

**Annual Report of the
New Zealand Export Credit Office
for the Year Ended 30 June 2013**

New Zealand Government

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**NEW ZEALAND
EXPORT CREDIT
OFFICE**

Purpose

The purpose of the New Zealand Export Credit Office (NZECO) is to help grow New Zealand exports by providing specialised financial guarantees and services that complement those available in the private sector and which assist New Zealand exporters to:

- ▶ manage risk,
- ▶ access trade finance, and
- ▶ secure international contracts.

Since its establishment, NZECO has issued a total 381 policies across 98 exporters, supporting \$1.5 billion worth of export transactions into 67 countries.

Summary of Performance for the year ended 30 June 2013

Output Priority 1: NZECO guarantees are delivered effectively and efficiently and this has led to an increase in exports

NZECO offers a range of products that may cover:

- ▶ Political / country risks of a foreign buyer's country;
- ▶ Overseas buyer repayment risks; and
- ▶ NZ exporter technical performance and financial capability risks.

NZECO's support was provided to New Zealand exporters of all sizes and sectors, supporting their export sales into 31 countries. Examples ranged from an education consultancy project in Oman, to satellite communication equipment supplied to Colombia; from the design and manufacture of carbon fibre masts for a European buyer, and an airport baggage handling system in China.

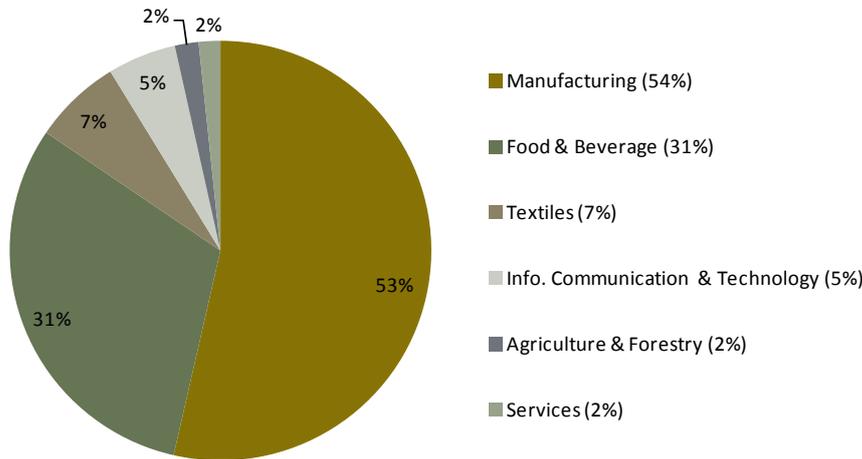
NZECO's performance in supporting exports is summarised in the following table:

Objective	2011/12 Actual	2012/13 Actual
Number of Applications received	88	100
Number of Offers issued	77	81
Number of Policies Issued	70	68
Total New Exposure for the year	\$104.1 m	\$64.5m
Value of Export transactions supported	\$271.2m	\$318.9m

A positive trend in these annual results was the increased demand (via applications) for NZECO support and the total value of exports supported relative to the previous year. The lower level of New Exposure was a result of the majority of policies being underwritten for lower guarantee amounts, combined with the absence of any significantly large policies (i.e. >\$10m exposure), compared to those of the previous years.

