



Annual Report of the New Zealand Export Credit Office for the Year Ended 30 June 2015

New Zealand Government

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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.

While the capacity and risk appetite of the trade finance and trade insurance markets have improved in recent years, the Global Financial Crisis period highlighted how NZECO's support can make the difference between New Zealand exporters securing and funding exports – or not. A well-established, resourced and skilled NZECO ensures a level of consistency and predictability in the availability of these financial services for the future.

Summary of Performance for the year ended 30 June 2015

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 has demonstrated a role for its services and products. Since its establishment, NZECO has issued a total 490 policies to 128 exporters, supporting NZD 2.3 billion worth of export transactions into 77 countries.

In 2014/15, NZECO's support was provided to New Zealand exporters of all sizes and sectors, supporting their export sales into 23 countries. As in previous years, there was a wide geographical spread. NZECO's support ranged from an airport project in India, to education services into Saudi Arabia; from wool exports to Lithuania, to food processing machinery into Australia.

NZECO's performance in supporting exports is summarised below:

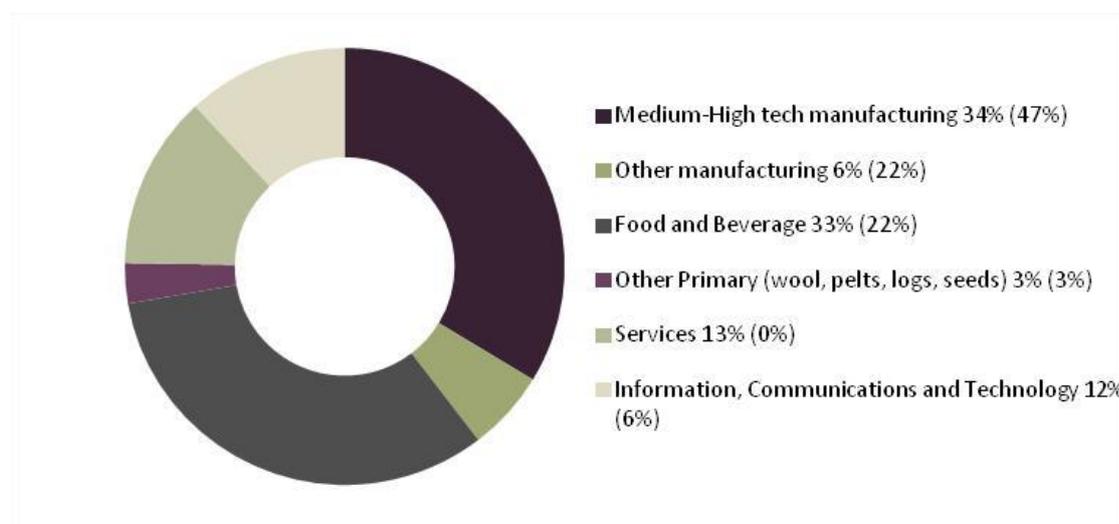
Figure 1 – Key Performance Deliverables

Objective	2013/14 Actual	2014/15 Actual
Number of Offers issued	78	60
Offers issued (Total Exposure)	\$240m	\$204m
Number of Policies issued	59	50
Total New Exposure for the year	\$86m	\$158m
Value of Export transactions supported	\$306m	\$513m
Number of Exporter clients ¹	43	36

A positive trend in these annual results was the increased value of new exposure issued and the historically high total value of exports supported. Over two-thirds of the exports underwritten by NZECO were non-primary sector such as high tech manufacturing, tourism, ICT and education consultancy services all which contribute to the improved diversification and added value of New Zealand's exports.

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

Figure 2 – Exports supported by industry (last year's percentage in brackets)



¹ An exporter client is a firm whose exports benefitted from a NZECO guarantee during the year.

