



NEW ZEALAND
EXPORT CREDIT
OFFICE

Annual Report of the New Zealand Export Credit Office for the Year Ended 30 June 2014

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Purpose

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

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

The New Zealand Government has set an ambitious goal of increasing exports as a percentage of GDP from 30% to 40% by 2025, and its Business Growth Agenda (BGA) is designed to create the conditions that assist businesses connect to international opportunities and become more productive and internationally competitive.

At the core of NZECO's Mandate is its unique position to assess, accept and manage levels of financial risk in order to facilitate the success of New Zealand companies in international markets. These achievements are leveraged by NZECO's expertise, its international connectedness and its New Zealand Government imprimatur. NZECO works closely with other New Zealand Government and international agencies, as well as the private sector partners, to leverage their knowledge and resources in support of New Zealand companies.

NZECO has demonstrated a role for its services and products. Since its establishment, NZECO has issued a total 440 policies to 116 exporters, supporting \$1.8 billion worth of export transactions into 74 countries.

Summary of Performance for the year ended 30 June 2014

Output Priority 1: Facilitate exports through the efficient and effective delivery of NZECO guarantees

NZECO offers a range of products that may cover:

- ▶ political/country risks of a foreign buyer's country,
- ▶ overseas buyer repayment risks, and
- ▶ New Zealand 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 28 countries. As in previous years, there was a wide

geographical spread. NZECO's support ranged from a solar power system project in the Pacific, to search and rescue vessels supplied to the United Arab Emirates; from meat exports to Peru, to a gas compression system into Australia.

NZECO's performance in supporting exports is summarised below:

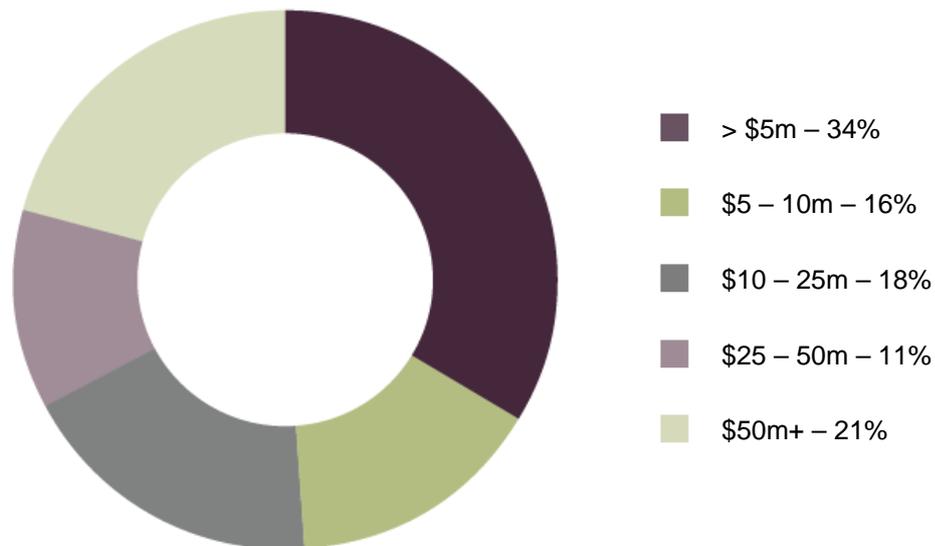
Figure 1 – Key Performance Deliverables

Objective	2012/13 Actual	2013/14 Actual
Number of Offers issued	81	78
Offers issued (Total Exposure)	\$142m	\$240m
Number of Policies Issued	68	59
Total New Exposure for the year	\$64.5m	\$85.6m
Value of Export transactions supported	\$318.9m	\$306.3m
Number of exporters clients	30	36

A positive trend in these annual results was the increased value of offers and total new exposure issued relative to the previous year. The increased value of committed offers related to several large facilities in support of projects ranging between NZD 20 – 60 million in value. The majority of these larger facilities remain outstanding at 30 June 2014, due to delays in final contract awards or execution, and NZECO forecasts several of them to be finalised in the following financial year.

