

November 2017 Update

Pencarrow Newsletter

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If you require any further information please contact:

Nigel Bingham
Managing Partner
P: +64 4 917 0116
E: bingham@pencarrowpe.co.nz
W: www.pencarrowpe.co.nz

Pencarrow poised to raise Fund V in early 2018

Since our last newsletter update in June 2017, Pencarrow has successfully neared completion of the investing of the Bridge Fund with a \$12.5 million investment into Netlogix in October. This has been followed by a very successful realisation of Icebreaker this month from Fund IV through the 100% sale of the business to NYSE-listed VF Corporation. The sale results in a gross IRR of approximately 70% for Fund IV and a money multiple of 3.4 times for the two-year investment.

With virtually all of the aggregate committed capital of Fund IV (\$124 million) and the Bridge Fund (\$80 million) deployed, and seven remaining investments following the recent sale of Icebreaker and the sale of BrewGroup in late 2016, Pencarrow is planning to launch a target \$200 million Fund V early in 2018. This new fund will take advantage of Pencarrow's very strong deal pipeline and continue to invest in lower mid-market opportunities (enterprise values between \$20 million and \$100 million) like prior Pencarrow funds.

Icebreaker Sale

Earlier this month, Fund IV accepted an offer by NYSE-listed VF Corporation to acquire 100% of Icebreaker. VF is one of the world's largest apparel, footwear and accessories companies with operations spanning numerous countries, product categories and distribution channels. Its brand portfolio includes The North Face, Timberland, SmartWool and Vans. Icebreaker's products and brand are highly complementary to those of VF, enabling VF to expand further into the key strategic area of natural performance and fibre.

Fund IV invested \$15.0 million in Icebreaker in November 2015 alongside Fund IV investor, Accident Compensation Corporation (whose interest was managed by Pencarrow), management and selected existing shareholders. Under the Fund's guidance, Icebreaker successfully executed a number of strategic initiatives to drive shareholder value, including better alignment of the Icebreaker brand

with consumer demand and product assortments, optimisation of Icebreaker's direct-to-consumer strategy, and a number of margin improvement initiatives. The transaction is expected to settle in early April 2018 and was a very successful outcome for the Fund generating a multiple of invested capital of 3.4 times and a gross IRR of approximately 70%.

Netlogix Investment

In early October 2017, the Pencarrow Bridge Fund (an \$80 million annex fund to Fund IV) made its third investment into Netlogix, a technology-enabled freights logistics company, acquiring a 39.7% stake for \$12.5 million and the possibility of increasing its stake in the future with a further \$5.0 million of investment should the company need further capital to accelerate its expansion.

Netlogix is a business that connects independently contracted freight carriers with customer freight demand. It has developed a highly specialised offering that optimises a freight customer's transport and logistics costs by finding the most efficient route and rate card across a network of carriers. The technology is built around best-of-class third party software and integrates with both the freight customer and freight carriers' systems. Core growth elements of the investment thesis include further expansion of the New Zealand freight base through conversion of a strong pipeline, geographical expansion into Australia and further diversification into other modes of transport. The investment from

the Bridge Fund will enable the founders to de-risk their personal investment and provide Netlogix with growth capital to accelerate the acquisition and on-boarding of customers and carriers.

The Netlogix investment complements the two existing investments in the Bridge Fund – MMC, New Zealand's leading fund administration outsourcing business, and Mix, a leading New Zealand natural skincare and haircare products business. Remaining investments in Fund IV following the sales of BrewGroup and Icebreaker are BeGroup, a retirement and aged care business; solarcity, New Zealand's leading rooftop solar business; Seequent (previously ARANZ Geo), the world leader in 3D visualisation and data interpretation for the mining sector and other earth science applications; Umbrellar, New Zealand's leading domain names and SME-focused cloud hosting business.

Fund Performance

With the successful sales of BrewGroup and Icebreaker in the past 12 months and generally strong performances from the four other companies in Fund IV that fund is showing a good return for investors with the original investment cost basis of \$106m now marked at \$214m including the realised proceeds of BrewGroup and expected proceeds of Icebreaker. Overall Fund IV gross IRR is 29.7% and multiple of invested capital is 2.01 times.

The three Bridge Fund investments are currently marked at cost as they are all less than 12 months investment duration.

About Pencarrow

Pencarrow was formed in 1993 and is New Zealand's longest established private equity manager.

In December 2012 we closed our fourth fund, the Pencarrow IV Investment Fund, with committed capital of NZ \$123.7 million. In November 2016 Pencarrow closed an extension of that fund at the hard cap of \$80 million. The combination of Fund IV and the Bridge Fund plus co-investment capital extends Fund IV to in excess of NZ\$225 million of commitments and will allow a portfolio of 8-10 companies.

The Pencarrow team is made up of eight executives with a range of complementary skills and experience.

More information on Pencarrow and the team can be found at www.pencarrowpe.co.nz.

