales and marketing, and an alien legal structure to the companies they are used to investing in. United States-based VCs rarely deviate from their hypothesis on what a great business for funding looks like, which is formed with United States-based companies in mind. When you have geography, culture, a new legal system and other things in the mix, and it comes down to comparing apples with apples, New Zealand companies have a bigger hill to climb.

I don't mean to say it doesn't happen or won't happen, it's just a system that is harder for us.

If you are willing to be United States headquartered or have a United States executive team, I am sure it would be different. For us, staying Kiwi has always been important so we have secured investment from outside of the United States.

**Paul Cameron:** Investing in a New Zealand entity can be challenging for a United States investor as New Zealand is not only geographically a long way away, but they also do not understand the foreign tax implications. Having a friendly capital gains structure in New Zealand helps with the tax issue (but still needs some explaining), and setting up your business in the United States and being there all the time provides assurance on the geographic issue.



**Herald: What strategies have enabled you to be so successful in attracting capital from high-profile United States investors?**

**Paul Cameron:** Being there, all the time. We only attracted investment from United States investors after spending a long time in the market building networks and understanding the local market. The Kiwi Expats Association (Kea) was a great resource to connect us with New Zealanders in the United States who had great networks. It is important that New Zealand entrepreneurs remember that our cultures are different even though we both speak English and watch the same TV shows. I once observed a New Zealand entrepreneur in the United States mistake a conversation on the Warriors to be about the New Zealand rugby league team and not the Golden State Warriors basketball team. New Zealand entrepreneurs need to think, act, and be local if they are going to attract US capital. That takes a lot of time and commitment.

**Vaughan Rowsell:** A few years ago we secured funding from Valar Ventures which is Peter Thiel's vehicle to fund non-American businesses, and that immediately overcame the hurdles for us that you get with most other United States investors. They had the great idea that some of the world's best companies will come from outside the States, and we are honoured to have been picked.

**Herald: In your opinion, should more New Zealand companies be looking to the United States when embarking on seed and Series A capital raises?**

**Paul Cameron:** The first question any New Zealand start-up trying to raise funds in the United States will be asked is "how much have you raised in New Zealand?" And then "why are you raising this round here and not in New Zealand?" New Zealand companies need really good answers to these questions if they have any chance of raising US capital. We New Zealanders sound and look funny to US investors, and while it



“ We need to put more energy into making local investment dollars work for our tech sector versus cows, anti-personnel mines and property. We need to be able to tell dozens of high profile New Zealand success stories.

Vaughan Rowsell

might be cute, it is a super-competitive market for capital in the United States. New Zealand companies, especially at the seed stage, should always be raising in New Zealand unless they are already established in the United States, and have a good strategic reason to be seeking funds in the United States over New Zealand. Series A is a more likely stage to be approaching US investors for capital, but I would still try in New Zealand first as there are great funds like Sparkbox Ventures always on the look out for good deals.

**Vaughan Rowsell:** My advice to younger companies looking for

capital is to look local, or at least over the Ditch. There is an emerging Australian Angel/VC base growing and a few New Zealand companies are finding success with them which is really exciting. Companies can also consider Singapore, but the further you need to fly the greater the pull will be to base yourself closer to the venture capitalist's postcode. There are always exceptions to any rule, and for us that is Point Nine Capital, based out of Berlin, who again deviate from the usual profile of venture capital. They actively seek investment in world-class SaaS companies all over the globe, and

have been very successful at that. It is my hope that more US investors start to follow Valar and Point Nine's footsteps when they try and answer their own question, "Why are there so many damn world-beaters coming out of New Zealand?"

**Herald: Is there more that our public and private financial sectors should be doing to ensure New Zealand companies can access US capital?**

**Paul Cameron:** They already do a lot more than most people realise. Our Seed, Angel, Venture Capital and Private Equity funds and groups are well networked in the United States and leverage those networks for their investee companies. The Government, through NZTE, (NZ Trade and Enterprise), Mfat (Ministry of Foreign Affairs and Trade), Callaghan Innovation and Ateed (Auckland Tourist, Events and Economic Development) have vast investment networks that are working everyday to connect New Zealand companies with US capital.

