



THE TREASURY

Kaitohutohu Kaupapa Rawa

New Zealand Export Credit Office Annual Review

2016/17

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Foreword



The Treasury's vision is to be a world leading Treasury working towards higher living standards for New Zealanders. In acknowledgment of the benefits arising from increased trade, capital

flows, communication and cultural flows, the Treasury has a strategic focus on supporting an internationally connected and competitive business environment.

Through my engagement with businesses, I admire those New Zealanders who are facing the world with their innovative ideas, products and services. They aim to be world-leading within niche sectors, and demonstrate ingenuity, integrity and perseverance.

The New Zealand Export Credit Office (NZECO) is a unit within the Treasury's Financial Operations directorate, with the mandate, expertise and solutions to help exporters respond to the challenges arising from a dynamic global environment, and to achieve their international opportunities.

NZECO collaborates with other government agencies, and complements banks and trade credit insurers, to help exporters mitigate international payment risks and access additional finance to enable their trade. As a result, NZECO helps exporters to enter new markets and build new relationships with foreign buyers. The Treasury was proud to have NZECO's efforts recognised at the AUT Business School Excellence in Business Support Awards by winning the "Excellence in Export Support" category.

As a small open economy, New Zealand enjoys many benefits from greater international connectedness. Supporting New Zealand businesses to enter and thrive on the world stage is a key component of how we will deliver on our vision of higher living standards for New Zealanders.

A handwritten signature in black ink, appearing to read 'Gabriel Makhoulf'. The signature is stylized and fluid.

Gabriel Makhoulf
Secretary to the Treasury
January 2018

Purpose

NZECO is New Zealand's official export credit agency, and a unit within the Treasury. NZECO reports to the Minister of Finance, and works alongside other government agencies to promote New Zealand exports and export related investments.

NZECO's purpose is to promote and support New Zealand exports and the internationalisation of New Zealand companies by helping exporters and their integral domestic suppliers to:

- mitigate payment risk
- secure sales, and
- access finance to enable trade.

The Treasury's economic growth strategy, has focused on policies and actions that:

- strengthen international connections
- help businesses diversify into value-added, knowledge-intensive exports
- diversify our range of export markets beyond our traditional destinations, and
- support Māori and regional economic development.

NZECO's mandate, expertise and range of solutions is positioned to support and protect exporters with the challenges of securing and delivering contracts into new markets.

The strategic objectives of NZECO during 2016/17 were 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 founded on 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 2017

1 Supporting exporters' growth and diversification

Since its establishment, NZECO has issued a total of 583 policies covering NZD 1.13 billion of risk, in support of 150 exporters and NZD 2.7 billion worth of export transactions into 90 countries. But for our support, these exports would either have not have occurred, or would have occurred with increased exposures to the exporter.

During 2016/17, NZECO supported New Zealand companies of various sizes and sectors, supporting their export sales into 28 countries. Most of this support was for exports to market destinations outside of New Zealand's traditional markets, often

helping an exporter to undertake its first project or shipment into a new market or with a new buyer. Examples ranged from an exporter implementing a retail e-commerce platform in Australia, to ICT products into Brazil; from a small hydro project in Samoa, to specialist outdoor clothing into Finland.

NZECO also re-opened cover to support trade to Argentina, and began to approve short-term policies for New Zealand exporters.

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

Figure 1 – Key Performance Deliverables

| Objective | 2015/16 Actual | 2016/17 Actual |
|---|-------------------|-------------------|
| Number of Offers issued | 48 | 53 |
| Offers issued (Total Exposure) | \$184m | \$147m |
| Number of Policies issued | 46 | 47 |
| Total New Exposure for the year | \$131m | \$112m |
| Value of Export transactions supported | \$193m | \$182m |
| Number of Exporter customers ¹ | 39 | 48 |

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 last two years has seen the private market's capacity and willingness for risk remain relatively strong. NZECO has helped 'crowd-in' the private sector, with several short-term trade credit and loan guarantee customers obtaining full private sector support after NZECO's support demonstrated the creditworthiness of the buyer and/or the performance and profitability of the exporter.

