



NEW ZEALAND
EXPORT CREDIT
OFFICE

Annual Report of the New Zealand Export Credit Office for the Year Ended 30 June 2016

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 tailored trade finance and trade credit 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.

NZECO is positioned to support the Government's objectives via its unique position to assess, accept and manage levels of financial risk in order to facilitate the internationalisation of New Zealand companies.

The strategic objectives of NZECO are 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.

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 its private sector partners, to leverage their knowledge and resources in support of New Zealand companies.

Summary of Performance for the year ended 30 June 2016

1: Supporting exporters' growth and diversification

Since its establishment, NZECO has issued a total of 536 policies covering NZD 1.02 billion of risk, in support of 133 exporters and NZD 2.5 billion worth of export transactions into 80 countries. But for our support, these exports would either have not have occurred, or would have occurred with increased exposures to the exporter.

During 2015/16, NZECO's support was provided to New Zealand companies of various sizes and sectors, supporting their export sales into 27 countries. As in previous years, there was a wide geographical spread with over half of these countries being outside New Zealand's top ten export markets. NZECO's support ranged from an airport project in Macau, to training services into Oman; from wine exports to Britain, to a construction project in Vanuatu.

NZECO's annual results in supporting exports is summarised below:

Figure 1 – Key Performance Deliverables

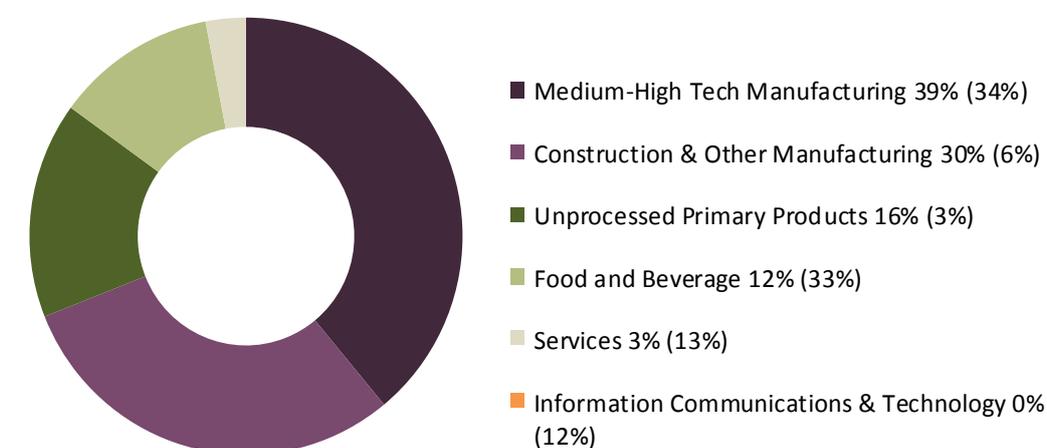
Objective	2014/15 Actual	2015/16 Actual
Number of Offers issued	60	48
Offers issued (Total Exposure)	\$204m	\$184m
Number of Policies issued	50	46
Total New Exposure for the year	\$158m	\$131m
Value of Export transactions supported	\$513m	\$193m
Number of Exporter clients ¹	36	39

Given our role is to complement the private sector, demand for NZECO's products is impacted by the capacity and appetite of the trade credit insurers and banks to assume financial risks in support of exports. The 2015/16 results reflect, in part, reduced market demand arising from higher credit risk appetite and capacity within the private sector, as well as a reduction in international trade finance flows. In addition, several of NZECO's commitments to support larger-value exports were not utilised due to unsuccessful tenders or postponed contracts. Accordingly the majority of the issued policies were in support of SME exporters and/or smaller-value export contracts.