**Vaughan Rowsell:** We attract attention by being awesome. It's all a numbers game. If United States VCs feel like they are going to miss out on opportunities to invest in great companies that originate from New Zealand, then they will come here and invest.

In the meantime, we shouldn't just wait and hope that happens. We should be doing all we can to help the current and future cohorts of amazing New Zealand businesses going global to make a dent and get noticed. The more successes we have as a nation in creating world-beating companies, the more attention we will get from the United States VCs and the rest of the world.

**Herald: How do we do that?**

**Vaughan Rowsell:** It's a 15-year strategy. There is no silver bullet. Firstly, success in the industry begets success, so we need to do what we can locally to support the next Xero, Vend, Orion or TradeMe. We need to put more energy into making local investment dollars work for our tech sector versus cows, anti-personnel mines and property. We need to be able to tell dozens of high profile New Zealand success stories. The importance of these stories are to inspire new people into starting businesses because they see how others have done it, and can literally sit down with the founders of companies making it and get advice. The stories also inspire future talent to go into technology careers and create the talent pool.

**Herald: Are there any other important messages we should be sending regarding US capital investment in New Zealand?**

**Paul Cameron:** There is plenty of capital in both New Zealand and United States for good Kiwi companies. For US investment, it really just comes down to the company strength, having great people involved, and a commitment to the United States market. Simple.

**Vaughan Rowsell:** Really simply, there are two choices: match the profile that United States investors look for in US companies, which often means becoming one and talking American; or decide you are a Kiwi-based enterprise and look to impress people who understand what awesome Kiwi-based businesses look like. In time, I hope FOMO (fear of missing out) brings more US capital to our shores, but in the meantime let's create the FOMO.



**CAPITAL MARKETS**

# No surprises key for Fintech's future

Dialogue with regulator is essential says **Garth Stanish**

**K**afka's *In the Penal Colony* is probably not a reference you'd expect to lead off a piece by the regulator about capital markets.

This odd little tale, involving the operator of a machine being consumed by the creation he loves, contains a salutary lesson all regulators should heed: If you ignore the purpose of your existence and treat what you are doing as purely an end in itself, you will end up in the dustbin of history.

Financial markets regulation should promote confident, informed participation of businesses, investors and consumers in fair, efficient and transparent markets. It should facilitate activity in capital markets.

However regulation is designed, it must work for both the suppliers of capital and those who seek it. It must be relevant, agile regulation.

At the Financial Markets Authority we work with a comprehensive, coherent and flexible system of financial regulation – the Financial Markets Conduct Act.

This Act, just three years old, provides a "fit for purpose" regime that is aligned to the Government's Business Growth Agenda, and this gives us the opportunity to help right-size regulation.

Our focus, alongside the Ministry of Business, Innovation and Employment, is on effectively implementing this Act and ensuring it remains relevant, sensible and does not lead to "Magenot Line" regulation. Being agile enough to sensibly respond to what the market is actually doing, as opposed to what it might have done five years



ago, is key for us.

Happily, one of the explicit purposes of the Financial Markets Conduct Act is "to promote innovation and flexibility in financial markets".

We have a facilitative approach to innovation generally, as shown by our approach to the peer-to-peer lending and equity crowdfunding space, the approval of the NXT market and a variable annuity retirement income product.

In looking to facilitate responsible innovation in the financial sector, a focus for us will be ensuring that the risks of new technology or products are appropriately mitigated, and not passed on to investors in ways they don't understand.

Regulators hate surprises. We want the industry to understand our approach and engage with us proactively. Talk to us at the hammer and chisel phase, not just before the cover is

whipped off the new product at a public launch.

We are interested in helping make markets work and we are not here to stop businesses succeeding.