As a result we have seen demand for our solutions:

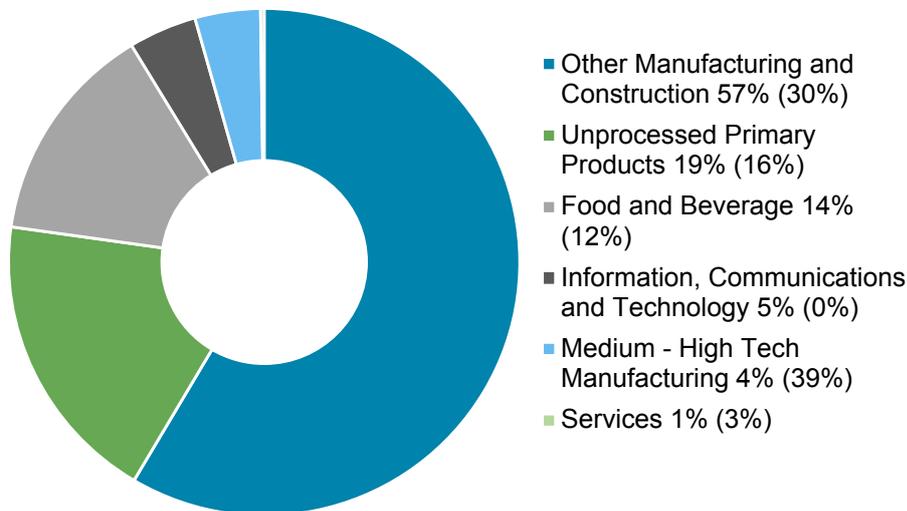
- trending towards lower value (median credit value: \$620k) and shorter-tenor (median tenor: four months) policies, and
- shrinking for our trade credit, bond and loan guarantees support, as many of our previous key customers are now being fully banked or insured.

Over 81% of the exports underwritten by NZECO were non-primary sector such as high tech and other manufacturing, food and beverage, construction, and ICT products all of which contribute to the improved diversification and added value of New Zealand's exports.

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

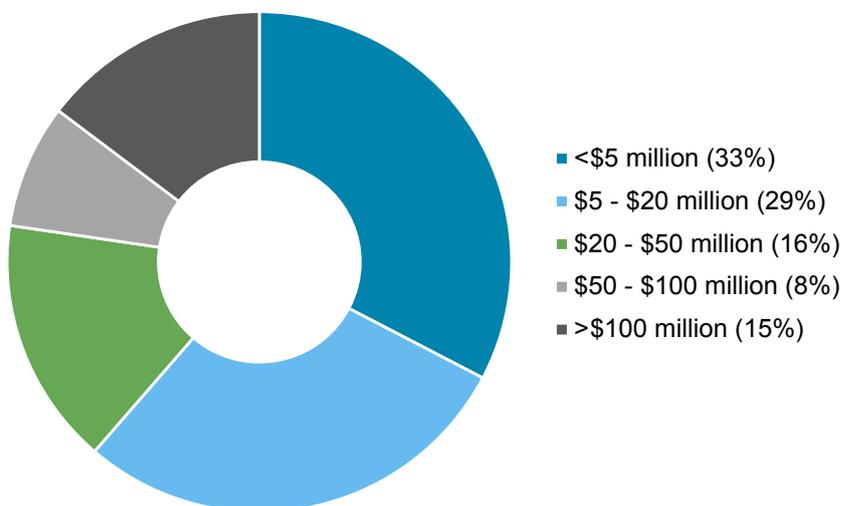
NZECO's breakdown by industry of exports supported was as follows:

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

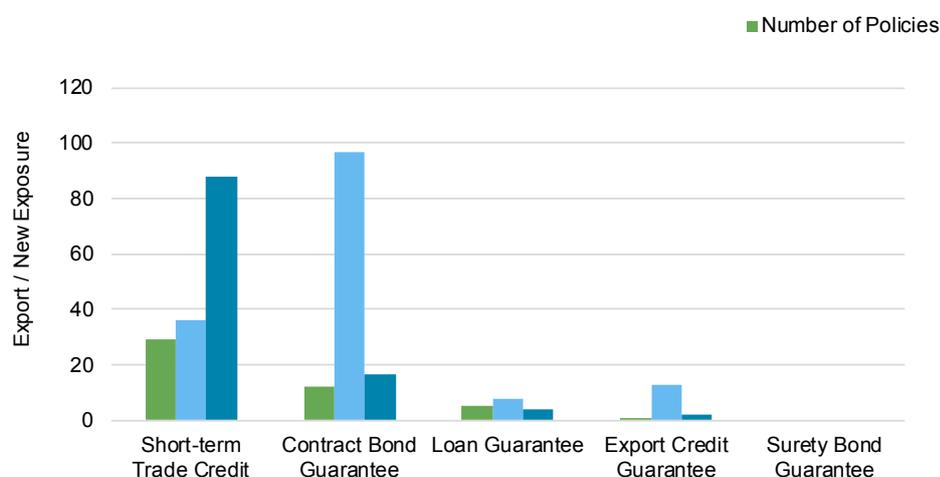


NZECO's exporter customers are predominantly small and medium-sized enterprises (SME). However the graph on the following page shows that there is also an important market need and economic development role for NZECO in supporting some of New Zealand's largest companies.

Figure 3 – Annual turnover of NZECO supported firms (historical to 30 June 2017)



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 ICT services exporters.

Figure 4 – Policies and exports supported by product

| | Short-term Trade Credit | Contract Bond Guarantee | Loan Guarantee | Export Credit Guarantee | Surety Bond Guarantee |
|--------------------|-------------------------|-------------------------|----------------|-------------------------|-----------------------|
| Number of Policies | 29 | 12 | 5 | 1 | 0 |
| Export Supported | \$36 | \$97 | \$8 | \$13 | \$0 |
| New Exposure | \$88 | \$16 | \$4 | \$2 | \$0 |

Short Term Trade Credit Insurance

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

During the year, this product underwrote over NZD 64 million of exports into 19 countries, including Brazil, Kenya, Morocco, Nepal, Pakistan, Qatar, Romania and Vietnam. 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.

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

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

There remained steady demand for NZECO's cover of foreign-bank issued letters of credit 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.

An example of NZECO providing its trade credit insurance to assist an exporter to establish a trading history into a new market is Sacred Hill:



When Sacred Hill Vineyards planned to begin exporting to a new customer in Poland, it wanted to ensure that its payments were protected. *“We wanted to dip our toe in the water in Poland – but in a controlled way”* says Glenn Cunningham, global sales and marketing manager. *“For us, credit insurance cover must always be secured before shipping to a new distributor but in this case that could not be obtained because our buyer lacked sufficient*

trading history”. Their solution was for their Polish buyer to obtain a letter of credit from its Polish bank, and then Sacred Hill asked its New Zealand bank to “confirm” the payment of this letter of credit. Because the New Zealand bank did not have a credit relationship with the Polish bank, NZECO’s cover was sought to help confirm the letter of credit payment. *“With the support of NZECO, we have been able to flourish in this new market”*, says Mr Cunningham.



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. The majority of these enquiries related to specialised machinery valued less than NZD 2 million, between a SME exporter and its SME international buyers. The challenges of assessing and approving these SME buyers, as well as obtaining private sector financing of these loans, proved challenging.

NZECO remains committed to identifying and structuring export credit guarantee 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, including within New Zealand.

With this objective in mind, NZECO entered into a Master reinsurance arrangement with Denmark’s EKF.

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 three committed offers, of which two remain current at year end and which are expected to be utilised to support engineering and services projects into Canada and United States during the latter half of 2017.

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 specialist contract 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 utilised on existing international contracts.