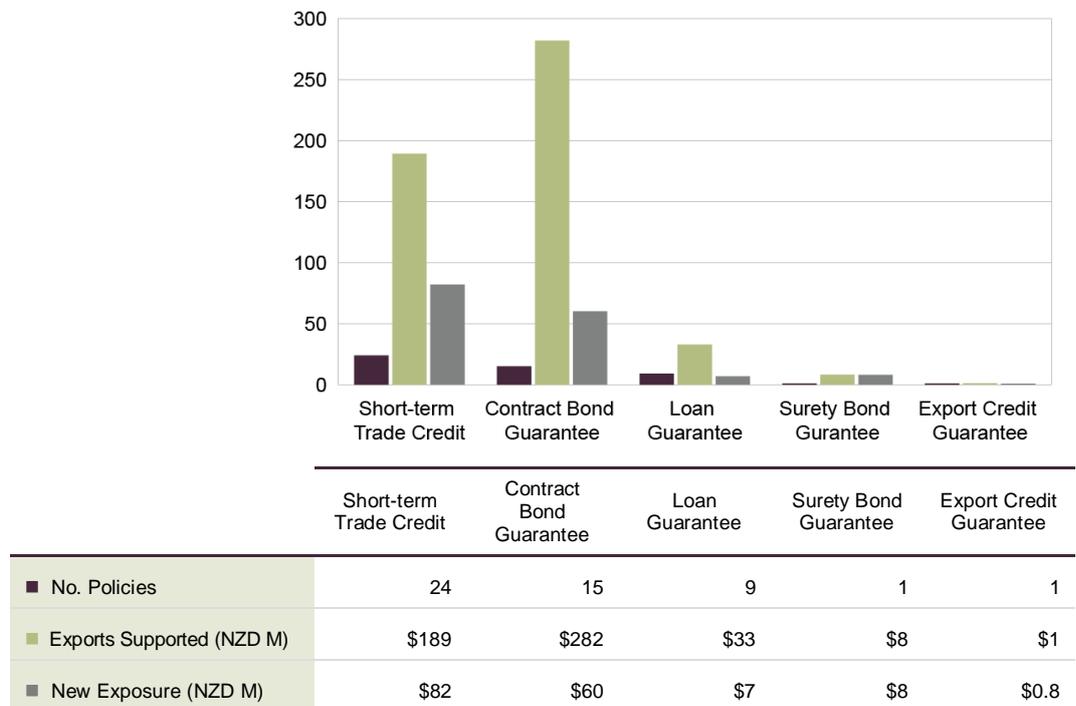
NZECO's exporter clients are predominantly SME. However the graph below shows that there is also an important market need and economic development role for the NZECO in supporting some of New Zealand's largest companies.

Figure 2 – Annual turnover of NZECO supported firms (historical to 30 June 2015)



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. NZECO's contract bond guarantee had the greatest impact in terms of the aggregate value of export contracts supported, and primarily in support of medium to high tech manufacturers and services exporters.

Figure 4 – Policies and exports supported by product (NZD M)



Short Term Trade Credit Insurance

NZECO's Short Term Trade Credit product covers the risk of a foreign buyer or foreign bank failing to make short-term credit payments due to political or commercial events.

NZECO can only accept applications once the exporter applicant has been declined by the private insurers, and demand for NZECO support reduced this year in response to the private sector's stronger credit risk appetite.

Since NZECO introduced this product in 2009, 82% of our exporter policyholders have subsequently received cover from the private trade credit insurers. This is a successful demonstration of how NZECO's support can facilitate the private insurers' future involvement by helping exporters establish a positive trading history with a new buyer, or growing their export turnover and number of insurable buyers.

Current demand for NZECO support is typically arising from either:

- a new or smaller exporters who have limited 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 has limited or no risk appetite for.

During the year, this product underwrote NZD 189 million of exports into 15 countries, including Bangladesh, India, Nepal, Pakistan, Vietnam, Algeria, Sudan, and Mexico. These countries are outside of New Zealand's top ten export markets, and it demonstrates how NZECO can support the diversification of New Zealand's international markets.

One example of NZECO's support for a small exporter beginning a trading history with a new foreign buyer is Walcovit New Zealand:

Walcovit New Zealand is a boutique, Hawkes Bay company that exports frozen calf stomach enzymes for use as a starter for traditional cheeses such as Romano and Parmesan. Walcovit approached NZECO to cover sales to a new client in Turkey, who was seeking short-term credit. NZECO assessed and approved cover on the buyer, which gave Walcovit the confidence to enter this new market and trading relationship. *"To have the ability to obtain single credit insurance on a buyer is a unique financial product. The entire process for applying for this service was surprisingly seamless."* – Matt Ward, Managing Director of Walcovit New Zealand.

Demand for NZECO's "top-up cover" arrangement with private insurers also continued. NZECO provided top-up cover in partnership with Atradius, which enabled exporters to sell increased amounts to buyers in Australia, United States and Mexico and still be covered in the event of buyer default.

Export Credit Guarantee

NZECO's Export Credit Guarantee covers credits or loans, greater than one year, provided to foreign buyers of New Zealand capital goods and related services. NZECO underwrites commercial or political risk events that result in the foreign buyer failing to make its repayments as they fall due.