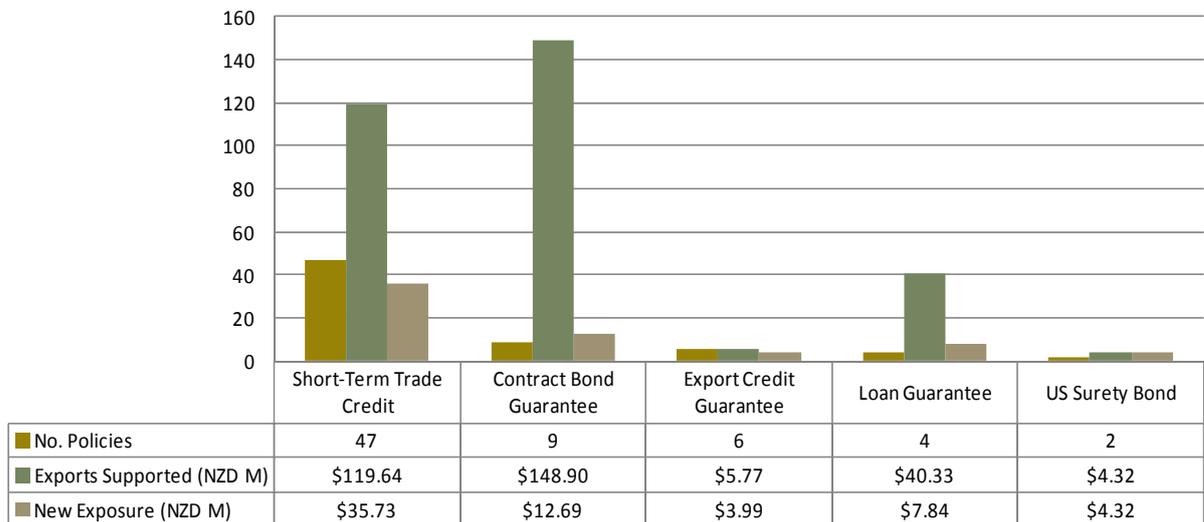
For the year, NZECO's value of exports supported by industry was as follows:

Figure 1.1 Exports supported by industry



Over the year the strongest demand was for NZECO's short term trade credit insurance, while NZECO's contract bond guarantee had the greatest impact in terms of the aggregate value of export contracts supported.

Figure 1.2 Policies and exports supported by product (NZD M)



Short term Trade Credit Insurance

NZECO received steady demand for this product, primarily from food and beverage firms (66%), as well as textiles, manufacturing, ICT, forestry and the services industries. NZECO can only accept applications once the exporter applicant has been declined by the private insurers, and the demand for NZECO support is typically arising from either:

- a smaller exporters who lack the range of buyers and/or insurable turnover for the private insurers; or
- b larger exporters that are selling to buyers in emerging markets which the private insurers are off-cover for.

Accordingly, NZECO has been supporting SME businesses to grow internationally by insuring their buyer payment risk as they establish a trading history with new buyers abroad. NZECO has also been supporting larger New Zealand exporters seeking cover on creditworthy buyers and banks in Spain, Costa Rica, Venezuela, Ghana and Bangladesh.

Many exporters also rely on NZECO's trade credit insurance to access trade finance facilities from their bank. An SME example of this is Christchurch-based company, Propane Performance Industries:

Propane Performance Industries (PPI) is an early stage company that utilised NZECO's short term trade credit insurance in order to secure bank funding for its first significant export contract with an Australian car manufacturer. PPI designed an aluminium LPG tank which their buyer selected to use in their first LPG-powered vehicle. PPI outsources their manufacturing to a Chinese supplier, and faced a funding gap (of up to 60 days) between the time it pays its Chinese supplier, ships the goods to Australia, and is paid by their buyer (33 days after delivery). NZECO recommended a trade finance solution secured by insuring their buyer's receivables. The private insurers declined to offer cover because their buyer was PPI's only buyer and the insurers have limited appetite for single buyer risk. NZECO stepped in to provide a credit insurance policy which was assigned to ANZ to support a trade receivables funding facility. *"Our first exports to this buyer are so important in order to demonstrate market acceptance of our product. Access to finance was a barrier, and NZECO's support has helped us secure a trade finance facility to pay our supplier prior to receiving payment from our buyer"* – Andrew Rodwell, CEO of Propane Performance Industries.

Utilisation of NZECO's "top-up cover" co-insurance arrangement with the private insurer Euler Hermes has also been regularly utilised over the period, and NZECO began to formalise a similar arrangement with private insurer Atradius. These co-insurance arrangements provided additional cover for wool, apple and meat exporters on buyers across Europe, China and Latin America in order to mitigate risks as well as access trade finance from their banks.

Export Credit Guarantee

NZECO had increased demand for this product although the individual policy amounts were small relative to previous years. One of the policies issued during this period was to a company new to receiving NZECO support, namely Syft Technologies. It is an example of how NZECO's support enabled Syft to increase the level of its high-value exports to its European buyer.