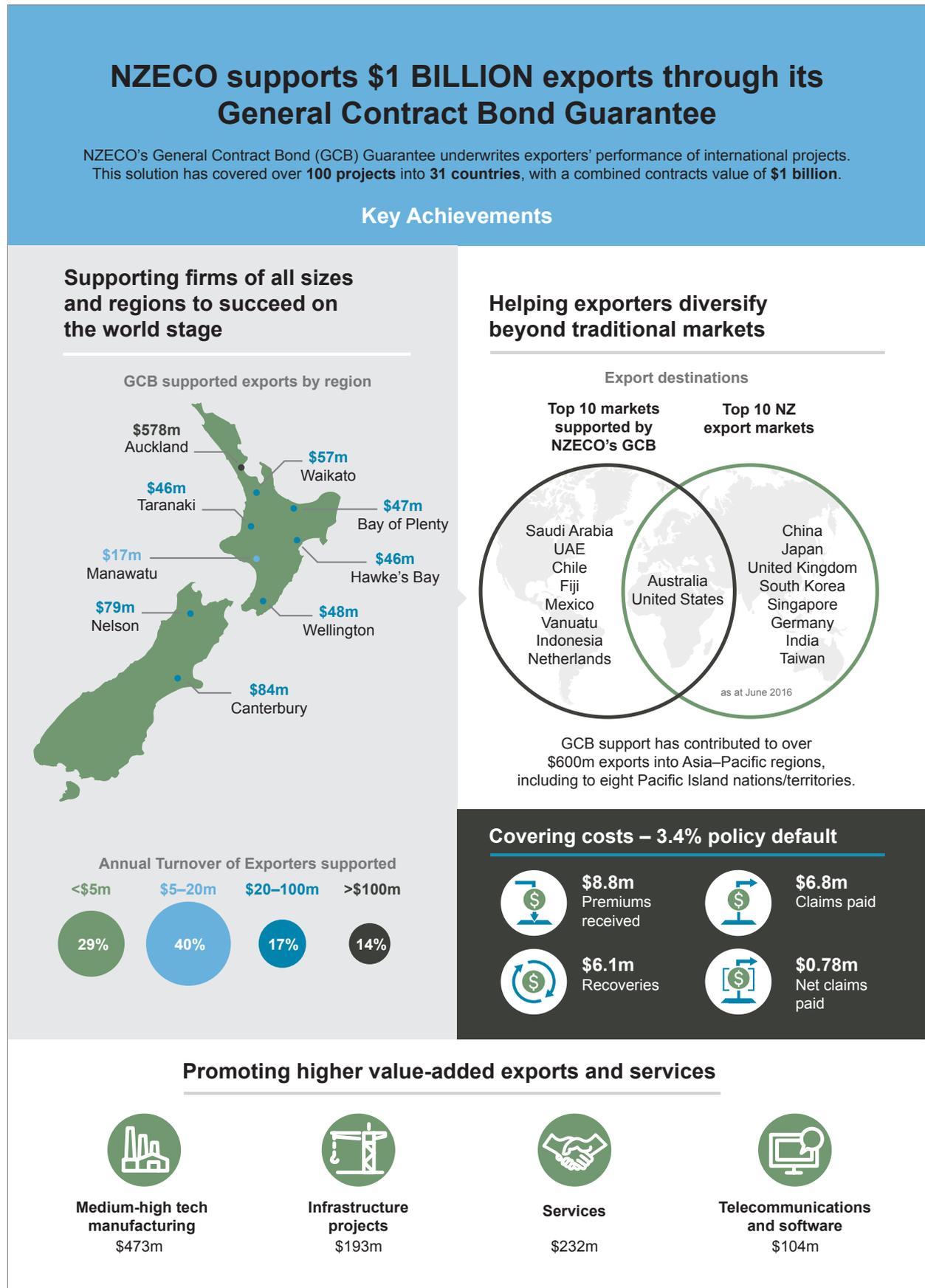
NZECO helped New Zealand firms secure a total NZD 97 million of multi-year, export contracts spanning high-tech manufacturing, engineering, construction, and ICT services projects.

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.

A milestone achievement during the year was NZECO reaching a total NZD 1 billion worth of international projects supported via this General Contract Bond Guarantee (at Figure 5 is a visual summary of this \$1 billion support). This \$1 billion figure does not account for flow-on benefits for the exporters such as:

- revenue arising from subsequent operations and maintenance contracts on these projects
- new projects awarded by leveraging from the successful "first project" delivered into a new market
- their bank fully supporting them for future projects as a result of demonstrated performance and/or retained earnings.

