

# June 2016 Update

Pencarrow Newsletter

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## Strong Focus on Acquisitions for Fund IV

It is now approaching five years since the first close of Pencarrow's Fund IV and the Fund is nearly at the completion of its investment period. Since our last newsletter update in October 2015 we have been particularly active having made a new portfolio platform investment into Icebreaker and four add-on acquisitions for the other portfolio companies.

The recent activity of the Fund results in a total of six portfolio investments with 92% of committed capital now called. The latest investment in Icebreaker completed in November 2015 rounds out the portfolio. The focus will now be on ensuring the highest possible value-added can be achieved with the six investments in the Fund. In that regard there has been a lot of activity with each of the portfolio investments, and as mentioned includes four add-on acquisitions in the past eight months.

Icebreaker, a leading global outdoor apparel business with a strong focus on merino wool apparel, represents an exciting addition to the Fund IV portfolio. Alongside one of our key LP investors, Accident Compensation Corporation, as co-investor, the Fund took a 38% stake in Icebreaker and became the largest single shareholder of the company. We discuss more about this business later in the newsletter. Icebreaker joins five other businesses in the Fund IV portfolio being BrewGroup (previously named Bell Tea & Coffee) (hot beverages), solarcity (renewable energy), BeGroup (aged care facilities), ARANZ Geo (geological modelling software) and Umbrellar (domain names and cloud hosting).

In addition to the Icebreaker investment, the Fund has concluded add-on investments in the past eight months for BrewGroup (Hummingbird Coffee), ARANZ Geo (Bloy Resource Estimation & 3Point Sciences) and BeGroup (an additional greenfield site in Half Moon Bay, Auckland) significantly improving the growth prospects and market position of each of these businesses.

### 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.

To assist with the investment of Fund IV we took the opportunity to boost our investment team and since raising the fund we have added four professionals with great complementarity in their skill sets. More information on Pencarrow and the team can be found at [www.pencarrowpe.co.nz](http://www.pencarrowpe.co.nz).

Fund IV continues 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 Lighthouses:** Representing the combination of our insight with your vision to create a strategy for future success

## Portfolio Investments

Since our last newsletter update in October, there has been a lot of activity in the Fund IV portfolio with add-on acquisitions for BrewGroup, ARANZ Geo and BeGroup and strong progress against the investment theses of the other portfolio companies. Icebreaker became an exciting new addition to the Fund IV Portfolio.



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

### **BrewGroup (previously named Bell Tea & Coffee Company)**

In October 2013, Pencarrow partnered with the management team of BrewGroup to acquire the business from Foodstuffs (New Zealand's leading grocery supermarket chain) who had owned it for the prior 50 years. BrewGroup is a market leader in the New Zealand hot beverage industry with key brands including Bell Tea, Twinning's (under licence), Gravity, Jed's Coffee and Burtons. BrewGroup sells to and services every major channel in New Zealand including retail grocery, food service and workplace. BrewGroup also owns a business called Coffee Solutions which provides coffee machines, coffee and tea supplies, barista training and kitchen consumables to workplace, food service and corporate customers.

The core elements of the investment thesis included continued expansion of distribution into traditional supermarket and food service channels, introduction of further new products, selective offshore expansion (particularly Australia) and bolt-on acquisitions.

BrewGroup completed its most recent financial year with a record EBITDA result assisted by a strong performance in its non-grocery channel, primarily hospitality and corporate/workplace. Weakness in tea due to the warm summer was offset by strength in coffee, particularly from the rapidly growing Jed's coffee brand which increased sales 67% on the prior year. BrewGroup has also built a solid base of business into Australia in both grocery and non-grocery channels as it begins to replicate its coffee business in New Zealand in Australia.

Of particular note in the last six months was the acquisition by BrewGroup of Hummingbird Coffee, a premium coffee business in both grocery and hospitality channels. Hummingbird's leading brand status arises from its strong resonance with customers as an organic and fairtrade brand. Following the acquisition, BrewGroup has the clear number one position in roast and ground coffee in New Zealand to complement its leading market position in tea.

## BeGroup

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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 own 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.

Progress with the investment thesis for BeGroup has been very good. Sales of villas at The Falls (the seed asset) continue to be strong with occupancy at effectively 100% and development has commenced on the building of additional villas with strong pre-sales of those villas. A resource consent was granted for development of the second site acquired in Remuera (one of Auckland's wealthiest suburbs) in September 2014 and construction is expected to begin shortly to build an integrated retirement village and premium aged care facility. In May 2016, BeGroup acquired a third site, located in Half Moon Bay, Auckland, which will also be used to construct an integrated premium aged care and retirement village facility. In conjunction with securing and settling that site BeGroup brought in two family office investors alongside the Fund and the management team. Further sites continue to be investigated.

## SOLARCITY

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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 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 rollout 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 five years and a target of 1,200 by June 2016. Early progress has been strong and solarcity is ahead of its target with sales in recent months around 400% ahead of the prior year.

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 begun installing some of its photovoltaic solar systems with batteries supplied by its key alliance partner, Panasonic. Panasonic has partnered with solarcity as its exclusive New Zealand distributor.