Utilisation of this product was very low this year, despite a relatively strong pipeline of applications and enquiries. The low policy conversion rate was primarily due to delays in finalising contract or financing terms, and/or receipt of financial and transactional information which did not meet NZECO's underwriting criteria.

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. One 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.

In light of a strong pipeline of opportunities, NZECO forecasts an increase in exports supported via the Export Credit Guarantee over the coming year.

General Contract Bond Guarantee

A contract bond is a financial guarantee which protects a buyer from losses in the event the contractor fails to properly perform its contractual obligations. NZECO's General Contract Bond Guarantee is provided to an exporter's bank or bond provider to support the issuance of these bonds when the exporter has insufficient collateral to secure the bond in addition to their working capital facilities.

NZECO received increased demand for this product from a mix of SME exporters with insufficient balance sheet strength and growing companies that lacked the bonding facilities to support large project requirements. NZECO helped New Zealand firms secure over NZD 280 million of multi-year, export contracts spanning projects in high-tech engineering, marine, construction, telecommunication and education services sectors.

For these exporters, the General 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 of how NZECO has provided bonding capacity to a growing exporter is BCS Group, who specialises in logistics hardware, automation controls and software solutions for the aviation and logistics sector:

Advance payment bonds, performance bonds and warranty bonds are all commonly required on the international projects that BCS Group performs. NZECO's General Contract Bond Guarantee has enabled BCS to secure several large international airport baggage handling and parcel handling projects. *"NZECO's guarantees have been invaluable to BCS Group. Their benefit is not just with bonding facilities but also the key message to international clients that we have NZ Government backing and support."* – Steve Fullerton, Chief Financial Officer, BCS Group.

Further to this point about the benefit of NZECO's government imprimatur, NZECO issued its second direct "sovereign" performance guarantee which was an initiative under the government's Business Growth Agenda. NZECO's guarantee was provided in support of the Waikato Institute of Technology's delivery of a five-year educational services project with a Saudi Arabian government agency.

Surety Bond Guarantee

A surety bond is a financial guarantee which provides assurance to a buyer that the contracted work will be performed and/or any losses incurred due to a contractor's non-performance will be indemnified.

NZECO's Surety Bond Guarantee is provided to international surety bond providers, and is crucial for many New Zealand firms seeking to bid for United States or Canadian federal or state funded projects, which require 100% surety bonds to guarantee the performance of the project. This is because most New Zealand firms are unlikely to be known by the offshore surety bond issuers, nor able to meet their minimum financial criteria.

During the year, NZECO issued its second surety bond under its arrangement with Liberty Mutual's Canadian business.

NZECO was also pleased to enter into an arrangement with AIG Australia Ltd to primarily assist New Zealand exporters secure surety bonds in respect to United States' federal-funded projects in American Samoa and other United States' Pacific territories. NZECO forecasts this arrangement will be utilised in the coming year, combined with continuing demand for Canadian surety bond support.

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. NZECO doubled the amount of loan guarantee policies issued this year from the previous year, and supported exporters across the horticulture, tourism, and high tech manufacturing sectors.

One innovative example of NZECO's Loan Guarantee is using it to help secure and fund an offshore operating lease, as demonstrated by Mercer Group Limited:

An Australian client wanted to lease Mercer's food slicing equipment and repay it over 30 monthly instalments. Because this operating lease could be terminated after a minimum period, and because the equipment was located offshore, Mercer's bank was unable to provide additional lending to help Mercer fund this leasing arrangement. NZECO's loan guarantee, covering this 30 month repayment term, enabled Mercer's bank to provide this lending and for Mercer to proceed with this sale. *"NZECO's support for leasing arrangements gives us an opportunity to boost sales into overseas markets, as our customers can obtain significant savings from the machinery in advance of the cash payments for the slicers."* – Tobin Blathwayt, Chief Financial Officer of Mercer Group.

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

In its delivery of supporting increased exports while appropriately managing risks, NZECO is strategically focused on “Sustainable Growth and Diversification”. NZECO’s targets for **Growth** are measured by increased exports supported as well as increased levels of premium. Improved **Diversification** is measured by NZECO supporting a broader range of exporters, as well as a more balanced portfolio of risks by sector, counterparty and country. The achievement of well-managed premium growth and diversification of risk will ensure the ongoing **Sustainability** of NZECO’s business.

NZECO is required to cover its operating costs and claims from the premiums and fees it collects. However, typical of an export credit agency which underwrites risks on countries, markets and businesses where political stability and commercial success are uncertain, NZECO operates with a longer-term perspective.