Our current funds continue our long established focus on MBOs, expansion capital and replacement capital investments in businesses with enterprise values typically in the range of NZ\$20 million to NZ\$100 million that have strong management teams, attractive positions in their markets and the opportunity to create significant value.



Pencarrow Lighthouse

Portfolio Investments

The investment period for Fund IV concluded in September 2016, with a portfolio of six investments (since reduced to four with the sales of BrewGroup and Icebreaker). In November 2016 we closed the Bridge Fund at its \$80m hard cap and have concluded three investments for that fund.



BrewGroup (previously named Bell Tea & Coffee Company)

BrewGroup was the first realisation from Fund IV, having been acquired by Jacobs Douwe Egberts (JDE) in November 2016, representing a very successful outcome for investors.

BrewGroup is an iconic
New Zealand business well
positioned for future growth

icebreaker

Icebreaker is a leading
designer and marketer of
outdoor apparel

Icebreaker

Icebreaker has been conditionally sold to VF Corporation in November 2017, another very successful outcome for Fund IV investors. The sole condition is New Zealand Overseas Investment Office approval.

BeGroup

BeGroup provides affordable and modern retirement villages with an emphasis on helping residents enjoy life to the fullest extent possible

BeGroup

In May 2014, Fund IV acquired a platform asset, The Falls Estate retirement village, located in Whangarei as the foundation for a larger opportunity in the rapidly growing retirement village and aged care industry. A holding company, BeGroup, was formed to acquire this seed asset and it aims to develop a network of modern retirement villages providing a full range of care ranging from independent living to hospital level care. The intention is to ultimately create a business with between six and eight sites.

Guy Eady, a highly respected and experienced retirement industry executive, was recruited to lead the rollout and he has subsequently hired a CFO and development manager.

BeGroup has made strong progress against its ambition of achieving a portfolio of aged care sites at various stages of development with three sites now in the portfolio.

The first site acquired by BeGroup was The Falls in Whangarei where occupancy was increased early on to 100%. Recently a 27-unit expansion development was completed and that is already close to full occupancy and the site has experienced strong surpluses from resales of units.

The second site at Rawhiti in one of Auckland's wealthiest suburbs was acquired in May 2015 and completion of construction of the 27 independent living units is targeted for September 2018 with 16 of the units pre-sold.

The third site at Half Moon Bay in eastern Auckland has received a resource consent for the construction of 200 villas and 80 care beds and construction has commenced ahead of schedule.

SOLARCITY

solarcity plans to revolutionise the way energy is delivered by giving customers a cleaner, more affordable alternative to their monthly utility bill

solarcity

In June 2014, Fund IV provided expansion capital in two instalments to solarcity, New Zealand's leading solar power company, resulting in it becoming the largest shareholder with a 37% stake. The expansion capital was primarily to assist solarcity to roll out a new rooftop solar offering, SolarZero, to residential customers. SolarZero is a solar-as-a-service offering requiring no upfront payment by the household with payments made monthly alongside the retail electricity bill over a 20-year contract period. The company is creating an attractive 20-year receivables book of residential installations and has a target of 15,000 residences within 5 years. Early progress has been strong and solarcity has significantly exceeded its targets.

There are strong economic and industry drivers for growth in distributed solar installations in New Zealand, as the cost of solar generated electricity is now below the generation cost from the grid without subsidies.

solarcity has recently enhanced its offering by allowing customers the option of installing batteries alongside the solar system and aims to provide 100% of a customer's electricity bill at the lowest cost of as residential offering.

solarcity recently secured an additional fourth cornerstone investor over the next 12 months to provide up to a further \$10 million of expansion capital.



Seequent is well placed to leverage its global sales footprint to capitalise on its investment in product development and innovation

Seequent (previously ARANZ Geo)

In July 2014, Fund IV made a significant minority investment in Seequent providing mainly expansion capital to become the largest single shareholder. Seequent is a leading global provider of 3D geological modelling software for mining and exploration geologists. The flagship product is Leapfrog, which uses sophisticated mathematical functions to rapidly analyse scattered data for surface interpolation, enabling the creation of 3D images of ore bodies much more quickly and efficiently than other software.

Seequent has a global client base spanning over 50 countries and encompassing over 400 mining and exploration companies, including most of the majors. The business has strong recurring licence revenue and has performed strongly despite the significant downturn in the mining sector.

Pencarrow's investment was made to assist the company to enhance its product suite and provide capital for potential complementary acquisitions, two of which have been completed this year. Further acquisitions are being contemplated to augment the accelerated software development programme, which will enable Seequent to expand further along the mining chain and into other industry verticals such as civil engineering and oil & gas.

Seequent was recently rebranded from its original name of ARANZ Geo to reflect its expansion into a broader range of industries beyond its original core in the mining sector which now covers geothermal and renewable energy, civil engineering and environmental management.