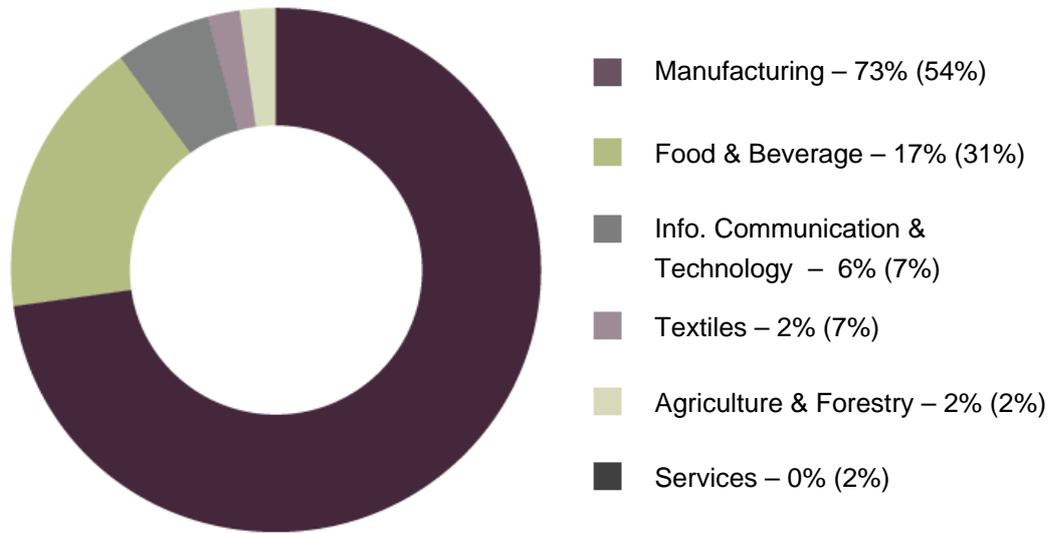
NZECO's exporter clients are overwhelmingly SME. However the graph below also shows that there is an important market need and economic development role for the NZECO in supporting some of New Zealand's largest companies as well.

Figure 2 – Annual turnover of NZECO supported firms (historical to 30 June 2014)



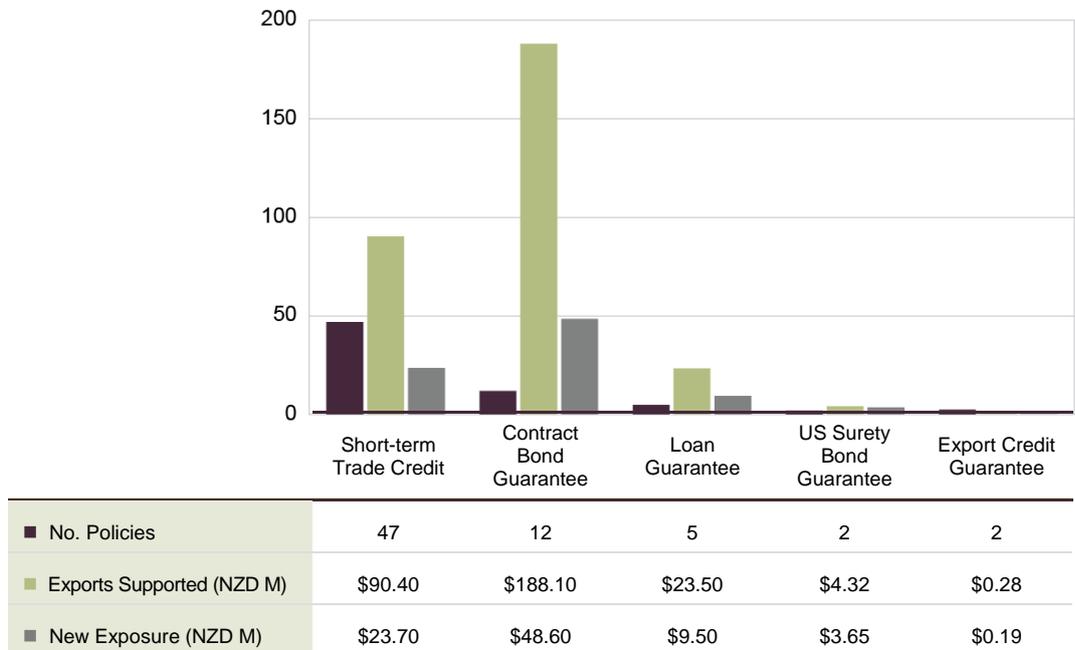
NZECO's breakdown by industry of exports supported was as follows:

