

# February 2015 Update

Pencarrow Newsletter

- 01 Fund update
- 01 About Pencarrow
- 02 Portfolio companies
- 05 Market environment
- 06 Our Team

If you require any further information please contact:

**Nigel Bingham**  
Executive Director

P: +64 4 917 0116

E: [bingham@pencarrowpe.co.nz](mailto:bingham@pencarrowpe.co.nz)

W: [www.pencarrowpe.co.nz](http://www.pencarrowpe.co.nz)

## Fund IV portfolio continues to grow

Since our last newsletter update (September 2014) the Pencarrow IV Fund has been active having acquired one further platform investment, Digiweb, and made an add-on investment in BeGroup, the aged care/retirement village business.

This takes the Fund IV portfolio to five investments with 63% of committed capital called to date.

Other than Bell Tea & Coffee, none of the five Fund IV investments has been in the portfolio for more than a year so it is early days for the portfolio. However we are broadly pleased with the progress of implementation of each of the investment theses for the five businesses. A common theme among these five investments is they are all run by very capable CEOs and in every case we have managed to create strong governance by complementing Pencarrow's own capabilities on the boards with individuals with strong industry specific expertise. The combination of a great CEO and strong complementary board provides the best platform for delivering on the original investment thesis for each investment.

With 63% of the Fund's capital now called we see room for one or two more portfolio investments in addition to deploying capital that can support add-on and expansion within the existing portfolio before rounding out the investment phase of the Fund.

### 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 will 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 Lighthouses:** Representing the combination of our insight with your vision to create a strategy for future success

## Portfolio Investments

On top of the four investments as at the last newsletter update in September, in the past six months Fund IV made two further investments; one being a platform investment, Digiweb, and the other being a land investment add-on for existing portfolio company BeGroup. In addition a small amount of follow-on investment was provided to existing portfolio company, solarcity, for rollout of the fully funded solar-as-a-service offering.



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Bell Tea & Coffee Company is an iconic New Zealand brand well positioned for future growth

### Bell Tea & Coffee Company

In October 2013, Pencarrow partnered with the management team of Bell Tea & Coffee Company (BTCC) to acquire the business from Foodstuffs (New Zealand's leading grocery supermarket chain) who had owned it for the prior 50 years. BTCC 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. BTCC sells to and services every major channel in New Zealand, including retail grocery, food service and workplace. BTCC also owns a business called Café Express which provides coffee machines, coffee and tea supplies, barista training and kitchen consumables to corporate customers.

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

In its first year under Fund IV's ownership significant progress has been made against the original investment thesis objectives. Operating profit has risen approximately 30% with significant growth in market share in both tea and coffee, particularly through greater penetration of Progressive supermarkets (the main competitor to Foodstuffs) following a greater ranging of BTCC products through that company's supermarkets. In addition, there has been a successful launch of a number of new herbal tea products and an innovative coffee product, Jed's Bean Bags, which has recently been accepted into major supermarkets in Australia as well as in New Zealand.

BTCC continues to investigate acquisition opportunities which are consistent with its strategic growth objectives.

## 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.

In September 2014, the BeGroup management team identified and acquired a second site in one of Auckland's wealthiest suburbs, Remuera, an old bowling club that will be used to develop a greenfields aged care facility. Concept design and resource consent approval are currently underway for this new site. Fund IV provided additional capital to fund the purchase of this site.

Further sites are being identified and reviewed as part of the continuation of the rollout plan.

## 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 (followed 5 months later by a second instalment), New Zealand's leading solar power company resulting in it becoming the largest shareholder with a 37% stake.

Solarcity has built its business on successful commercial and government solar installations, particularly in the Pacific Islands where the power is used to often displace expensive and environmentally unfriendly diesel generation. In addition it had begun taking advantage of opportunities in the new build residential market (particularly in Christchurch and Auckland).

Pencarrow identified with management the opportunity to establish itself in the retrofit market providing installations on existing residences and commercial properties using a funding model which would require no upfront payment by customers and result in a lower power bill. The primary purpose of Fund IV's expansion capital was to assist in funding (along with bank funding) this solar-as-a-service offering which was launched on 1 October 2014 which has generated an extensive sale pipeline validating management's view that the upfront cash outlay for solar installations had been an impediment to growth.

Management's focus is now on converting this sales pipeline through efficient and effective execution of installations.



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ARANZ Geo is well placed to leverage international markets and make further acquisitions to broaden its geosciences offering

### 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.

Following Pencarrow's investment, AGL acquired several of its global distributors and Quantitative Group, one of the leading geological consulting companies based in Perth. These acquisitions will enable it to achieve a higher margin through direct sales and distribution and allow it to provide high-end complementary consulting, an important part of the sale process.

Pencarrow's funding will also enable AGL to accelerate the buildout of its next generation software product, Leapfrog 4D, which will provide several significant enhancements over the current product including a cloud-based platform to allow effective project collaboration across mine sites and offices.



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Digiweb is the leading domestic domain name company and has strong position in the web hosting sector

### Digiweb

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

The combination of these three businesses represent the first part of a consolidation strategy in the domain names and web hosting industry in New Zealand. Digiweb is now New Zealand's leading domestic domain name company with an approximate market share of 26% and has a strong position in the web hosting sector. The business has historically demonstrated high recurring annuity-style revenues and the low customer churn.

Other acquisitions are being identified and reviewed as part of an ongoing roll-up of the sector.

## Market Environment

Globally New Zealand stands out as showing strong economic fundamentals along with the US and UK.

The current market conditions are creating positive momentum for private equity

Given its relatively strong outlook for GDP growth over the next 12 months New Zealand should remain an attractive investment market and New Zealand should also be relatively immune to potential significant geopolitical risks that may emerge in 2015 and create volatility in financial markets such as Greece exiting the euro or escalation of tensions surrounding Russia's economy and its relationship with the Ukraine.



**Shipping container in Auckland:** The recently reduced NZ Dollar is favourable for non-dairy exporters.

The fall in oil prices, in particular, is now raising the risk of deflation in the developed world, particularly Europe. The European central bank has acted recently to this risk by announcing a very large quantitative easing policy similar to those executed in Japan and the US. Our own Reserve Bank has indicated that tightening from the current OCR of 3.5% will now be longer than thought at the start of the quarter. The low prevailing level of interest rates should help to underpin asset values over the coming 12 months.

The recent significant reduction in the USD/NZD exchange rate should continue to benefit non-dairy exporters.

New Zealand has seen some of the strongest IPO activity levels in more than a decade and, while the pace of IPO activity is unlikely to remain as strong over the next 12 months, IPO activity is expected to remain healthy. The health of IPO markets is good for private equity as it provides an additional channel for liquidity in addition to the more traditional trade sale processes. The general level of confidence exhibited by listed equity markets is also helping to buoy mergers and acquisition activity with a number of high profile businesses expected to be transacted over the next six to 12 months. This level of activity and the opportunities this creates will certainly assist us in completing the investment phase of Fund IV where we still see the opportunity for a further one or two portfolio investments.



## Our Team

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The Pencarrow team.



**Nigel Bingham**  
*Executive Director*



**Rod Gethen**  
*Executive Director*



**Philippa Weston**  
*Investment Director*



**Jonathan Goldstone**  
*Investment Director*



**Michael Earby**  
*Investment Analyst*



**Leah Anderson**  
*Chief Financial Officer*