Figure 5 – \$1 Billion of exports supported by NZECO’s General Contract Bond Guarantee visual summary



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.

Typical working capital scenarios which the Loan Guarantee supports include for:

- proven exporters and domestic firms with mismatched cash flow between their suppliers and buyers
- exporters with buyers in markets where there may be payment delays eg, Middle-East buyers, or aid-funded projects.

During the year, NZECO helped firms from the marine, wine, services and horticulture sectors to overcome working capital constraints. One example is Maven International:



Maven International, a Wellington-based professional services company secured a large contract to provide face-to-face and online leadership training to school principals across Oman. Although its contract stipulated 30 day payments, Maven forecast payment delays of several months, which would impact their ability to pay staff and suppliers. NZECO's loan guarantee enabled Maven's bank to provide a working capital facility so Maven could pay all of its project-related bills on time, and keep its operations in

Oman ticking over. *"In the end, it took nine months for payments to begin, and we were grateful for the NZECO-supported working capital facility. It was a good move to set this up in advance"*, says Darryn Thorn, Maven International managing consultant.

2 Manage risks appropriately and sustainably

A core function of NZECO is to assess, accept and manage higher levels of commercial and political risks – where market gaps exist or private sector capacity or risk appetite is limited – in order to facilitate the success of New Zealand companies in international markets.

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.

Engagement with other export credit agencies, including a formal services arrangement with Sweden's export credit agency (Export Kredit Namnden – EKN) also remained a valued source for assessing country and foreign bank risk.

NZECO's Technical Advisory Committee (TAC) met nine times during the year, and provided specialist advice on NZECO's transactional risks to the Secretary to the Treasury, via the Director, Financial Operations and Head of New Zealand Debt Management Office (NZDMO). TAC's responsibility includes reviewing and advising on the majority of NZECO's credit risk assessments.

This year saw a continuing trend of NZECO's policies being primarily for shorter terms (median policy tenor: 4 months) and for relatively low amounts (median maximum credit amount: \$620,000). The credit risk profile of these policies had a high weighting towards SME commercial risks as well as emerging markets.

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 paid NZD 6.88 million of claims during the year, which was offset by NZD 5.88 million of recoveries. All of these claims and recoveries, related to covering an exporter's performance and financial risks, via the general contract bond and loan guarantee products. NZECO worked closely with exporters and banks to manage problems and to minimise claims and losses.

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.

NZECO follows the OECD Arrangement on export credits and pricing, as well as its own Crown mandated criteria and prudential limits. 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.

As at 30 June 2017, NZECO's risk portfolio, including committed offers, was valued at NZD 147 million across 58 policies (as compared to a total NZD 274 million risk portfolio across 68 policies at 30 June 2016). This comparison is further evidence of the market demand for smaller credit 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 18 countries, with the largest concentration (40%) recorded on New Zealand (reflecting those New Zealand firms whose performance NZECO underwrites). The second highest concentration risk is on the United Kingdom (31%) and the third highest on Sri Lanka (11%).

The distribution by sector of NZECO's risk counterparties is broadening.



Financial Service is the largest sector, representing 35% of NZECO's counterparty exposure and this reflects NZECO's underwriting of letters of credit issued by foreign banks.



Manufacturing is the second largest sector, accounting for 22% of the total exposure.



Food and beverage is the third largest sector accounting for 14% of the total exposure.

The remaining sectors are spread across ICT, other services, and primary sectors. These sector concentrations are mitigated by being disbursed across a range of geographies.

NZECO's largest exposure by counterparty equates to 12% of NZECO's total committed exposures, as at 30 June 2017. The next two largest counterparty exposures are 11% each.

One way to balance NZECO's future risk concentrations is through facultative (single risk) reinsurance with other export credit agencies and multilateral insurers. During the year NZECO

signed a reinsurance arrangement with Denmark's Eksport Kredit Fonden (EKF), which is intended to support projects that source goods and services from both New Zealand and Denmark, including in the renewable energy, food processing and agritech sectors.