Be open. Explain your business and your product to us. Help us understand how your product is going to work; we don't know your business like you do.

We will probably have questions to ask you. But this is because we want products in our markets that are fit for purpose, not because we think effective regulation means saying no.

If you want to know the type of questions we might ask, our *Strategic Risk Outlook* and *Guide to Conduct*, both published earlier this year, are a good place to start.

Some regulators have adopted what's known as a sandbox model to manage Fintech.

Our counterparts in the UK, Australia, Singapore and Canada use this model to exempt firms from rules and regulations for a limited time. This is seen as encouraging innovation and enables companies to bring products to market.

We are an active member of the international body of securities regulators, IOSCO, and take a keen interest in how the policy of our peer regulators develops. However, we do not see the sandbox model as the silver bullet and we are not currently planning to adopt this policy. We consider that the Financial Markets Conduct Act contains enough flexibility to make it unnecessary.

More important is a culture of collaboration and facilitation, especially for new entrants. We are working hard

## Robo-advice gains ground overseas

Technology is not going to stand still and neither should we. For example, robo-advice, or advice by computer programme, is gaining ground around the world.

In New Zealand, the law as it stands is clear – personalised financial advice can be given only by a human. Law reform to change that is under way, but we're exploring ways in which we could enable robo-advice earlier.

The example of robo-advice highlights that one of the most interesting challenges we face is regulating technological innovation in financial services – Fintech in shorthand. There has always been a close relationship between technological change and financial markets, but what has changed is the speed of that change.

The ever-increasing pace of technology change poses challenges to businesses. No-one wants to be Betamax. Fintech is about partnership as much as disruption. Innovation is as likely to come from

an incumbent as a start-up.

There are huge opportunities and risks with this innovation. Platforms like crowdfunding enable investors to get behind early-stage companies and small businesses to raise capital.

The downside is the greater chance of business failure in that sector catching naive investors by surprise, as well as the risk of mis-selling and fraud.

Financial institutions around the world are looking at distributed ledgers or Blockchain. These technologies can reduce the cost of services like international transfers by creating a reliable and traceable record agreed by all parties in the chain.

But the risks of money laundering, fraud, data theft and traceability remain.

Our *Strategic Risk Outlook* published earlier this year makes clear that the potential benefits of Fintech are worth pursuing. However, the risks must be acknowledged and managed well.

to create such a culture internally.

Capital markets matter, and how our capital markets perform is a key part of New Zealand's prosperity. This simple proposition underlies everything we are trying to do.

Regulation is a cog in the capital markets infrastructure. The point of its

work is to keep capital markets humming. When businesses can get the capital they need and people can achieve their financial goals, the machine is working as it should.

● *Garth Stanish is FMA Director of Capital Markets*



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## CAPITAL MARKETS

# A new way to transfer money

**B**itcoin has gained increased notoriety with hackers responsible for a worldwide cyber attack demanding ransom payments made in the cryptocurrency, seemingly in an attempt to avoid the tracing of payments and identification of their recipients.

However, while the digital currency itself continues to enjoy a mixed reputation, the technology underlying it – known as blockchain – is being embraced by an increasing number of providers in the financial sector. Ironically, the technology may in fact increase cyber security in the sector by reducing the prospects of fraud, while also reducing transaction costs.

“Traditional financial businesses have identified hundreds of different use-cases of blockchain technology within their current business models,” says Stephen Macaskill, President of the Blockchain Association of New Zealand. “Barclays, as an example, has identified over 80 uses within its own business.”

Across the Tasman, the ASX has been actively exploring the potential replacement of share ownership and settlement platform CHESS with a blockchain system. In January 2016, the ASX bought a 5 per cent interest in United States distributed ledger software company Digital Asset Holdings, and later increased its interest to 8.5 per cent.

A Consultation Paper released in September stated that the first phase of testing for this new system had been completed and the technology “has met initial capacity tests for ASX’s scalability, security and performance requirements for a replacement system when deployed in a permissioned private network.”