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

Figure 5 – Key Financial Results (NZ Dollars)

	2013/14 Actual	2014/15 Actual
Operating Income (Earned premium & application fees)	\$1.59m	\$2.45m
Recoveries	\$0.04m	\$1.25m
Operating Expenses	(\$1.90m)	(\$1.89m)
Claims Expenses	(\$0.53m)	(\$3.28m)
Changes in Provisions	(\$0.47m)	(\$2.06m)
Profit / Loss for Year ²	(\$1.27m)	(\$3.53m)

Operating Income grew this year which reflected a trend of increased business volume over the last 18 months. The calculation of Operating Income recognises that premiums received from its policies are accrued over the term of each policy. Hence, Operating Income includes premium associated with policies that have been issued in the previous years where NZECO remains at risk.

NZECO works closely with exporters and banks to manage problems with our guaranteed counterparties and to minimise claims and any losses. The Claims Expenses amount recognises five claims paid under NZECO’s Short-Term Trade Credit, Loan and Bond Guarantees. Recoveries of NZD 1.25 million were subsequently collected, and there is the prospect of additional recoveries to be received. Provisions for NZD 2.06 million relate to NZECO risk exposures in Brazil which have been adversely impacted by their economic recession.

² Before any notional interest earned or paid on NZECO’s notional Cash Balance.

This year's financial result demonstrates how, by virtue of its role in filling market gaps and supporting exporter development, NZECO faces fluctuating income and claims. With outstanding commitments totalling NZD 51 million at year end, combined with a strong pipeline of applications, NZECO forecasts an increase in Operating Income for 2015/16 financial year.

NZECO's ability to assess and manage the risks it takes to help New Zealand exporters be successful is a key component of its operations. During the year, NZECO increased its staff to 10 people, all with a range of international private sector experience.

NZECO's Technical Advisory Committee (TAC) met nine 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. TAC's responsibility extends to reviewing and commenting on the majority of NZECO's credit risk assessments. NZECO welcomed Linda Robertson as a fourth TAC member in June 2015. Linda has over 30 years corporate and banking experience, most recently as Group Manager Treasury & Procurement at Meridian Energy Limited.

NZECO follows the OECD Arrangement on export credits and pricing, as well as its own Crown mandated criteria and prudential limits. Engagement with other export credit agencies, including a formal services arrangement with Sweden's export credit agency (Export Kredit Namnden – EKN) remain a valued source of country risk, foreign bank, pricing and other technical expertise for NZECO.

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 monitors its foreign buyer repayments and New Zealand exporter performance on a monthly basis. 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.

As at 30 June 2015, NZECO's risk portfolio (including committed offers) was valued at NZD 214 million across 63 policies. The majority of NZECO's commercial risks are unrated companies and banks that NZECO has assessed as being equivalent to a limited range of between B to B+ credit rating.

NZECO has outstanding exposure across 14 countries, with the largest concentration (69%) recorded on New Zealand (reflecting those New Zealand firms whose performance NZECO underwrites). The second highest concentration risk is on the United Kingdom (17%) and the third highest on India (7%), which are both acceptable. Less than 2% of NZECO's total portfolio is concentrated in higher risk countries (e.g. Pakistan, Egypt, Nepal and Bangladesh) and these policies are closely monitored.

The distribution of risks across New Zealand sectors is broadening. Medium to high-tech manufacturers transactions represent 45% of NZECO's exposure, and the food and beverage (including dairy) represent 19%. The remaining risks are spread across ICT, services and other manufacturing and primary sectors.

NZECO's largest exposure by counterparty equates to 25% of NZECO's total committed exposures, as at 30 June 2015. The next two largest counterparty exposures are 14% and 13% respectively. These counterparty risk concentrations reflect how the majority of NZECO's policies are for relatively small guarantee amounts. NZECO's median policy exposure for the year was NZD 675,000, and an average policy term of 15 months.

This mix of predominantly small policies provides a challenge for NZECO to build a 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 is in discussions with several agencies and plans to implement its first facultative reinsurance arrangement before the end of 2015.