NZECO continues to explore other reinsurance opportunities, in order to help New Zealand exporters access larger contracts and for the NZECO to manage its risk concentrations within its prudential limits.



Chris Chapman, Head of NZECO and Anette Eberhard, Chief Executive, EKF signing the reinsurance arrangement in May 2017.

3 Building awareness and improving engagement

An operational objective of NZECO is to educate, and to promote a more informed risk culture within firms of all sizes, as well as awareness of the financing solutions that can better support their international growth.

NZECO focuses on building this awareness and understanding through various stakeholder channels (including banks, 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 472 face-to-face external engagements, which included delivering 75 presentations to external groups, as summarised below:



Phil Quinn, NZECO Senior Business Originator, presenting on exporting risks and challenges into Latin America at Fielddays 2017.

Figure 7 – NZECO's education seminars delivered during 2016/17

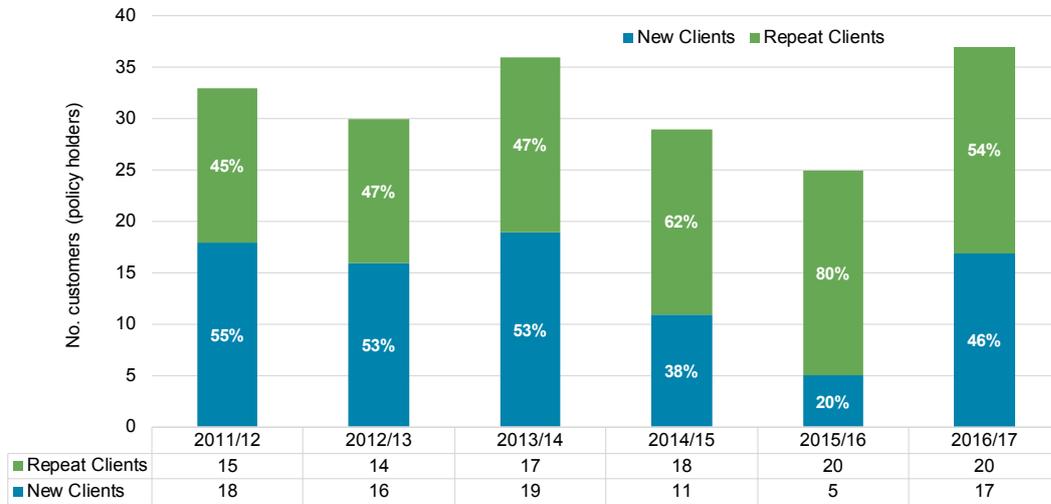
| Objective | 2015/16 Actual | 2016/17 Actual |
|---|----------------|----------------|
| Number of NZECO presentations at exporter events | 18 | 12 |
| Number of NZECO presentations to NZ bank staff | 17 | 49 |
| Number of NZECO presentations to export-facing agencies (Government & Industry) | 11 | 14 |

The high number of presentations to banks across New Zealand recognised the important role banks perform as referrers and partners in NZECO-supported trade finance solutions for their clients that are exporting or who are integral suppliers to an exporter.

NZECO also focused its relationships with other New Zealand government export promotion agencies (eg, 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.