Almost three-quarters of the exports underwritten by NZECO were non-primary sector such as high tech manufacturing, construction, tourism and training services all of 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:

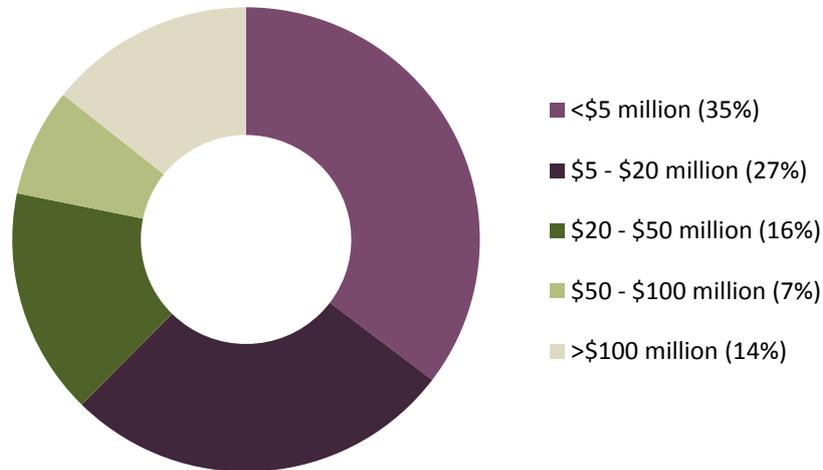
Figure 2 – Exports supported by industry (last year's percentage in brackets)



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

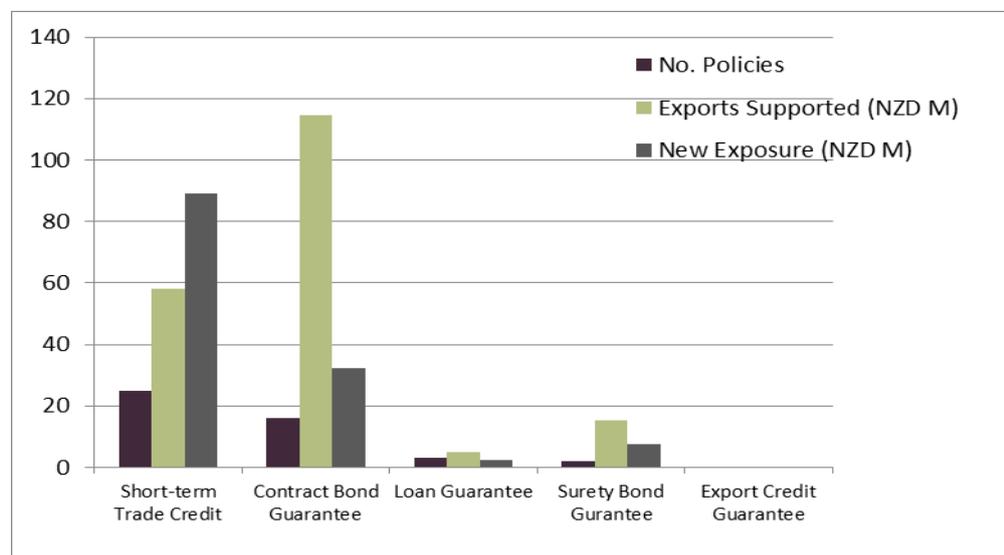
NZECO's exporter clients are predominantly SME. However the graph below shows that there is also an important market need and economic development role for NZECO in supporting some of New Zealand's largest companies.

Figure 3 – Annual turnover of NZECO supported firms (historical to 30 June 2016)



Similar to previous years, NZECO's contract bond guarantee had the greatest impact in terms of the aggregate value of export contracts supported, and this was wholly in support of medium to high tech manufacturers, engineering, construction, and services exporters.

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



	Short-term Trade Credit	Contract Bond Guarantee	Loan Guarantee	Surety Bond Guarantee	Export Credit Guarantee
No. Policies	25	16	3	2	0
Exports Supported (NZD M)	\$58	\$115	\$5	\$15	\$0
New Exposure (NZD M)	\$89	\$32	\$3	\$8	\$0

A review of NZECO's operations and performance was undertaken by the Treasury during the year, in consultation with other government agencies, exporters, banks and private trade credit insurers. After this review, the Government approved to renew NZECO's mandate, and to amend some operational criteria and products in a manner that complements the banks and trade credit insurers and enables NZECO to support a wider range of New Zealand exports and companies.

One new change is the ability for NZECO to provide its range of solutions in support of a New Zealand company that has been awarded a supply chain contract that is integral to the ultimate delivery of exports. Another key change is the approval to provide political risk investment insurance.