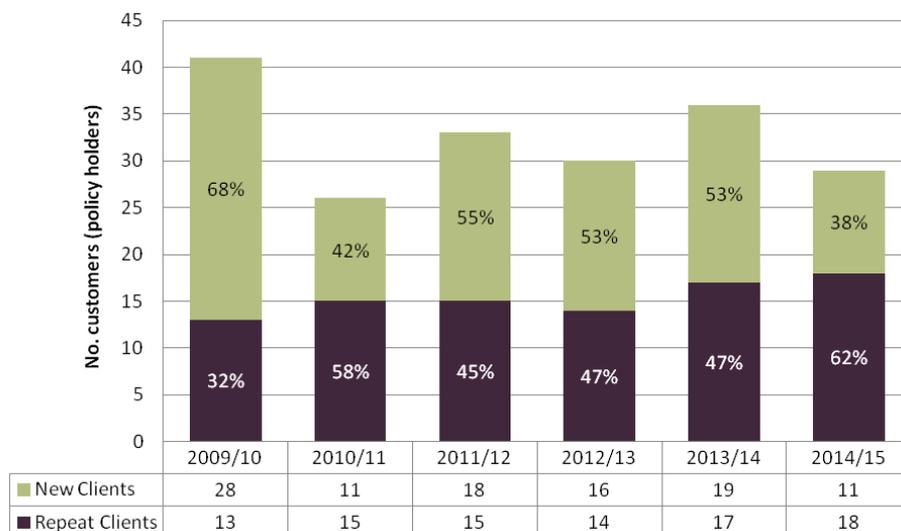
Output Priority 3: NZECO is highly engaged to market conditions

NZECO's ability to be highly engaged to market conditions requires it to be actively communicating with the exporters, banks and exporter-focused agencies. During the year, NZECO undertook a survey seeking exporters' feedback on their experiences and key challenges in respect to insuring, funding and securing export sales. NZECO also asked for feedback on how NZECO it could improve its services to exporting firms.³ These responses have helped inform recommendations which NZECO has presented to the New Zealand Treasury in advance of a review of NZECO's mandate and product range which will occur in the latter half of 2015.

Building awareness of NZECO's solutions and their benefits is a key focus for NZECO's client-facing team. The table below illustrates how many new customers relative to repeat clients that NZECO has supported over recent years.

³ For a summary of the survey findings visit NZECO's website: www.nzeco.govt.nz/news/17oct14/

Figure 6 – Ratio of New and Repeat users of NZECO



This year there was a reduction in new customers supported by NZECO, which highlights the importance of NZECO continuing to broaden its national profile in a targeted manner. To support this, NZECO increased the staff numbers of its client-facing team during the year.

This team had a very busy year with 522 external face-to-face engagements. NZECO delivered 51 presentations to external groups, as summarised below:

Figure 7 – NZECO’s education seminars delivered during 2014/15

Objective	2013/14 Actual	2014/15 Actual
Number of NZECO presentations at exporter events	9	24
Number of NZECO presentations to NZ bank staff	16	11
Number of NZECO presentations to export-facing agencies (Government & Industry)	11	16

NZECO’s staff champion and partner with other export-industry associations and government agencies (e.g. NZTE, Ministry of Foreign Affairs and Trade, Ministry of Business, Innovation and Employment, and Education New Zealand). This includes joint “NZ Inc” presentations in partnership with private sector speakers, and targeted at educating exporter audiences. NZECO and NZTE also coordinated a “hot-desk” arrangement in which a NZECO member spends one day a fortnight in the NZTE Auckland office, and once a month in the NZTE Wellington and Christchurch offices.

Key elements of NZECO’s engagement is focused on how to manage the financial risks of exporting, as well as educating exporters (particularly SME firms) about trade finance solutions. Bankers and insurers are important referrers and partners in these trade finance and insurance solutions, and NZECO focuses on building their awareness of how NZECO can provide additional credit capacity and security to their exporter clients.

The Year Ahead

NZECO is committed to supporting the Government's export-growth objectives of its Business Growth Agenda. The recent downturn in commodity prices combined with a slowing China have further highlighted 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's strategy remains focused on building a sustainable business based on well-managed growth and risk diversification, where the markets' demands and NZECO's mandate allows.

In order to manage risk concentrations, as well as facilitate exports that otherwise may not be secured, NZECO will focus on establishing new co-operation and reinsurance arrangements with other export credit agencies and private reinsurers. Success will be demonstrated by NZECO supporting New Zealand exports via one or more of its cooperation or reinsurance arrangements during 2015/16.

NZECO looks forward to a review of its mandate, product range and performance, and will support where possible the Treasury's preparation of a policy paper and recommendations for Cabinet's review by November 2015.

Political, corporate and banking uncertainties across a range of international markets that New Zealand exporters trade with leads NZECO to forecast increasing demand and opportunities for its solutions during 2015/16. Successful delivery of these solutions will be achieved in close partnership with New Zealand exporters, banks, insurers and NZ Inc agencies, and NZECO looks forward to further building these partnerships in order to contribute to New Zealand's export-led growth.



Chris Chapman

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Tim Sole

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