Syft Technologies designs and manufactures units which analyses air samples for toxic or volatile compounds, in real time. Syft has a European customer who provides the service of testing the interior of ship containers for toxic compounds prior to port workers unloading them. The buyer has an increasing demand for Syft's units, but because the buyer earns its revenue from Syft's units over time it was unable to pay upfront for all the Syft units it wanted. NZECO assessed and approved the creditworthiness of the European buyer, and Syft then offered three year payment terms on all sales planned for the next 12 months. *"Our ability to offer 3 year repayment terms, underwritten by NZECO, enables our buyer to order more units than it otherwise would if we negotiated our standard upfront payment terms"* – Doug Hastie, CEO of Syft Technologies.

NZECO is forecasting improved results in 2013/14, as we expect to provide export credit support for longer-term and higher-value transactions. We also plan to leverage a Master Guarantee arrangement which we finalised this year with a Canadian financier, Northstar Trade Finance. Northstar specialises in funding export credit agency covered, medium-term (i.e. up to 5 years) loans that are typically too small (i.e. less than USD 10m) for international banks to be interested in funding. NZECO has identified several high-value manufacturing exporters who may benefit from this arrangement and improve their competitiveness by offering credit instead of requiring prepayment from their customers.

Surety Bond Guarantee

This product remains crucial for most New Zealand companies seeking to bid for US or Canadian federal or state funded projects, which require 100% surety bonds. One example is Glidepath.

During 2012/13, NZECO underwrote 100% surety bonds for two baggage handling projects awarded to Glidepath in the US states of Washington and Missouri. NZECO's indemnity arrangement with Liberty Mutual Surety enabled Liberty to issue these bonds on Glidepath's behalf. *"NZECO's support is critical to our ongoing export business in United States and the NZECO staff put in a great deal of work to help us win the projects that we have contracted"* – David Mead, Vice President of Glidepath (US).

In November 2012, NZECO finalised an agreement with Liberty Mutual's Canadian operation. This is similar to NZECO's arrangement with Liberty Mutual US, and enables NZECO to provide support to exporters facing 100% surety bonds on Canadian government funded projects. NZECO also plans to negotiate an arrangement with another surety bond provider to support surety bonds for US federal-funded projects in American Samoa.

General Contract Bond Guarantee

NZECO received steady demand for this product, from a mix of SME firms with insufficient balance sheet strength and growing companies that lacked the bonding facilities to support large project requirements. For these exporters, the Contract Bond Guarantee has enabled them to bid for and win larger transactions, get paid during the construction period, and continue to receive their normal trade finance from their banks, without providing additional security.

NZECO supported \$150 million of multi-year, export contracts across the aviation, specialised engineering, education services and marine sectors. One example is the specialist marine company, Southern Spars:

In September 2012, Southern Spars won a contract worth over \$30m to design and supply carbon fibre masts, booms and rigging for an 85m ketch in the Netherlands. Southern Spars sought a \$2m deposit to help fund their up-front costs and their buyer required this to be matched by a \$2m bank guarantee for the duration of the 28 month contract. Southern Spars lacked the bond facilities with their bank for a bond of this size and duration. NZECO issued its bond guarantee to Southern Spars' bank (ASB) who then issued the bond to the Dutch customer. *"This project is the largest rig package the company has built to date. Accordingly our customer needed to have confidence we were in a position to see this project through to completion. With the assistance of the NZECO we were able to provide the required bond and importantly demonstrate we had the support of the NZ government"* - Samuel Watson, CFO of Southern Spars.