Figure 3 – Exports supported by industry (last year's percentage in brackets)



NZECO's provision of an export credit, bond or loan guarantee can be a decisive factor enabling New Zealand firms to secure new export sales. 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 4 – Policies and exports supported by product (NZD M)



Short term Trade Credit Insurance

Steady demand was maintained for this product, primarily from food and beverage, and manufacturing firms, as well as textiles, forestry and agricultural 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 market is off-cover for.

As a result, NZECO has been supporting SME firms' internationalisation 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 Egypt, Pakistan, Jordan, Papua New Guinea, Peru, Sri Lanka and Jamaica.

In addition to mitigating repayment risks, NZECO's insurance has also enabled many exporters to access trade finance facilities from their bank.

Demand for NZECO's "top-up cover" arrangement with private insurers has also continued. Since 2009, NZECO has maintained a successful arrangement with Euler Hermes and has co-insured over 80 policies for their exporter clients. During this year, NZECO provided similar top-up cover on Atradius and AIG trade credit policies, which enabled exporters to sell increased amounts and still be covered in the event of buyer default.

New Zealand Apple exports over four million cartons of apples to 137 customers in 39 countries. For those buyers that require credit terms, New Zealand Apple obtains credit insurance. Since 2009, NZECO has provided cover on their buyers in 15 countries ranging from Qatar to Indonesia. Earlier this year, New Zealand Apple's insurer was able to provide \$1.5 million cover on a \$5 million estimated credit exposure for a foreign buyer. New Zealand Apple approached NZECO to cover the additional \$3.5 million of risk. NZECO assessed and approved cover on the buyer, and provided the additional top-up cover in partnership with New Zealand Apple's insurer, Atradius. *"Taking out trade credit insurance is no different from insuring your house against fire. It's unlikely such an event will happen but, if it does, it could be potentially catastrophic. We're more comfortable now that NZECO has been able to reduce our risk"* – Grant Rae, Finance Manager of New Zealand Apple.

Export Credit Guarantee

Utilisation of the export credit guarantee was very low this year, despite a relatively strong pipeline of opportunities. One of the policies issued during this period was to a company that is very familiar with offering extended terms to buyers for competitive advantage.

Since 2008, Tait Communications has regularly used NZECO's export credit cover to enable it to offer 3 year credit terms to a key Brazilian client. This Brazilian firm delivers telecommunication network and terminal equipment to Petrobras' oil refineries under a 3 year lease arrangement. Tait identified the opportunity to match the payments their Buyer was receiving from Petrobras by offering a 3 year payment solution. NZECO assessed the Brazilian buyer and approved cover on the 3 year payment terms. *"Our ability to offer 3 year repayment terms, underwritten by NZECO, differentiated us from our competitors who demanded upfront payments. It enabled us to become the preferred supplier to our buyer, and continues to generate ongoing export orders"* – Nic Parker, Group Commercial Manager of Tait Communications.

NZECO remains committed to identifying and structuring export credit solutions, because the practices of other export credit agencies show that the provision of extended payment terms is a competitive tool.

An NZECO initiative is focused on proactively offering pre-approved lines of funding to creditworthy buyers in order to facilitate the procurement of New Zealand capital goods and services.

The first market that NZECO identified was Papua New Guinea with its pipeline of Government-funded projects. In close coordination with MFAT, NZTE, ANZ, and New Zealand firms, two NZECO-underwritten loan offers have been presented to the Papua New Guinea Government to support the commercial funding of two multi-million projects if awarded to New Zealand firms.

In the coming financial year, the above Papua New Guinea loan arrangements may be executed which will set a precedent for future opportunities. NZECO will collaborate with exporters and the export-focused government agencies in order to identify other markets and buyers to replicate this 'trade creation' arrangement.

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 to guarantee the performance of the project. During the year, NZECO issued its first surety bond under its new arrangement with Liberty Mutual's Canadian business.

