

June 2017 Update

Pencarrow Newsletter

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Bridge Fund now 50% invested

Following a successful raising of \$80 million for an annex to Fund IV (the Bridge Fund) on 30 November 2016 we have now successfully deployed approximately 50% of that fund in two investments, MMC, New Zealand's leading fund administration outsourcing business, and Mix, a leading branded manufacturer of natural men's and women's personal care products. We are likely to invest the Bridge Fund in only one or two further businesses before raising Fund V in the second half of 2017.

Fund IV, which closed in 2012 with \$124 million of committed capital, was fully invested in six investments (BrewGroup, BeGroup, ARANZ Geo, solarcity, Umbrellar and Icebreaker). Subsequently BrewGroup was successfully sold in late 2016 to the world's second largest coffee company (Jacobs Douwe Egberts) following an unsolicited approach leaving five remaining portfolio investments in that fund. In the past six months since our last newsletter that portfolio of investments has progressed well and in our most recent valuation review of those investments there has been a significant lift in the portfolio value reflecting the actual proceeds from the sale of BrewGroup and strong earnings growth performances, in particular, from Icebreaker and ARANZ Geo. Investors are now seeing an overall return of 26.2% gross IRR and 1.71 times money across that portfolio to date.

The very strong deal pipeline Pencarrow has built has enabled us to deploy a significant proportion of the \$80 million of capital raised in November 2016 as an annex to Fund IV quickly and productively. We now have two portfolio investments in the Bridge Fund with the most recent investment, Mix, concluded in March and a strong pipeline of opportunities in front of us for deploying the remainder of that fund's capital.

Mix is a leading New Zealand branded producer of natural personal care products including skincare and haircare for both men and women with a strong and growing presence in both New Zealand and Australia targeted at the "masstige" position in the market. The company has growth ambitions into China and South East Asia and a significant reputation for rapid product innovation. We believe Mix represents a very exciting new investment for the Fund.

About Pencarrow

Pencarrow was formed in 1993 and is New Zealand's longest established private equity manager.

In December 2012 we closed our fourth fund, the Pencarrow IV Investment Fund, with committed capital of NZ \$123.7 million. In November 2016 Pencarrow closed an extension of that fund at the hard cap of \$80 million. The combination of Fund IV and the Bridge Fund plus co-investment capital extends Fund IV to in excess of NZ\$225 million of commitments and will allow a portfolio of 8-10 companies.

The Pencarrow team is made up of eight executives with a range of complementary skills and experience. More information on Pencarrow and the team can be found at www.pencarrowpe.co.nz.

Our current funds continue our long established focus on MBOs, expansion capital and replacement capital investments in businesses with enterprise values typically in the range of NZ\$20 million to NZ\$100 million that have strong management teams, attractive positions in their markets and the opportunity to create significant value.



Pencarrow Lighthouse: Representing the combination of our insight with your vision to create a strategy for future success

Portfolio Investments

The investment period for Fund IV concluded in September 2016, with a portfolio of six investments (since reduced to five with the sale of BrewGroup). In November 2016 we closed the Bridge Fund at its \$80m hard cap and the two investments for that fund, MMC and Mix, have been concluded.



BrewGroup (previously named Bell Tea & Coffee Company)

BrewGroup was the first realisation from Fund IV, having been acquired by Jacobs Douwe Egberts (JDE) in November 2016, representing a very successful outcome for investors.

BrewGroup is an iconic New Zealand business well positioned for future growth

BeGroup

BeGroup provides affordable and modern retirement villages with an emphasis on helping residents enjoy life to the fullest extent possible

BeGroup

In May 2014, Fund IV acquired a platform asset, The Falls Estate retirement village, located in Whangarei as the foundation for a larger opportunity in the rapidly growing retirement village and aged care industry. A holding company, BeGroup, was formed to acquire this seed asset and it aims to develop a network of modern retirement villages providing a full range of care ranging from independent living to hospital level care. The intention is to ultimately create a business with between six and eight sites.

Guy Eady, a highly respected and experienced retirement industry executive, was recruited to lead the rollout and he has subsequently hired a CFO and development manager.

BeGroup has made strong progress against its ambition of achieving a portfolio of aged care sites at various stages of development with three sites now in the portfolio. The first site of The Falls in Whangarei is now close to 100% occupied and the further development of new villas is now well progressed with Stage 1 completed (and the majority sold) and Stage 2 due for completion in August 2017. A resource consent to build a 50-bed care facility on an adjacent site has been granted.