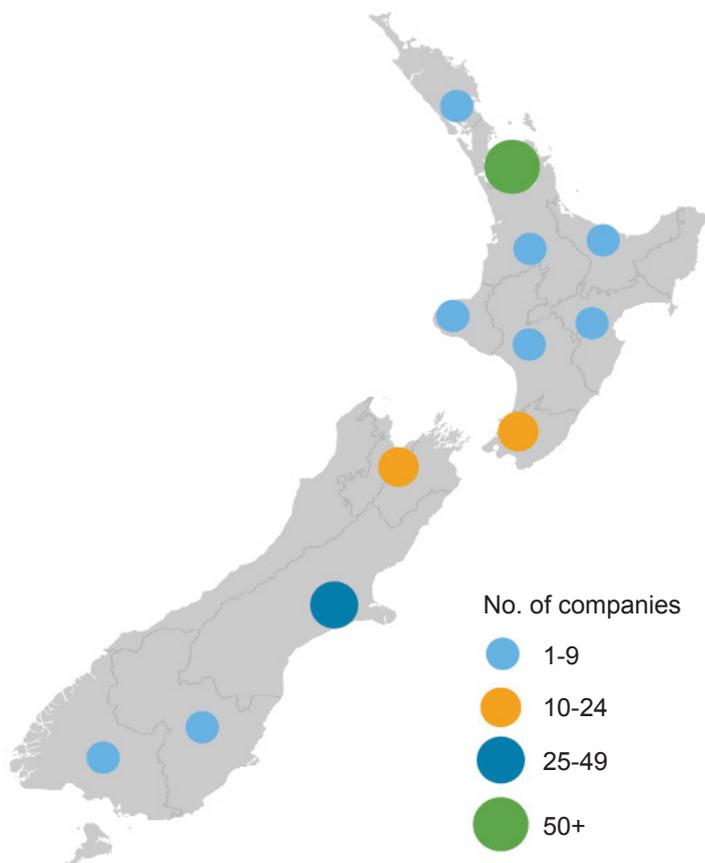
A priority was to increase the number of exporters supported, particularly firms who NZECO had not supported before. The year-end result was the highest number of exporters supported since 2010, including tripling the number of exporters new to NZECO from the previous year's total. This upward trend, during a time when the private market supply and appetite is strong, is attributed to the marketing and stakeholder relationship efforts of the NZECO team.

Figure 8 – New and repeat NZECO policy-holders



NZECO is focused on increasing its number of customers operating outside of New Zealand’s main cities, including regional companies who are providing goods and services which are integral to the delivery of New Zealand exports. The breadth of NZECO customers, to date, is represented in the map below:

Figure 9 – NZECO’s exporter clients (historical) by region



NZECO was proud to win the “Excellence in Export Support” category at the AUT Business School Excellence in Business Support Awards during this year. The judges’ assessment involved measuring NZECO’s operations against a range of criteria including leadership, strategic planning, workforce and customer focus, and processes for continuous assessment and improvement. It recognised the work that NZECO has undertaken in recent years to listen to its market and stakeholders, and to improve its solutions and processes in support of New Zealand exports.



NZECO team members receiving the “Excellence in Export Support” award at the 2016 AUT Business School Excellence in Business support awards.

International Connections

NZECO’s international connections help identify and facilitate export opportunities for exporters, while also enhancing the quality of risk assessments and potential reinsurance opportunities.

Our connections with NZTE’s offshore teams and MFAT are important, particularly to coordinate our support and information sharing in respect to firms that we are both supporting.

NZECO also values the importance of its relationships with other export credit agencies in order to share current market information and case studies, compare operational processes, and monitor new product developments (particularly for SME exporters).

NZECO participated in three conferences of the Berne Union members, which is an international

association for public and private sector export credit and investments insurers. The Berne Union reports that eleven percent (USD 1.9 trillion) of the world’s exports has been insured by its members in 2016.

The Head of NZECO was Chair of the Berne Union Prague Club Committee, an association of smaller and younger export credit agencies. This role included representing the Prague Club members during the process of formalising an integration with the Berne Union, as well as supporting the planning and chairing of conferences.

This engagement helped build NZECO’s wide network of international partners who are committed to sharing information and experiences, which assist in our respective roles of facilitating and underwriting international trade.



Attendees of the Berne Union Spring meeting in Botswana, Kasane 2017.

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's export promotion agencies, including NZECO, strive to collaborate in support of its exporters.

NZECO's strategy remains focused on sustainably executing its mandate with well-managed growth and risk diversification, where the market's demands and NZECO's mandate allows. This also includes being proactive in identifying and delivering new business opportunities for New Zealand companies which they, their buyer and/or their bank may not have properly considered.

NZECO's mandate to provide its range of solutions to New Zealand domestic firms that supply goods and services which are integral to an exporting firm's delivery of exports also provides new opportunities to support a wider range of firms including across New Zealand's regions.

There will be ongoing improvement to the way that customers and stakeholders are communicated with and serviced, with a focus on clarity of communications and the ease of sharing information.

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.