As a result, NZECO's solutions can support New Zealand companies at different stages of an exporting life cycle:



from supporting NZ suppliers integral to an exporter's supply chain,



to repayment cover for an exporter's first offshore sales,



to working capital solutions for NZ companies' export-led growth,



to enabling exporters offer extended payment terms to foreign buyers,



to political risk cover for companies investing directly into foreign markets.

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.

During the year, this product underwrote NZD 58 million of exports into 16 countries, including Lebanon, Palestine, Tunisia, United Arab Emirates, Bangladesh, Nepal, Pakistan, 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.

NZECO can only accept applications once the exporter applicant has been declined by private trade credit insurer. NZECO provides its support with the objective of helping an exporter to establish a positive trading history with a new buyer, or grow their export turnover and number of insurable buyers, which in turn may result in the private insurers stepping in to provide future cover.

Since NZECO introduced this product in 2009, 86% of our policyholders have subsequently received cover from the private trade credit insurers. During the year, several exporters obtained private sector cover on foreign buyers after NZECO had

successfully underwritten their sales over the last one to two years. This market practice, combined with strong credit risk appetite and capacity, resulted in demand for NZECO's insurance for open account trade remaining at historically lower levels.

Current demand for NZECO's open-account, trade credit insurance is arising from either:

- a new or smaller exporters who are looking to insure small value shipments (e.g. less than NZD 100,000) into new markets, or
- b exporters selling to buyers in emerging markets that the private market currently has limited or no risk appetite for e.g. Egypt.

One example of NZECO providing its trade credit insurance to assist an exporter establish a trading history with a new foreign buyer is NZ Natural Juice Company:

NZ Natural Juice is a small business based in Napier that exports high-end fruit juice. It secured a first-time sale with a large Taiwanese supermarket chain, who required payment to be made after receiving the goods in Taiwan. The deal was worth less than \$50,000 but a loss of that size would put stress on a young business in growth mode. Given the single buyer and low insurable value, NZ Natural Juice was referred to NZECO. *"Small businesses need all the help we can get to grow and prosper. NZECO's support gives us confidence to go out there and seek more markets."* – Sally Symes, Operations Manager of NZ Natural Juice

There was steady demand for NZECO's cover of foreign-bank issued letters of credit. During the year, NZECO's operational criteria was amended to enable it to provide 100% political and commercial risk cover in relation to letters of credit. This enabled NZECO to meet the industry practice and market demand in circumstances where New Zealand banks have limited credit capacity for certain regions and banks. This year, the majority of demand related to banks in the Middle East and Asian regions.

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.

NZECO received regular enquiries and discussions about potential export credit support throughout the year but only three applications arose. A key limiting factor is that the underlying transaction size was typically less than NZD 2 million (and often less than NZD 500,000) between an SME exporter and their SME international buyers.

For the first time in eight years, none of the Export Credit Guarantee enquiries or applications received by NZECO converted to an export credit policy. This was 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, particularly for sales over NZD 5 million. One NZECO initiative is focused on identifying

opportunities to coinsure or reinsure with other export credit agencies, on projects involving a New Zealand joint contractor.

With this objective in mind, NZECO entered into a Master reinsurance arrangement with the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC) and cooperation arrangements during the year with Iran's EGFI and China EximBank.

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 continued to receive steady demand 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 also helped provide additional bonding capacity to larger firms whose international opportunities were being constrained due to their bank bonding facilities being full with domestic bonding requirements.

NZECO helped New Zealand firms secure over NZD 114 million of multi-year, export contracts spanning high-tech engineering, construction, and consultancy projects.

For these exporters, the General Contract Bond Guarantee enabled them to bid for and win larger transactions, get paid during the project period, and continue to receive their normal trade finance from their banks, without providing additional security.