Seequent has performed strongly since Fund IV's investment with revenues up over 100% since its investment in 2014. Its software licensing is primarily subscription-based revenue with renewal rates of in excess of 90% in addition to consistent growth in geologist clients.



Over
& Above.

Umbrellar is the leading domestic domain name and SME-focused cloud hosting company in New Zealand

Umbrellar (previously named Digiweb)

In September 2014, Pencarrow partnered with the management team of Umbrellar to acquire the business from its founder. Simultaneously, Umbrellar acquired Webdrive, another domain name and web hosting business, and Arrenway, a small underutilised data centre. Both acquisitions offer significant cost synergies with Umbrellar and an early part of the investment thesis was to execute and realise these synergies.

The combination of these three businesses represented the first part of a consolidation strategy in the domain names and web hosting industry in New Zealand. In September 2015, Umbrellar undertook further consolidation of the industry via the acquisition of Freeparking.

Umbrellar is now New Zealand's leading domestic domain name company and has a strong position in the web hosting sector. The business has historically demonstrated high recurring annuity-style revenues and low customer churn. The combined business has a ~36% share of the domestic domain name market and around 30% of the domestic SME-focused hosting market, further entrenching Umbrellar's position as the leading tier two player. Leading industry consolidation was one of the core elements of our original investment thesis for Umbrellar when we acquired the business in September 2014. Umbrellar is now focused on ensuring the cost synergies are realised from this significant consolidation of businesses.

Fund IV recently invested a further small follow-on investment into Umbrellar to enable the company to invest in a new third party technology platform which will allow the business to market an enhanced product offering to existing and new customers. The new technology will also enable Umbrellar to reduce the investment required to maintain its own platform. These initiatives are expected to enhance the business and underpin improved performance over the next 18 months.



MMC is the leading NZ outsourced fund and investment administration service provider

MMC

In November 2016, the Bridge Fund acquired a 50% stake in MMC, a leading New Zealand outsourced fund and investment administration business with over \$25 billion of client funds under administration. MMC is well positioned for strong growth by increasing economies of scale through organic growth, capturing a significant part of the funds management value chain and introducing adjacent services to new and existing clients.

MMC has a history of strong revenue growth and is forecast to increase revenue through a number of strategic growth initiatives which include:

- Securing additional clients in the core fund accounting and unit pricing service primarily those in a rapidly growing Kiwisaver market;
- Providing additional services to both existing and new clients;
- Transitioning further in-house providers to an outsource arrangement driven by an increasingly complex administrative and compliance burden.

MMC has performed in line with expectations since the Bridge Fund's investment driven primarily by the growth of funds under administration to in excess of \$30 billion.



Mix is a leading New Zealand branded producer of natural personal care products.

Mix

In March 2017, the Bridge Fund acquired a 44% stake in Mix, a leading New Zealand personal care products business, alongside the founders. Following some post-settlement adjustments this stake has been increased to 50%. Mix is strongly positioned in the pharmacy and grocery channel in both New Zealand and Australia with a diverse portfolio of brands using natural ingredients covering the facial skincare, hand & body skincare, haircare and men's grooming categories. The main skin and haircare brand is Essano. Future growth is expected to come from further expansion of its sales base in New Zealand and Australia including through an expanded product portfolio and through expanding distribution into South East Asia and China.

Mix's product portfolio is positioned in the "natural" segment, a high growth area as consumers steer away from products considered unsustainable, unethical or to contain harmful ingredients. Its brands also have a mid-market price point positioning it at the top end of the mass market.

A key factor in Mix's success has been its ability to expedite the commercialisation of new products rapidly in response to market trends. Mix's R&D laboratory and team of technical staff provide it with a platform to engage in new product development to increase its shelf presence with key retailers and drive sales growth.

Outlook

Following the third investment, Netlogix, into the Bridge Fund and the recent sale of Icebreaker out of Fund IV, Pencarrow is well positioned to begin raising Fund V, a fund with target size of \$200 million of commitments. Fund raising will formally commence at the beginning of 2018 with key documentation available from then.

We believe the investment environment for private equity remains very strong in New Zealand. The country recently had a general election which saw a minority coalition government formed from the Labour party and New Zealand First, a small populist party, (with support outside government from the Greens) despite the aggregate of those two parties' votes being smaller than the incumbent National party which received 45% of the votes.

Despite the change in government, policy settings are likely to remain very similar to earlier governments though there may be some reduction in net migration through increasing restrictions and an easing of fiscal policy which is likely to result in a mild inflationary/growth bias compared to earlier policy. In general, however, we believe the market for investment opportunities remains very attractive and conducive to attractive private equity opportunities.

Our Team

The Pencarrow team



Nigel Bingham
Managing Partner



Rod Gethen
Managing Partner



Jonathan Goldstone
Partner



Philippa Weston
Investment Director



Hazel Martin
Investment Manager



Bryn McLennan
Investment Analyst



Leah Anderson
Chief Financial Officer



Jing Rowland
Accounts Administrator