New Zealand’s exchange, the NZX, appears to have not taken such concrete steps, despite being interested in the technology’s potential.

“NZX continues to engage with international specialists in this space to understand the opportunities and the challenges blockchain brings,” says David Godfrey, Chief Information Officer at NZX.

“Deployed well, blockchain technology could support a true single source for real-time transaction sharing, streamline processes that are currently complex, enhance sharing of data across the industry, create an immutable transaction record – and perhaps be suitable for a range of other applications that have not yet been contemplated.”

However, Godfrey sees challenges in “fundamental market design” that need to be solved. Specifically, the development of a single market blockchain would be preferable to the potential proliferation of a series of independent, private blockchains that could create interoperability challenges.

In the United States, a consortium of 30 large banks and other companies – including JP Morgan, BP, Microsoft, and UBS – have formed the Enterprise Ethereum Alliance to coordinate efforts to create a public blockchain. No such co-ordination appears to be under way domestically.

Says Godfrey: “There has been tremendous interest in the potential of blockchain but this has not yet translated into explicit demand for the technology. NZX has discussed various blockchain solutions with market stakeholders and maintains a close watch on how these solutions could develop.”

Another example of the scope of potential blockchain applications is reflected in shareholder voting systems. The Nasdaq announced in January that they had successfully completed a test using blockchain technology to run a voting system on its Estonian stock exchange.

However, these are “baby steps”, according to Macaskill. “By the time the incumbents have fully adopted blockchain technology in their business models, they may already be

The ASX is looking to replace its existing settlement platform with a blockchain system, while the New Zealand counterpart NZX is checking out the true worth of the new financial technology, reports **James Penn.**



## What is Blockchain?

Blockchain is a peer-to-peer platform that allows money and other property to be given to other people without needing to go through a middleman. It uses cryptographic algorithms to protect itself and users’ property, creating an immutable and anonymous record of transactions between potentially millions of users.

There are already several operational blockchains in the market with the most popular, Bitcoin, currently worth US\$20 billion. Users of Bitcoin rely on no bank and, importantly, have no fees charged for their transactions.

Some blockchain purists see the technology as a way to remove power from global giants like banks and government. Others – like banks themselves – see blockchain as a technological enabler to massively drive down operational expenditure.

disrupted by companies that started with blockchain technology from day one.”

And though the big players are eager to broadcast the successes of their trials, Macaskill cautions that the task of larger scale integration is much more challenging.

“There is no infrastructure to connect the blockchain to legacy systems, so they have to be built from scratch,” he points out. “Many institutions are piloting projects in an incubation environment, and then tout them as proof of concepts without going through with implementing them in their business models.”

Fran Strajnar, CEO of Brave New Coin, a blockchain news and data analysis company, also believes the NZX is not doing enough to explore this new frontier.

“They are largely irrelevant for significant projects to grow, but it would be in their best interest if they upskilled and signed off some development to participate with various key activities

### How does it work?

The computers’ processing transactions on a blockchain collate a number of transactions and put them through a series of cryptographic functions – creating a “block” of transactions.

The block of transactions is then compared with the existing blockchain so that the system can guarantee when a party tries to send money, there is proof in the blockchain (which acts as an audit trail) that they actually have the money.

Once this is completed, the block will formally be added to the blockchain. Once all of this processing is completed, all computers on the blockchain update the record so that the exact same information is held by all parties.

This ‘distributed ledger system’

makes it almost impossible for one bad actor to change how much money they have as their record would conflict with every other record.

In the Bitcoin Blockchain, the platform can process 25 transactions per second, and many other platforms – like Ethereum or Hyperledger – can process even more.

### What can it be used for?

Beyond trading cryptocurrencies, businesses have begun applying blockchain to a variety of other industries and use cases. It can be used for identity management – with the Estonian government developing a blockchain digital identity system, for example – as well as ownership verification, voting, creating smart contracts, and more.

million worth of the platform’s currency, Ether.