One example of how NZECO's support enabled an exporter to secure a larger project is HydroWorks, who specialises in the design and manufacture of turbines for the hydro generation industry:

When HydroWorks was awarded an NZD 8.5 million contract to refurbish a hydroelectric plant in Australia, it lacked the collateral to enable its bank to issue the required advance payment, performance bonds and warranty bonds. NZECO's General Contract Bond Guarantee enabled HydroWorks' bank to issue the bonds, and for HydroWorks to receive advance payments to help cashflow its project. *"This project is a transformational step-change which has earned us credibility in the market. NZECO's support was incredibly instrumental in enabling us to proceed."* – Andrew Rodwell, Chief Executive, HydroWorks

NZECO also issued its first Contract Bond Guarantee under its arrangement with AIG Australia Ltd in support of a material handling manufacturer's project in Australia.

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 two policies under its arrangement with Liberty Mutual Canada in support of two high-tech manufacturing projects in Canada.

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.

Previously the Loan Guarantee was limited to firms with an annual turnover of less than \$50 million. This turnover cap was removed during the year to broaden the range of firms that NZECO could support. Another operational criteria change extended the maximum tenor from three to five years, in order to better support longer-term debt funding for an exporter's capital investments.

These operational changes enabled NZECO to support a mix of SME and larger firms from horticulture, tourism, and services sectors.

A tourism example is JUCY:

JUCY has a growing campervan rental operation in the United States. In order to meet growing demand, JUCY wanted to buy and custom-fit 50 campervans in time for the 2015 summer peak tourism season. Jucy faced funding constraints from their New Zealand bank because the vehicles were to be located offshore. NZECO's loan guarantee enabled JUCY to access an additional NZD 1m of lending from its New Zealand bank, with a 3 year repayment term. JUCY managed to get the campervans on the road in time for a profitable peak season. *"Growth in the market has translated to growth in returns. NZECO's support gave us a lot of confidence, and made us even more determined to get this right."* – Jonathan Duncan, Chief Financial Officer of JUCY

2: Manage risks appropriately and sustainably

Assessing and managing risk is a critical component of NZECO's operations. Typical of an export credit agency which complements the private sector, NZECO's portfolio of exposures has a higher and more concentrated risk profile than commercial lenders and insurers.

During 2015/16, NZECO's policies were primarily shorter term (median policy tenor: 6 months) and lower value (median credit value: \$306k). The credit risk profile of these policies had a high weighting towards SME commercial risks as well as emerging markets.

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)

	2014/15 Actual	2015/16 Actual
Operating Income (Earned premium & fees received)	\$2.41m	\$2.56m
Operating expenses	(\$1.90m)	(\$2.21m)
Net operating profit (before claims and recoveries)	\$0.51m	\$0.35m
Recoveries	\$1.25m	\$0.06m
Claims expense	(\$3.28m)	0
Changes in provisions	(\$2.06m)	(\$2.55m)
Net profit / loss for the Year ²	(\$3.58m)	(\$2.14m)

Operating Income remained relatively steady this year. 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. A small level of recoveries were received which related to a previous year's claim payment. No claims were paid during 2015/16, however a NZD 2.55m provision was made, primarily in respect to one outstanding policy that NZECO has assessed as having a higher likelihood of default.

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 63 million at year end, combined with a strong pipeline of applications, NZECO forecasts an improved financial result for the 2016/17 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. NZECO retained and developed its small team, all with a range of international private sector experience.

NZECO's Technical Advisory Committee (TAC) met eight 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 includes reviewing and commenting on the majority of NZECO's credit risk assessments.

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

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 for assessing country and foreign bank risk.

NZECO's risk assessment, management and governance processes are designed to manage risk to a reasonable level rather than eliminate all risk of loss. Such losses that do occur are expected over time to be covered by premiums received less expenses.

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 premiums charged in the context of potential future claims and the adequacy of premium rates applied to those policies.

As at 30 June 2016, NZECO's risk portfolio (including committed offers) was valued at NZD 274 million across 68 policies. The majority of NZECO's commercial risks are unrated companies and banks that NZECO has assessed as being equivalent to a range of between B to B+ credit rating.