Loan Guarantee

As part of the Government's Business Growth Agenda, amendments to the scope of the loan guarantee were implemented resulting in an increased pipeline of enquiries and applications from SME exporters and banks. During the year NZECO supported exports worth \$40 million across specialised manufacturing, ICT, horticulture and wine sectors. One example is Christchurch-based firm, Bellmor Engineering:

When rendering and separating manufacturer, Bellmor Engineering, encountered increased demand for decanter centrifuges from its US customers in the oil and gas sector, they faced additional short-term working capital requirements. At lending limits with their bank (BNZ), they sought NZECO's loan guarantee to enable BNZ to provide an additional USD 2.5m facility. This funding helped Bellmor manufacture machinery in advance of its export orders, and the facility was fully repaid within seven months. *"With our offshore client's expectations to have our product available, maintaining cash flow throughout a period of growth can be a challenge and that's where the assistance of NZECO has been invaluable"* - Geoff Carston, GM of Bellmor Engineering.

Output Priority 2: Risks are appropriately managed, in accordance with export credit agency best practice

NZECO operates on a commercial basis and prices risks to ensure it covers all operating costs and claims over the longer term. NZECO follows the OECD Arrangement on export credits and pricing, as well as its own Crown mandated criteria and prudential limits. Its risk assessment, management and governance processes are designed to manage risk to a reasonable level rather than eliminate all risk of loss.

NZECO monitors its foreign buyer repayments and New Zealand exporter performance and reports on a monthly basis to NZECO's Technical Advisory Committee (TAC). Any delays in payment (beyond 10 days) or performance are actively managed. NZECO also undertakes quarterly reviews of all policies to review premium charged in the context of potential future claims and the adequacy of premium rates applied to those policies.

Engagement with other export credit agencies, including our agency relationship with Sweden's ECA (Export Kredit Namnden - EKN) remains a valued source of country risk, foreign bank, pricing and other technical expertise for NZECO.

NZECO's Technical Advisory Committee (TAC) met ten times during the year and provided specialist advice, assurance and oversight of NZECO's strategy, operations and risks to the Secretary to the Treasury, via the Deputy Secretary, Financial Operations. Anthony Ractliffe concluded his twelve-year tenor as the Chair of TAC. Throughout this period, Anthony's expertise, experience and commitment to NZECO were highly valued by NZECO and Treasury. Tim Sole, a current member of TAC, was appointed as the new Chair. We also welcomed Burke Steel as a new TAC member. Burke was previously CEO of Euler Hermes Oceania and has over 20 years underwriting and management experience in trade credit insurance.

Chris Chapman was also appointed as NZECO's Manager following the departure of Carmen Moana. Carmen was a foundation member and long-term manager of NZECO, and was passionate about the role that NZECO can play in supporting New Zealand exporters. Carmen was instrumental in advocating for and implementing the extensions to NZECO's mandate and product range. We would like to record our appreciation for all Carmen's achievements, which are best evidenced by NZECO's business growth during her tenure.

NZECO's financial performance for the year is summarised in the table below.

Objective	2012/13 Actual
Operating Income (Earned premium & application fees)	\$1.90m
Total Operating Expenses (excluding claims)	\$1.79m
Claims Paid	\$0
Net income	\$0.52m
Claims Reserves	\$29.70m
Cash Balance (notional) at Year End	\$16.40m

Our premium (cash) received was lower than previous years primarily due to a lower number of higher value, high exposure policies being underwritten. This demonstrates how, by virtue of its role in filling market gaps and supporting exporter development, NZECO faces fluctuating business volumes, income and claims. However, NZECO forecasts an increase in premiums received for the 2013/14 financial year based on current outstanding offers and the pipeline of expected applications.

As at 30 June 2013, NZECO's actual exposures are relatively evenly distributed by NZECO product. NZECO's five largest policies remain all within acceptable limits relative to NZECO's total portfolio, with the largest exposure being 14% of NZECO's total risk portfolio. The average maturity in our portfolio is one year.

The majority of NZECO's commercial risks are unrated companies that NZECO has assessed as being equivalent to a B credit rating. NZECO has outstanding exposure across 30 countries, with the largest concentration (45%) recorded on New Zealand (reflecting those New Zealand firms whose performance NZECO underwrites). The second highest concentration risk is on United States (20%) where the actual risks of adverse country or political risk events occurring are considered to be minimal. The third highest country risk exposure is on Australia (13%), which is within acceptable limits. Less than 1% of NZECO's total portfolio is concentrated in higher risk countries (i.e. Venezuela and Pakistan), and these policies are closely monitored.