Eventually it was decided by the community to carry out what is called a ‘hard fork’, essentially rolling back the blockchain to before the hack took place and leaving the hacker with ether that the majority of the Ethereum community did not recognise as legitimate.

Though this may represent a partial solution, Ether’s value plummeted over 30 per cent within two days of the hack. Perhaps more importantly, it exposed potential issues for regulators in the future: Should the “hard fork” be allowed for cryptocurrencies that become more widely used in the future?

What happens if the community was more divided over whether they wish to recognise the ‘stolen’ currency? Macaskill says the regulators may be redundant in any case, given that many blockchain projects have no particular jurisdiction of operation. “One would have to shut down the internet to shut down these projects.”

### It’s ICO not an IPO

Stephen Macaskill is CEO of a new platform called the Digital Asset Exchange, which will be launched in the coming months.

The platform will enable the trading of blockchain and cryptocurrency ventures and the raising of funds through ICOs (Initial Coin Offerings). ICOs which allow investors to purchase coins (the equivalent of shares) in return for funds that will be used to develop the project. Put simply, this is a trading of blockchain-based assets through a blockchain system.

“Some of these ICOs are done on an already established blockchain, such as Ethereum,” says Macaskill. “Other ICOs are launches of new public blockchains.” An example is the ICO of First Blood, an eSports betting platform that reportedly raised \$5.5 million within 10 seconds through Ethereum.

Because these ICOs occur on a decentralised ledger, there is no need for a bank to manage the capital raise, and as a result administration costs and friction are reduced.

“A project can raise funds and have them within a matter of weeks, rather than 6-9 months,” says Macaskill.



“Regulation does not address these new business models, and it may not even be possible to regulate them through legislation as they exist across borders. Rather, they end up being regulated by cryptography, code, and global consensus,” he says.



## CAPITAL MARKETS

# More cloud on the horizon

The capital markets sector is catching up with the cloud computing solution, writes **James Penn**

**T**he adoption of cloud-based solutions in the capital markets sector has gathered pace over the past year, in an attempt to catch up with other, more early-adopting industries.

While elements of the financial sector, such as consumer-facing retail banking, have held pace in their integration of cloud computing to their business infrastructure, capital markets have historically been slow to move.

But that is beginning to change, according to PwC's Technology Director Andrew Wilshire.

"The pace at which banks have started using cloud technology has increased significantly, to the point where most are considering cloud-based solutions as their first option."

The continued growth of adopting cloud-based solutions was listed in global IT consulting firm Capgemini's recent *Top Ten Trends in Capital Markets 2017* report.

"As a result of cloud computing's unique blend of scalability, flexibility, cost efficiency and massive processing power, the technology is gaining application in capital markets," said the report.

Cloud computing – essentially the concept of storing and processing data on remote computer servers on the Internet rather than physical servers held locally by the given company – has a number of advantages.

Outsourcing IT infrastructure via the cloud to third party providers such as Amazon Web Services, Microsoft, or Google enables a company to reduce its focus on maintenance of commodity technology.

This enables more resources to be devoted to creating differentiated offerings for each client segment, and improves the use of data to better target those segments.

The customer experience is improved when information can be processed more quickly and seamlessly across applications all integrated on a single cloud server.

"The benefits of modern digital experiences, well-thought out customer journeys and straight through, real-time processing are inherent in modern cloud-based banking and financial market systems," says Wilshire.

On the cost side, there are further efficiencies that come from centralisation of IT capacity through major cloud computing providers. This enables companies to benefit from economies of scale in IT infrastructure. It provides an added ability to smoothly scale computing capacity as the company grows.



“Well-thought out customer journeys and straight through, real-time processing are inherent in modern cloud-based banking.”

Andrew Wilshire

Adoption has been slow due to prior investment in legacy IT systems and concerns about the transition to the cloud, regulatory factors, and a segregated departmental approach to IT infrastructure among capital markets firms in the past.