Glidepath has a long history of delivering baggage handling systems into Canadian airports. However the collateral requirement for 100% surety bonds constrains Glidepath's ability to bid for many projects. Glidepath was awarded a contract to design and install a reconfigured baggage handling system for the Prince George Airport. Because this project was federally funded, surety bonds amounting to 100% of the contract value were required. NZECO's new indemnity arrangement with Canadian-based Liberty Mutual enabled Liberty to issue these bonds on Glidepath's behalf. *"NZECO's support is critical to delivering increased projects in Canada, and the NZECO staff put in a great deal of work to help us win the projects that we have contracted"* – John Fitzgerald, Business Development Manager, Glidepath.

NZECO plans to finalise an arrangement with another surety bond provider to support surety bonds on behalf of New Zealand exporters awarded US federal-funded projects in American Samoa and other Pacific territories.

General Contract Bond Guarantee

NZECO received increased 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. NZECO supported over \$180 million of multi-year, export contracts across the specialised engineering, construction, renewable energy and boat building sectors.

For these exporters, the Contract Bond Guarantee 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. One example is an SME exporter, Xenos, which specialises in aseptic bottling technology:

Xenos won a contract to design and manufacture aseptic bottle filling machines and sterilising equipment with a Brazilian company. Xenos negotiated a 30% deposit to help fund their advance working capital requirements and their buyer required this to be matched by a 30% bank guarantee. Xenos lacked the credit facilities with their bank to secure a bond of this size, and sought NZECO's assistance. NZECO was comfortable with Xenos' ability to successfully deliver this project, and issued its bond guarantee to Xenos' bank who then issued the bond to the Brazilian customer. *"Without NZECO support we would not have been able to meet the bonding requirements, and not benefitted from receiving a high deposit. We would have had to renegotiate a lower deposit, which then would have affected our cashflow."* – Andrew Barclay, Managing Director of Xenos.

During the year, NZECO issued its first direct "sovereign" performance guarantee which was an initiative under the government's Business Growth Agenda. This guarantee was provided in support of BCS Group's delivery of a baggage handling system at Kuala Lumpur International Airport. NZECO's performance guarantee, in conjunction with complementary efforts by the High Commissioner and Trade Commissioner in Malaysia, helped facilitate the award of this strategic project by the Government-linked entity that owns the Kuala Lumpur Airport to BCS.

NZECO also received and paid its first claim under the Bond Guarantee. The claim was lodged by the indemnified bank after its exporter client went into receivership and unable to continue to deliver its warranty obligations on a multi-year project which NZECO was guaranteeing.

Loan Guarantee

NZECO's Loan Guarantee is provided to banks as security to enable proven small to medium sized exporters to access additional loan facilities to deliver on export contracts. During the year NZECO supported exporters in specialised manufacturing, horticulture and wine sectors. One example is Blenheim-based firm, Wine Technology:

Wine Technology International Ltd. was awarded a NZD 200k deal to supply its temperature control software and hardware for wine fermentation, to Chile's largest wine supplier. The Chilean buyer demanded to pay for the bulk of the contract after delivery and installation. Wine Technology lacked sufficient collateral to access working capital from its bank. NZECO's loan guarantee was provided to Wine Technology's bank to enable it to fund the firm's pre-shipment costs, and the facility was fully repaid within seven months. *"I was a relatively small company just emerging from the Global Financial Crisis and NZECO's support was exceptional. The technology is now a showpiece for the winery and additional Chilean sales will result"* – Bob Richards, Owner.

Output Priority 2: Manage risks appropriately and in accordance with export credit agency best practice

NZECO's ability to adequately assess and manage the risks it takes to help New Zealand exporters be successful is a key component of its operations. 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.

During the year, an external audit was undertaken on the business and operational controls of NZECO. Overall, it recorded positive findings in respect to NZECO's business practice and also highlighted how NZECO's risk assessment, management and governance processes are designed to manage risk to a reasonable level rather than eliminate all risk of loss.

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.

Engagement with other export credit agencies, including a formal services arrangement with Sweden's ECA (Export Kredit Namnden – EKN) remained a valued source of country risk, foreign bank, pricing and other technical expertise for NZECO.

Another key measurement of NZECO's success remains its ability to cover its operating costs and claims from the premiums and fees it collects. NZECO follows the OECD Arrangement on export credits and pricing, as well as its own Crown mandated criteria and prudential limits.