NZECO has outstanding exposure across 20 countries, with the largest concentration (54%) recorded on New Zealand (reflecting those New Zealand firms whose performance NZECO underwrites). The second highest concentration risk is on the United Kingdom (12%) and the third highest on India (9%). Almost 13% of NZECO's total portfolio is distributed across higher risk countries (including Pakistan, Egypt, Nepal and Bangladesh) and these policies are closely monitored. This geographical distribution of risk would be quite different from that of a private market credit insurer.

The distribution by sector of NZECO's risk counterparties is broadening. Manufacturing is the largest sector, representing 40% of NZECO's counterparty exposure, while the financial services sector is 37% and reflects NZECO's underwriting of letters of credit issued by foreign banks. The remaining sectors are spread across ICT (Information and Communications Technology), services, public agencies, and primary sectors. These sector concentrations are mitigated by being disbursed across a range of geographies.

NZECO's largest exposure by counterparty equates to 20% of NZECO's total committed exposures, as at 30 June 2016. The next two largest counterparty exposures are 8% each. These counterparty risk concentrations reflect how the majority of NZECO's policies are for relatively small guarantee amounts.

One way to balance NZECO's future risk concentrations is through facultative reinsurance with other export credit agencies and multilateral insurers. NZECO's operational criteria was amended during the year to enable it to cover up to 100% political and commercial risk cover, where NZECO is co-insuring or reinsuring an export credit guarantee and is required to match the primary insurer's higher level of cover.

During the year NZECO issued its first committed offer to reinsure another export credit agency in respect to an export credit policy involving New Zealand goods and services. This NZD 20 million reinsurance commitment remained outstanding as at 30 June 2016.

NZECO also agreed to a Reinsurance Arrangement with the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), which will provide joint reinsurance opportunities for exports across ICIEC's 44 member states as well as in New Zealand.

Feedback from private reinsurers and NZECO's own modelling shows that NZECO requires a minimum scale of gross written premium in order to have a treaty reinsurance 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.

The enhancements to NZECO's product range during the year are expected to help NZECO sustainably build its revenue and broaden its risk portfolio across a wider range of New Zealand companies and foreign counterparties.

3: Building awareness and improving engagement

While NZECO cannot create the exports or the demand ultimately needed to secure export orders for New Zealand companies, it can help ensure that these companies and/or their financiers or advisers are aware of the support available from NZECO and that commercial export opportunities are not lost due to insufficient trade financing or insurance.

NZECO focuses on building this awareness and understanding via stakeholder channels (including bankers, trade credit insurers and brokers, industry groups, and government's export-promotion agencies) as well as through direct exporter engagements.

NZECO had a busy year with 559 face-to-face external engagements, which included delivering 46 presentations to external groups, as summarised below:

Figure 6 – NZECO's education seminars delivered during 2015/16

Objective	2014/15 Actual	2015/16 Actual
Number of NZECO presentations at exporter events	24	18
Number of NZECO presentations to NZ bank staff	11	17
Number of NZECO presentations to export-facing agencies (Government & Industry)	16	11

An important focus of our external engagements is about how to manage the financial risks of exporting and educating exporters (particularly SME companies) 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.

Often NZECO works with an exporter to understand their challenges, to identify solutions and then refer to their bank or trade credit insurer, who may have the capacity to provide assistance without requiring NZECO's guarantees.