The second site at Rawhiti in one of Auckland's wealthiest suburbs has had construction commence for 27 apartments, a 20-bed dementia facility and a 48 care bed facility.

In regard to a third site in Half Moon Bay in eastern Auckland acquired in May 2016 BeGroup has filed a resource consent for Stage 1 of a facility consisting of 200 villas and 80 care beds.

SOLARCITY

solarcity plans to revolutionise the way energy is delivered by giving customers a cleaner, more affordable alternative to their monthly utility bill

solarcity

In June 2014, Fund IV provided expansion capital in two instalments to solarcity, New Zealand's leading solar power company, resulting in it becoming the largest shareholder with a 37% stake. The expansion capital was primarily to assist solarcity to roll out a new rooftop solar offering, SolarZero, to residential customers. SolarZero is a solar-as-a-service offering requiring no upfront payment by the household with payments made monthly alongside the retail electricity bill over a 20-year contract period. The company is creating an attractive 20-year receivables book of residential installations and has a target of 15,000 residences within 5 years. Early progress has been strong and solarcity has significantly exceeded its targets.

There are strong economic and industry drivers for growth in distributed solar installations in New Zealand, as the cost of solar generated electricity is now below the generation cost from the grid without subsidies.

solarcity has recently enhanced its offering by allowing customers the option of installing batteries alongside the solar system and aims to provide 100% of a customer's electricity bill at the lowest cost of as residential offering.

solarcity recently secured an additional fourth cornerstone investor over the next 12 months to provide up to a further \$10 million of expansion capital.



ARANZ Geo is well placed to leverage its global sales footprint to capitalise on its investment in product development and innovation

ARANZ Geo

In July 2014, Fund IV made a significant minority investment in ARANZ Geo (AGL) providing mainly expansion capital to become the largest single shareholder. AGL is a leading global provider of 3D geological modelling software for mining and exploration geologists. The flagship product is Leapfrog, which uses sophisticated mathematical functions to rapidly analyse scattered data for surface interpolation, enabling the creation of 3D images of ore bodies much more quickly and efficiently than other software.

AGL has a global client base encompassing over 50 countries and over 400 mining and exploration companies, including most of the majors. The business has strong recurring licence revenue and has performed strongly despite the significant downturn in the mining sector.

Pencarrow's investment was made to assist the company to enhance its product suite and provide capital for potential complementary acquisitions, two of which have been completed this year. Further acquisitions are being contemplated to augment the accelerated software development programme, which will enable AGL to expand further along the mining chain and into other industry verticals such as civil engineering and oil & gas.

ARANZ Geo has performed strongly since Fund IV's investment with revenues up around 100% in the past two years. Its software licensing is primarily subscription-based revenue and renewal rates are around 87% providing a very high quality revenue stream.

Several significant acquisitions globally are currently being assessed to assist the company to expand into new vertical industries beyond mining.



Umbrellar is the leading domestic domain name and SME focused cloud hosting company in New Zealand

Umbrellar (previously named Digiweb)

In September 2014, Pencarrow partnered with the management team of Umbrellar to acquire the business from its founder. Simultaneously, Umbrellar acquired Webdrive, another domain name and web hosting business, and Arrenway, a small underutilised data centre. Both acquisitions offer significant cost synergies with Umbrellar and an early part of the investment thesis was to execute and realise these synergies.

The combination of these three businesses represented the first part of a consolidation strategy in the domain names and web hosting industry in New Zealand. In September 2015, Umbrellar undertook further consolidation of the industry via the acquisition of Freeparking.

Umbrellar is now New Zealand's leading domestic domain name company and has a strong position in the web hosting sector. The business has historically demonstrated high recurring annuity-style revenues and low customer churn. The combined business has a ~36% share of the domestic domain name market and around 30% of the domestic hosting market, further entrenching Umbrellar's position as the leading tier two player. Leading industry consolidation was one of the core elements of our original investment thesis for Umbrellar when we acquired the business in September 2014. Umbrellar is now focused on ensuring the cost synergies are realised from this significant consolidation of businesses.

Fund IV recently invested a further small follow-on investment into Umbrellar to enable the company to invest in a new third party technology platform which will allow the business to market an enhanced product offering to existing and new customers. The new technology will also enable Umbrellar to reduce the investment required to maintain its own platform. These initiatives are expected to enhance the business and underpin improved performance over the next 18 months.