Typical of an export credit agency whose role is to underwrite risk exposure on countries, markets and businesses where political stability and commercial success are uncertain, NZECO operates with a long-term perspective.

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

Figure 5 – Key Financial Results

	2012/13 Actual	2013/14 Actual
Operating Income (Earned premium & application fees)	\$1.89m	\$1.59m
Recoveries	\$0	\$0.04m
Operating Expenses	(\$1.79m)	(\$1.90m)
Claims Expenses	\$0	(\$0.53m)
Changes in provisions	\$0	(\$0.47m)
Profit / Loss for Year ¹	\$0.10m	(\$1.27m)
Cash Balance (notional) at Year End	\$16.40m	\$15.81m

The calculation of Operating Income recognises that premiums received from every policy are accrued over the credit term of the deal. Hence, Operating Income includes premium associated with deals that have been executed in the previous years where NZECO remains at risk.

NZECO's reduced 2013/14 Operating Income was impacted by a lower number of higher exposure, longer tenor policies being generated during 2012/13, which resulted in reduced premium revenue flowing through to this Financial Year. NZECO's net result was also adversely impacted by a NZD 530,000 claim, which was NZECO's fourth claim to date.

This financial result demonstrates how, by virtue of its role in filling market gaps and supporting exporter development, NZECO faces fluctuating business volumes, income and claims. However, there was a positive upturn in policies issued in the final Quarter of this year which contributed to NZD 2.2 million of cash being received during 2013/14. With outstanding offers totalling NZD 125 million at year end, combined with a pipeline of new application, NZECO forecasts an increase in Operating Income for 2014/15 financial year.

As at 30 June 2014, 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 13% of NZECO's total risk portfolio.

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 20 countries, with the largest concentration (75%) recorded on New Zealand

¹ Before any notional interest earned on notional Cash Balance.

(reflecting those New Zealand firms whose performance NZECO underwrites). The second highest concentration risk is on Brazil (7%) which is acceptable. Less than 1% of NZECO's total portfolio is concentrated in higher risk countries (e.g. Pakistan) and these policies are closely monitored.

NZECO's current exposure to sectors is weighted towards manufacturing (72% of NZECO's total exposure). This relates primarily to specialist engineering, automated machinery, radio equipment, and ship-building.

The majority of NZECO's policies are for relatively small guarantee amounts, with the median policy exposure being NZD 550,000. The average policy term is one year. This mix of predominantly small policies provides a challenge for NZECO to build 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. Feedback from private reinsurers and NZECO's own modelling show that NZECO requires a minimum scale of gross written premium in order to have an arrangement that benefits both parties. NZECO is not consistently achieving the required level of gross written premium, which is why achieving higher business growth is important for NZECO's sustainability and risk mitigation.

One-off, facultative, reinsurance remains another option for larger policies. NZECO will continue to develop relationships with private reinsurers and export credit agencies with this option in mind.

Output Priority 3: NZECO is highly engaged to market conditions

NZECO's ability to be highly engaged to market conditions requires it to be actively communicating with the exporters, banks and exporter-focused agencies. NZECO can offer the most value to these stakeholders by:

- ▶ providing a higher degree of certainty and stability of support (particularly in times of crisis);
- ▶ leveraging the imprimatur and networks of government;
- ▶ exclusively accessing and sharing market information through its linkages with other Export Credit Agencies; and
- ▶ applying its staff's experience and expertise in a professional manner that is responsive, relevant, and solution focussed to the market's cyclical needs.