NZECO's current exposure to sectors is weighted towards manufacturing (54% of NZECO's total exposure). This relates primarily to radio equipment, textile, food processing and automated machinery.

The challenge for NZECO is building a diversified and balanced portfolio without constraining its support for New Zealand firms that have high-value export opportunities which may otherwise result in a high concentration risk - whether by sector, country or transactional - relative to NZECO's total portfolio.

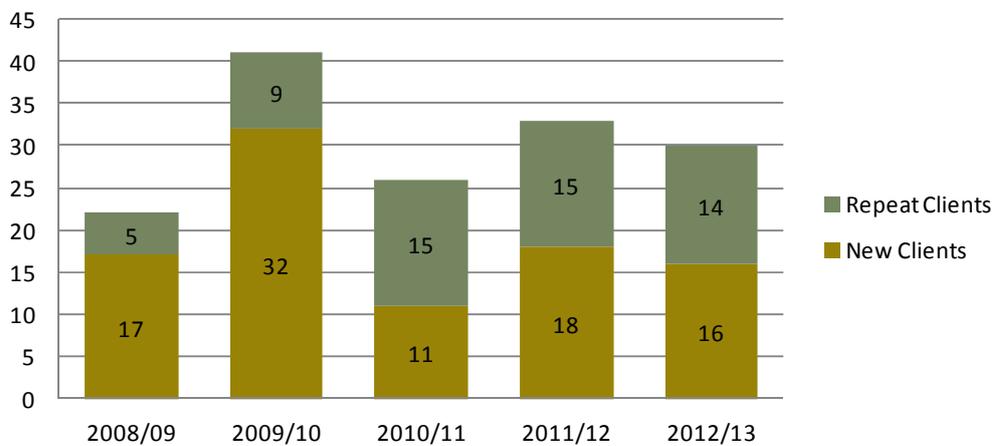
One way to balance NZECO's future risk concentrations is through reinsurance with other export credit agencies and private reinsurers. During this period, NZECO had positive meetings with several European reinsurance agencies to explore their appetite to reinsure a portion of NZECO future policies. Developing and implementing a reinsurance strategy will be one priority for the coming year.

NZECO's products are designed to complement the offerings of banks and private trade credit insurers. Often the private sector will be able to provide support to a NZECO client after we have helped that exporter grow in turnover and/or become more profitable. Accordingly, new clients are needed for NZECO to sustainably deliver its results. A positive outcome of NZECO's external engagement was that 53 percent of those exporters that NZECO issued policies to during the year were firms that NZECO had never previously supported.

Equally, NZECO aims at facilitating repeat business from key clients, especially those that have customers that suit extended export credit arrangements, or are on a steep growth curve for the medium term, or face barriers that only NZECO can best support (e.g. surety bond requirements).

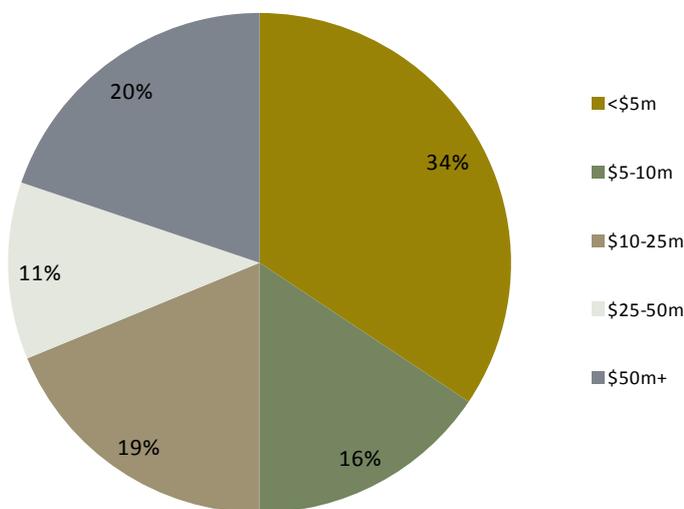
The table below illustrates how many new customers relative to repeat clients that NZECO has supported over recent years.