Icebreaker is a leading designer and marketer of outdoor apparel

Icebreaker

In November 2015, Fund IV took a significant minority stake in Icebreaker, a leading designer and marketer of outdoor apparel focused on merino wool. Icebreaker offers a diverse set of products using natural and sustainable fibres including next-to-skin products and outer and mid-layers. It employs a multi-channel distribution model incorporating wholesale, e-commerce and company-owned stores to service primary markets in Europe, Canada, United States, New Zealand and Australia.

The company has a very high quality management team led by ex-CEO of Air New Zealand, Rob Fyfe, and a management team comprising executives from many of the world's leading apparel companies. Many of this management team have been hired very recently as Icebreaker seeks to improve its profit margins and accelerate its overseas growth.

Icebreaker is one of New Zealand's most iconic brands and fits well into Pencarrow's strategy of investing in New Zealand-based emerging global champions.

Since our investment, management has undertaken a number of key initiatives to improve gross margin across the business including expanding its supplier base, assessing moving to a finished goods model for some core products, undertaking a freight tender, reducing discounting, assessing in-market pricing positioning and improving product engineering to reduce manufacturing costs. Management has also been strongly focused on inventory reduction and efficient inventory management.

As a consequence of the successful execution of the strategy, management has significantly increased the gross margin and EBITDA margin of Icebreaker in the past 18 months resulting in a more than doubling in operating profit.



MMC is the leading NZ outsourced fund and investment administration service provider

MMC

In November 2016, the Bridge Fund acquired a 50% stake in MMC, a leading New Zealand outsourced fund and investment administration business with over \$25 billion of client funds under administration. MMC is well positioned for strong growth by increasing economies of scale through organic growth, capturing a significant part of the funds management value chain and introducing adjacent services to new and existing clients.

MMC has a history of strong revenue growth and is forecast to increase revenue through a number of strategic growth initiatives which include:

- Securing additional clients in the core fund accounting and unit pricing service primarily those in a rapidly growing Kiwisaver market;
- Providing additional services to both existing and new clients;
- Transitioning further in-house providers to an outsource arrangement driven by an increasingly complex administrative and compliance burden.

MMC has performed ahead of expectations since the Bridge Fund's investment driven primarily by the growth of funds under administration to in excess of \$30 billion.



Mix is a leading New Zealand branded producer of nature personal care products.

Mix

In March 2017, the Bridge Fund acquired a 44% stake in Mix, a leading New Zealand personal care products business, alongside the founders. Mix is strongly positioned in the pharmacy and grocery channel in both New Zealand and Australia with a diverse portfolio of brands using natural ingredients covering the facial skincare, hand & body skincare, haircare and men's grooming categories. The main skin and haircare brand is Essano. Future growth is expected to come from further expansion of its sales base in New Zealand and Australia including through an expanded product portfolio and through expanding distribution into South East Asia and China.

Mix's product portfolio is positioned in the "natural" segment, a high growth area as consumers steer away from products considered unsustainable, unethical or to contain harmful ingredients. Its brands also have a mid-market price point positioning it at the top end of the mass market.

A key factor in Mix's success has been its ability to expedite the commercialisation of new products rapidly in response to market trends. Mix's R&D laboratory and team of technical staff provide it with a platform to engage in new product development to increase its shelf presence with key retailers and drive sales growth.

Outlook

With one or two further portfolio investments to be made in the Bridge Fund and a strong deal pipeline, Pencarrow is likely to begin raising its fifth major pool of capital, Fund V, in the latter half of 2017.

In anticipation of that fund raising Pencarrow has been building and increasing its team capacity and we are delighted to have appointed Hazel Martin as a new investment manager to our team. This brings our total investment team size to six alongside our CFO and Administration Manager. Hazel has a background in corporate finance and private equity having worked at PwC in Wellington before several contracting roles in London including with John Lewis, Walt Disney Company and Palamon Capital Partners.

We believe the New Zealand market environment is highly attractive for private equity currently. New Zealand's economy and markets remain in very good shape with New Zealand continuing to register one of the highest GDP growth rates in the western world at in excess of 3%. This has been assisted by strong tourism figures and ongoing record levels of business and consumer confidence. Inflation remains low and the government continues to record budget surpluses, one of the few in the western world doing so. New Zealand is also seeing a steady level of mergers and acquisition activity which is aiding Pencarrow's strong deal pipeline and interest from trade buyers and larger private equity firms in some of our larger portfolio investments.

Our Team

The Pencarrow team



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