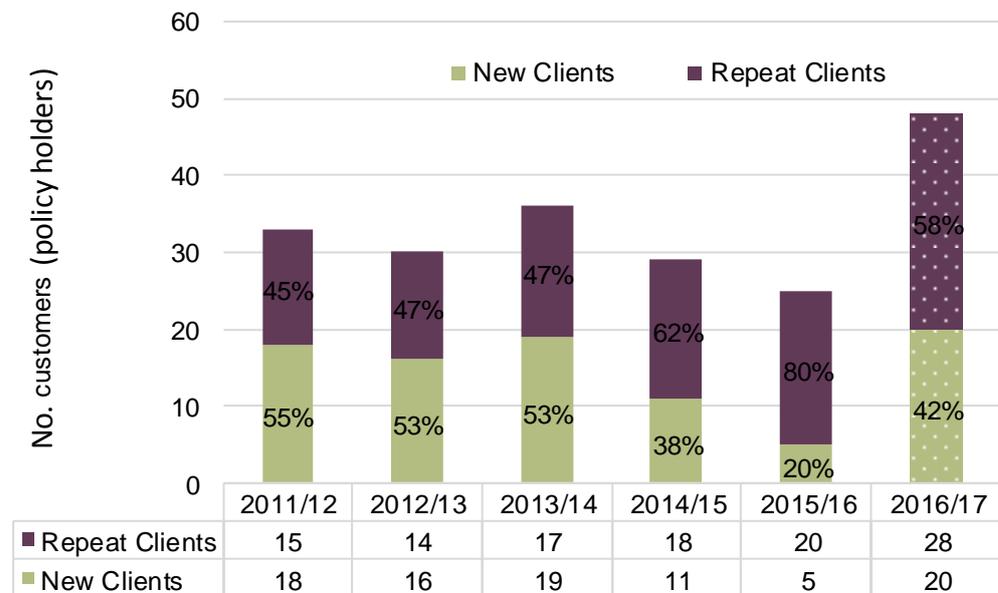
NZECO has continued to build its staff relationships with other New Zealand government export promotion agencies (e.g. New Zealand Trade and Enterprise (NZTE), Ministry of Foreign Affairs and Trade (MFAT), Ministry of Primary Industries, Callaghan Innovation, and Education New Zealand) in order to better coordinate and improve the quality of its collective services to exporting companies. This includes its “hot-desk” arrangement with NZTE offices, in which an NZECO staff member spends one day a fortnight in the NZTE Auckland office, and once a month in the NZTE Wellington, Hamilton and Christchurch offices.

During the year, NZECO undertook a customer ‘design-led’ review of its customer engagement and processes. This involved a series of interviews with exporter customers to review the way NZECO engages with them, and to understand their ‘pain points’ as they progress through an enquiry, application, assessment and documentation process with NZECO. The findings and recommendations arising from this review have formed part of our strategic activities for 2016/17.

Increasing the annual number of new exporter customers is an important measure for NZECO, and this was not achieved over the last year. NZECO did have its highest number of repeat customers, which were a mix of those exporters who NZECO underwrote letters of credit for in those markets where their banks lack the credit appetite, and those growing exporters requiring NZECO support for their project-related performance bonding requirements.

In light of our product enhancements, NZECO has set a higher, aspirational target for 2016/17 of supporting 48 exporter customers, with at least 20 of these companies being new NZECO policyholders (see Figure 7).

Figure 7: New and repeat NZECO policy-holders



NZECO expects to also increase its number of customers operating outside of New Zealand’s main cities, including regional companies whose goods and services are integral to the delivery of New Zealand exports. The breadth of NZECO customers, to date, is represented in the map below:

The Year Ahead

As global economies and geo-political risks continue to be uncertain, New Zealand exporters must be able to adapt to the shifting opportunities and risks. It is within this context that the New Zealand Government expects its export promotion agencies, including NZECO, to collaborate in support of its exporters.

The broadening of NZECO's solutions, including the ability to support domestic suppliers integral to New Zealand exporters, increases the range of companies that NZECO can support. It also provides the opportunity to re-engage with business, banks and regional agencies who may have limited, or a one-product awareness about NZECO.

A primary focus for the first half of the year is to re-engage with key stakeholders to refresh their awareness and understanding of NZECO's full range of support. The primary target audience will be banks, regional NZTE offices and regional economic development agencies. The promotion of our domestic supply chain support will be a particular focus, and success will be measured by a pipeline of new enquiries and applications.

Two key operational targets is increasing the number of companies that NZECO supports, as well as the number of longer-tenor and larger exposure policies, without detrimentally affecting the quality of our risk portfolio.

NZECO's strategy remains focused on building a sustainable business based on well-managed growth and risk diversification, where the market's demands and NZECO's mandate allows.

NZECO looks forward to the successful delivery of its solutions, in close partnership with New Zealand exporters, banks, insurers and government agencies, with the aim of enabling New Zealand firms to diversify, compete and win on the world stage.



Chris Chapman

Head
New Zealand Export Credit Office



Tim Sole

Chair
New Zealand Export Credit Office
Technical Advisory Committee