New Zealand firms, in particular, have faced the challenge of a lack of domestic providers, with most cloud computing infrastructure existing offshore. This results in the need to manage the risks inherent with offshoring data if the choice is made

to adopt cloud solutions. "The limited investment in large-scale public cloud infrastructure in New Zealand creates additional complexity around data, network performance and outsourcing, and off-shoring regulations," explains Wilshire. "The closest existing and planned nodes for the cloud giants are on the eastern seaboard of Australia."

This, in turn, creates a barrier for large banks due to the Reserve Bank's existing outsourcing policy, which requires they have the legal and

practical ability to control and execute core outsourced functions.

Adherence to this reduces the commercial advantages of adoption cloud computing in the first instance.

However the policy, developed in 2006 before cloud services were developed and ubiquitous, is currently under review by the Reserve Bank. Industry players hope the regulations will become more accommodating of cloud technologies.

With high-profile cyber attacks occurring with increasing regularity,

storing data with offshore cloud services will carry some risk. But cloud providers can often provide greater assurances of limiting that risk than a single company can by using its own servers.

"Many businesses now rely on outsourcing vendors to provide services, such as third-party data warehouses, or data custodians/caretakers, who often provide a higher level of infrastructural and data security than can be provided in-house by banks," the Asia Cloud Computing Association submitted during the Reserve Bank's policy consultation process.

"In such a case, we recommend that the focus of the amendments be whether the bank has the appropriate contractual assurance on both concepts of ownership and control."

Peter Bailey, General Manager at Aura Information Security, says "as the technology grows and more people use it, I think there's bound to be some more regulation."

"But I think it needs to remain flexible enough to give people the opportunity to use the systems in the way they need to."

Much of the responsibility for managing cyber security risk will fall on individual companies doing their due diligence during the selection and implementation phase. Bailey says companies must guard against complacency. "There's a tendency to think 'if I'm going with a cloud supplier I'm passing my risk over to someone else'."

"Organisations can use cloud to reduce risk so long as they implement it well. But they need to do their homework up front," he says.

This homework includes understanding the supplier, matching their needs with the capability of the supplier, and ensuring contracts are clear on what services are in fact being provided.

Looking forward, cloud computing may impact the capital markets in ways even more visible to consumers, depending on the regulatory environment.

"Changes to the Financial Advisers Act and the Financial Service Providers Act to enable robo-advice, which allows codified advice to be provided by digital means to retail investors, has the potential to dramatically improve the digital offerings of fund managers," predicts Wilshire.

"These changes have a great upside for the New Zealand public to take better control of their KiwiSaver portfolios. Expect to see new offerings in the next 6-12 months focused on this space," he says.



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Be fearful when others are greedy. Be greedy when others are fearful*

– Warren Buffett



## CAPITAL MARKETS



# It makes you WannaCry

**M**any of the warnings that cybersecurity experts have been sounding came to fruition with the "WannaCry" ransomware attack penetrating the UK's National Health Service (NHS) computers and locking down crucial patient data.

But this incident should itself be a warning for the much more severe attacks that are surely inevitable.

The attack spread rapidly, infecting over 100,000 computers within the first day. It hit the shores – or the networks – of more than 100 different nations.

Though the spread was eventually slowed by a 22-year old stumbling upon the ransomware's kill switch, this raises questions about the vulnerability of global cyber networks. For the financial sector, these vulnerabilities go to the heart of what companies claim to offer their clients: privacy, security and stability.

If a future iteration penetrates banks and other financial institutions, the liquidity of financial markets could also be jeopardised. The panic caused by the ransomware attack was limited by virtue of the NHS's ability to provide clear, centralised direction to its employees.

For industries that are, by their nature, competitive and fast-moving, the impact could be exacerbated. If a particular stock exchange is reported to have been targeted, for example, the safe response by hedge funds, investment banks, and private investors would likely be to try and withdraw funds. However, acting together, this would cause a crash in the market, sparking further panic and flow-on risks for other exchanges.