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

### ARANZ Geo

In July 2014, Fund IV made a significant minority investment in ARANZ Geo (AGL) providing mainly expansion capital to become the largest single shareholder. AGL 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.

AGL has a global client base encompassing over 50 countries and 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 in the past three months.

Those acquisitions were South Africa-based Bloy Resource Estimation, a global leader in grade control software and advice in the mining industry and Alberta, Canada-based software company, 3Point Sciences. These acquisitions will enable ARANZ Geo to accelerate its development plans further along the mining value chain and into other industry verticals such as civil engineering and oil & gas. In addition, ARANZ Geo has made four new major product releases in the past three months including a cloud-enabled enterprise product and an augmented reality product.

ARANZ Geo has performed strongly since Fund IV's investment with revenues up around 100% in the past two years. Its software licensing is primarily subscription-based revenue and renewal rates are around 87%, despite the woes of the mining sector, providing a very high quality revenue stream. Looking forward, the management team plans to accelerate its software development and pursue further acquisitions while remaining profitable.

To support further acceleration of product developments and possible additional acquisitions, Fund IV agreed to subscribe for \$5m of expansion capital into ARANZ Geo effective July 2016.



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 is to execute and realise these synergies.

The combination of these three businesses represents the first part of a consolidation strategy in the domain names and web hosting industry in New Zealand. 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.

In September 2015, Umbrellar undertook further consolidation of the industry via the acquisition of Freeparking. The Freeparking business is based in New Plymouth and provides web hosting, e-commerce, domain registration and hosting and other supplementary services under two brands, WebFarm and Freeparking. Since 1997, Freeparking has grown to become one of New Zealand's largest web hosting and domain name registrars. This growth has been achieved organically and through the acquisition of 2Day.com in 2005.

The combination of Umbrellar and Freeparking represents an imminent opportunity to further consolidate the New Zealand domain name and web hosting sectors, mirroring similar consolidations in the United States, Australia, Canada and the UK. Freeparking is one of the few remaining acquisition targets of scale. The combined business will have a ~36% share of the domestic domain name market and around 30% of the domestic 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.



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**Icebreaker is a leading designer and marketer of outdoor apparel**

### **Icebreaker**

In November 2015, Fund IV took a significant minority stake in Icebreaker, a leading designer and marketer of outdoor apparel focused on merino wool. Icebreaker offers a diverse set of products using natural and sustainable fibres including next-to-skin products and outer and mid-layers. It employs a multi-channel distribution model incorporating wholesale, e-commerce and company-owned stores to service primary markets in Europe, Canada, United States, New Zealand and Australia.

The company has a very high quality management team led by ex-CEO of Air New Zealand, Rob Fyfe, and a management team comprising executives from many of the world's leading apparel companies. Many of this management team have been hired very recently as Icebreaker seeks to improve its profit margins and accelerate its overseas growth.

Icebreaker is one of New Zealand's most iconic brands and fits well into Pencarrow's strategy of investing in New Zealand-based emerging global champions.

Since our investment, management have undertaken a number of key initiatives to improve gross margin across the business including expanding its supplier base, assessing moving to a finished goods model for some core products, undertaking a freight tender, reducing discounting, assessing in-market pricing positioning and improving product engineering to reduce manufacturing costs. Management are also strongly focused on inventory reduction and efficient inventory management.

While early days for the Pencarrow investment, financial performance is in-line with our investment plan.

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Local merger and acquisitions markets locally remain relatively strong in volatile global market

## Market Environment

The current year began with volatile global sharemarkets driven by nervousness about the health of China and oil price weakness.

More recently however, financial markets have recovered most of their lost ground when these factors proved to be less pronounced than originally perceived. New Zealand's markets have been significantly less volatile and stronger through this period.

Merger and acquisitions markets locally remain relatively strong. This year has seen some significant listed company takeovers with takeover offers or mergers announced for Nuplex, Diligent and Sky Television indicating that the activity we have seen in private markets has spilled over to the public company environment. Looking forward, we continue to believe that merger and acquisition activity in New Zealand will remain strong based on ongoing confidence in the economy and very low interest rates, which are likely to fall further during the coming year.

With Fund IV now almost fully invested, the ongoing strength in merger and acquisition activity augurs well for the positioning and future performance of portfolio companies. Fund IV, of course, is a participant in this activity through the opportunities that we are identifying to add on bolt-on acquisitions to the platform investments. Fund IV should also be a future beneficiary once the investment theses of the portfolio companies are complete and higher value owners emerge who might wish to acquire these companies. Making these portfolio companies attractive to future owners will be a strong focus of the Manager over the next 12 or so months.

That focus will be a combination of organic revenue growth, cost containment and additional acquisitions by the underlying portfolio companies. Acquisitions by portfolio companies continue to be identified and evaluated. In particular, ARANZ Geo remains active in reviewing opportunities and Fund IV recently provided additional capital to support these initiatives. Remaining acquisitions being investigated, including by BeGroup and BrewGroup are able to be financed from other capital sources.



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## Our Team

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### The Pencarrow team



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