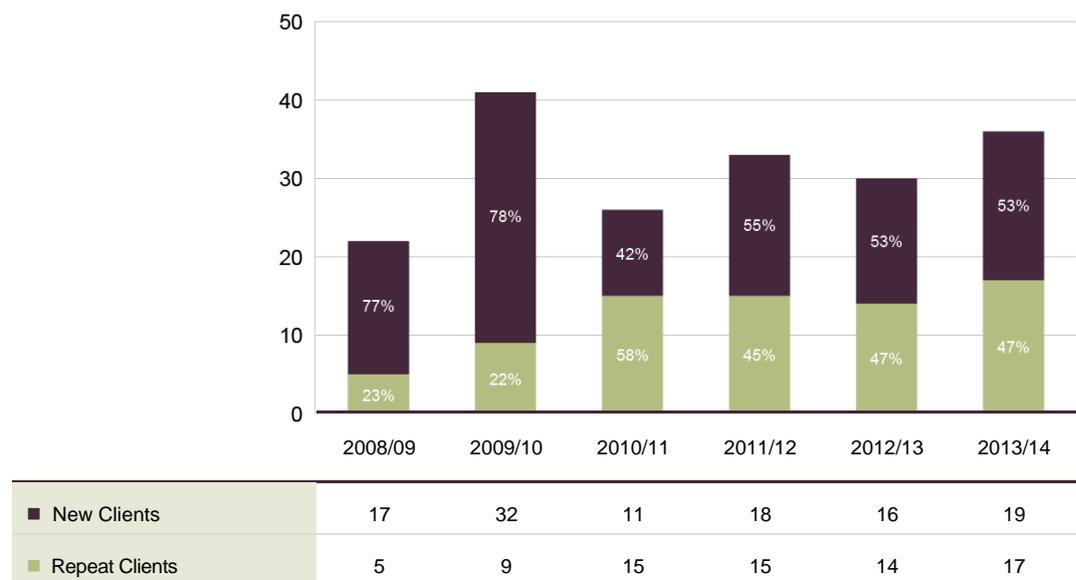
NZECO doubled its client-facing team from two to four staff, and this team had a busy year with 482 external face-to-face engagements. This engagement was nationwide and contributed to NZECO achieving broad geographical coverage of its support, as demonstrated in the map below.

Another element to NZECO’s education of exporters is how to properly prepare information to enable an informed credit decision. Often credit applications lack incomplete financials and cash-flow projections, which is sometimes the reason why a financier has declined their initial lending approach. NZECO is prepared to take the time to help the exporters understand a credit process and improve their financial reporting which should enable them to submit better quality credit submissions to private financiers in the future.

A positive outcome of NZECO’s external engagement was that 53 percent of the exporters that NZECO issued policies to during the year were firms that NZECO had not previously supported. Equally, NZECO facilitated repeat business from key clients, especially those on a sustained steep growth curve; those facing barriers that only NZECO can best support (e.g. surety bond requirements); or those offering extended payment terms to buyers to gain a competitive edge.

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

Figure 8 – Ratio of New and Repeat users of NZECO



NZECO also 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). In December 2013, NZECO hosted a 4 day conference of international export credit agencies, attended by 47 delegates from 22 countries across Eastern, Central, and Mediterranean Europe, Middle East, Africa, Central and South-east Asia.

The Year Ahead

The Global Financial Crisis period and its continuing hangover have highlighted how access to financial and insurance services can make the difference between success and failure for New Zealand exporters. A well-established, resourced and skilled NZECO ensures a level of consistency and predictability of the availability of these financial services.

NZECO has been included as one of nine "key areas" in support of the "Building Export Markets" workstream in the government's Business Growth Agenda "Future Directions" report that was released in June 2014. This references the NZECO initiative to identify and offer lines of credit to sovereign buyers in order to facilitate the procurement of New Zealand goods or services, and implementation of this will be a goal of NZECO.

The Government and private sector has also identified the desirability of trade diversification both in terms of exports (e.g. beyond agricultural commodities to manufacturing, agri-business and services exports) and in terms of markets (i.e. including opportunities that ASEAN, Latin American and African markets provide). NZECO's range of products is well-suited to support these sectors and markets, and we will be focused on facilitating this.

NZECO will undertake a survey across New Zealand exporting firms in the first Quarter to obtain feedback on the current private sector provision of trade credit insurance and trade finance, as well as on NZECO's performance and product range. This will inform NZECO's and Treasury's planned review of strategic options that may improve NZECO's performance in support of the Government's Business Growth Agenda.

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.

The continuing political, corporate and banking uncertainties across the broad spectrum of international markets that New Zealand exporters trade with leads NZECO to forecast increasing demand for its products during 2014/15. In addition, NZECO is focused on working with New Zealand exporters, banks and insurers to proactively identify opportunities and NZECO-supported solutions that contributes to New Zealand's export-led growth.



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