A swift response by central authorities such as the US Securities and Exchange Commission might take the form of suspending trading on certain markets. But that, in itself,



The increased capabilities of information technology have made cyber security risks far more systemic, raising the stakes of every attack, says **James Penn**

would be a costly exercise and cause panic in other markets.

Additionally, the ability of these regulators to respond to such attacks before they cause lasting damage is limited. When data from thousands of different companies are stored together, often on common cloud servers, the potential for a single attack to affect vast swathes of the economy is greater.

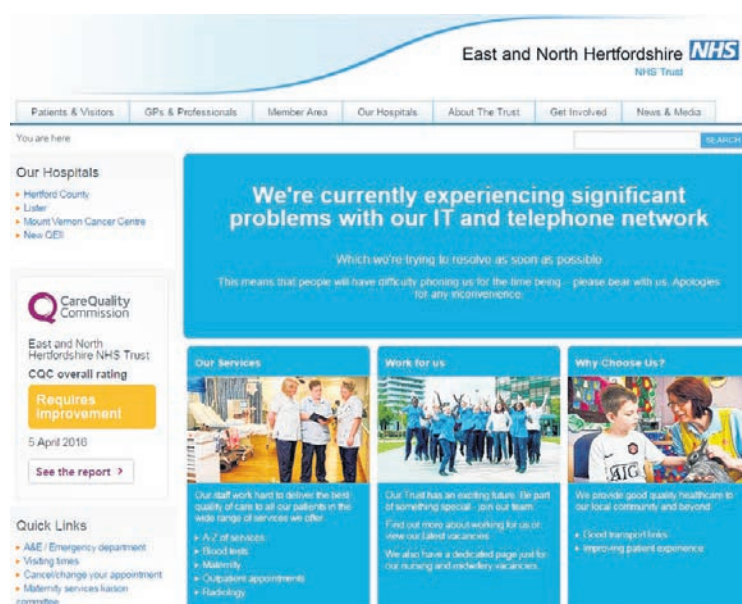
Though the pooling of resources through cloud computing companies enables greater investment in security for all, the flipside is that in the single instance that this fails a much greater number of companies are exposed.

And when so many computer systems are intricately linked through interoperating platforms and communication tools, particularly in the financial sector, the spreading of ransomware and other malware can occur rapidly through email and other file-sharing tools.

In essence, the increased capabilities of information technology, for all their virtues, have made cyber security risks far more systemic – raising the stakes of every attack.

With some estimates for the cost of cyber crime at more than US\$600 billion per year worldwide, protection against such attacks is worthy of investment.

The New Zealand Government, for its part, has invested \$22.2 million in a new organisation to limit the fallout



These vulnerabilities go to the heart of what companies claim to offer their clients: privacy, security and stability.

when these attacks do occur, the Computer Emergency Response Team (CERT). A briefing paper to Communications Minister Simon Bridges last year indicated CERT will be responsible for "incident response and triage; situational awareness and information sharing; advice and outreach; international collaboration; and co-ordination of serious cyber incidents."

However, while these are admirable goals, there is of course no replacement for vigilance on the part of the private sector.

Last week's attack, for example, was possible only because of a failure by many users to install an update released by Microsoft to resolve a weakness in their Windows operating system. The update was released in March, but the importance of installing it only became apparent to users once it was too late.

The ability to trace and punish the source of such attacks is also becoming more challenging.

Last week's hackers demanded that ransom payments were paid in the form of Bitcoin, a cryptocurrency, making it impossible to know who the recipients of such funds were or to place a freeze on the fraudulently-obtained funds in the aftermath.

Regulators have long resisted taking steps to limit the use of such digital currencies, arguing that they do not fulfil the normal definitions of a currency in large part due to their limited use.

However, on reflection they may realise this view is myopic given that the limited use of bitcoin can be connected to such systemically influential events. Whether or not regulation could actually affect cryptocurrencies is a question in its own right, but the failure to devote significant attention to doing so could be costly in the long run.

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