1.4 Profile of NZECO's clients (historical)



NZECO's exporter clients have been overwhelmingly SME. However, the graph below also shows that there is an important market need and economic development role for the NZECO in supporting some of New Zealand's largest companies as well.

Figure 1.5 Annual turnover of NZECO supported firms (historical to 30 June 2013)



An action item under the Government's Business Growth Agenda was to enhance NZECO's products, and during the year Cabinet approved incremental changes to NZECO's Loan Guarantee scheme (previously known as the Working Capital Guarantee) and General Contract Bond Guarantee. As at year end, NZECO had issued binding offers to support an additional \$42m of export transactions via these new product enhancements.

The New Zealand banks also play an important role in the success of NZECO in terms of:

- ▶ identifying exporter prospects for NZECO and market feedback
- ▶ providing additional funding and bonding to exporters directly covered by NZECO policies, and
- ▶ sharing information, risk sharing and supporting recoveries.

During the year HSBC, Kiwibank and Heartland Bank all utilised one of NZECO's products which means that for the first time every main New Zealand bank has examples of providing funding or bond support underwritten by NZECO to their exporting clients.

NZECO values the importance of developing relationships with other export credit agencies in order to share current market information, benchmark best practices, and monitor new product developments (particularly for SME exporters). We hosted a secondee from EKN's Small Business Team for six months, which provided a beneficial exchange of experiences and practices.

NZECO is also building international credibility and this was reflected by invitations this year to present at an APEC "SME Trade Finance" conference in Manila, an Underwriting conference for Asian export credit agencies (speaking about NZECO's co-insurance arrangement with the private insurer Euler Hermes), and at the December meeting of the Prague Club (consisting of 35 export credit agencies) where NZECO presented on how it markets its services to SMEs.

Output Priority 4: Education of exporters on how to appropriately manage their own trade finance risks

An important function of NZECO is educating New Zealand exporters (particularly SME firms) about how to appropriately manage their financial risk, as well as highlighting trade finance solutions. During the period, NZECO delivered 40 presentations to external groups, as summarised below:

Objective	2011/12 Actual	2012/13 Actual
Number of NZECO presentations at exporter events	21	12
Number of NZECO presentations to NZ bank staff	12	12
Number of NZECO presentations to export-facing agencies (Govt & Industry)	13	16

NZECO also published case study articles (via industry magazines), and prepared country-specific risk reports for Russia, Turkey, Australia and Japan to complement NZTE's country information guides.

NZECO was also actively engaged with other government agencies (i.e. NZTE, Ministry of Foreign Affairs and Trade, Ministry of Business, Innovation and Employment, and Education New Zealand) to highlight how NZECO's products may support their agency's sector-specific initiatives or export-growth strategies.

The Year Ahead

NZECO is focused on supporting, in close collaboration with other government agencies, the Government's aspirational goal of achieving a 40% export to GDP target by 2025.

One strategic priority is to leverage NZECO's government imprimatur to support the competitiveness of exporters including via direct performance guarantees to foreign government buyers. NZECO will also explore opportunities to underwrite lines of credit to sovereign buyers in order to facilitate the procurement of New Zealand goods or services.

NZECO will continue to focus on establishing new guarantee and reinsurance arrangements with other export credit agencies, surety bond providers and private reinsurers in order to help diversify and balance NZECO's portfolio as well as facilitate exports.

NZECO is also proud to be arranging and hosting the Berne Union (Prague Club) December meeting in Queenstown. We forecast over 50 delegates from 30 export credit and private sector agencies to attend and we look forward to facilitating a successful event of information sharing and relationship building.

A combination of growing trade opportunities for New Zealand exporters in emerging markets, and increased corporate and banking risks in the advanced economies, leads NZECO to forecast increasing demand for its products during 2013/14. In response, NZECO will continue to work proactively with New Zealand exporters, banks and insurers to help support export growth.



Chris Chapman

Manager
New Zealand Export Credit Office



Tim Sole

Chair
Export Credit Office
Technical Advisory Committee