

# October 2015 Update

Pencarrow Newsletter

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## Fund IV portfolio progressing well

Since our previous newsletter update in February 2015 Pencarrow IV has continued to make pleasing progress with all five of its platform investments. In particular, Digiweb (since renamed Umbrellar) has completed a significant add-on acquisition to complete its consolidation of the New Zealand web-hosting and domain names market.

With the add-on investment for Umbrellar, Fund IV has 72% of its committed capital called which leaves room for one to two platform investments in the fund before the investing period is complete on or before November 2016. With this in mind and a very healthy forward deal pipeline we are commencing the planning for Fund V capital raising.

The Fund IV portfolio of five businesses covers hot beverages (Bell Tea & Coffee), renewable energy (SolarCity), aged care (BeGroup), geological modelling software (ARANZ Geo) and domain names and web hosting (Umbrellar). A highly attractive attribute of most of these businesses is their high and growing level of recurring revenue providing robustness to earnings through the economic cycle. These businesses have been held by the fund for on average less than 18 months but already we have seen significant forward momentum and progress against their original investment theses. Several add-on acquisitions have been concluded, many of which are highly synergistic and we are pleased with the impact this is having on value accretion for our investors.

### 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.

To assist with the investment of Fund IV we took the opportunity to boost our investment team and since raising the fund we have added four professionals with great complementarity in their skill sets. More information on Pencarrow and the team can be found at [www.pencarrowpe.co.nz](http://www.pencarrowpe.co.nz).

Fund IV will 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 Lighthouses:** Representing the combination of our insight with your vision to create a strategy for future success

## Portfolio Investments

Since our last newsletter update in February, there has been a lot of activity in the Fund IV portfolio with add-on acquisitions for Bell Tea & Coffee and Umbrellar and strong progress against the investment theses of the other portfolio companies. Several add-on acquisitions are currently under investigation as well as a new potential platform investment.



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Bell Tea & Coffee Company is an iconic New Zealand brand well positioned for future growth

### Bell Tea & Coffee Company

In October 2013, Pencarrow partnered with the management team of Bell Tea & Coffee Company (BTCC) to acquire the business from Foodstuffs (New Zealand's leading grocery supermarket chain) who had owned it for the prior 50 years. BTCC is a market leader in the New Zealand hot beverage industry with key brands including Bell Tea, Twinings (under licence), Gravity, Jed's Coffee and Burtons. BTCC sells to and services every major channel in New Zealand including retail grocery, food service and workplace. BTCC also owns a business called Café Express which provides coffee machines, coffee and tea supplies, barista training and kitchen consumables to corporate customers.

The core elements of the investment thesis included continued expansion of distribution into traditional supermarket and foodservice channels, introduction of further new products, selective offshore expansion (particularly Australia) and bolt-on acquisitions.

During the last six months Bell Tea has continued its growth trajectory with an additional number of coffee and tea products being ranged in Progressive supermarkets (the main competitor to Foodstuffs) and a doubling of market share to 10% for the Jed's brand of coffee. In addition a small South Island coffee distributor, KNS, was acquired and added to Café Express, BTCC's business-to-business coffee offering. The Jed's bean bag offering was further expanded into Woolworths in Australia and is now ranged in all 800 of its stores. BTCC also won a number of new major coffee accounts including the largest in New Zealand, Wild Bean cafes through BP service stations.

A significant add-on acquisition is currently under exclusive due diligence.

## BeGroup

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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 own 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.

In September 2014, the BeGroup management team identified and acquired a second site in one of Auckland's wealthiest suburbs, Remuera, an old bowling club that will be used to develop a greenfields aged care facility. Concept design and resource consent approval are currently underway for this new site. Fund IV provided additional capital to fund the purchase of this site.

Further sites are being identified and reviewed as part of the continuation of the rollout plan.

BeGroup has shown a strong performance in the past six months with strong sales of units at The Falls increasing occupancy to over 98% and this has enabled unit prices to increase by between 10 and 15% higher than forecast. Resource applications for significant expansion of The Falls have been granted in addition to the resource consenting process underway for Rawhiti.

## SOLARCITY

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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.

Solarcity has built its business on successful commercial and government solar installations, particularly in the Pacific Islands where the power is used to often displace expensive and environmentally unfriendly diesel generation. In addition it had begun taking advantage of opportunities in the new build residential market (particularly in Christchurch and Auckland).

Pencarrow identified with management the opportunity to establish itself in the retrofit market providing installations on existing residences and commercial properties using a funding model which would require no upfront payment by customers and result in a lower power bill. The primary purpose of Fund IV's expansion capital was to assist in funding (along with bank funding) this solar-as-a-service offering which was launched on 1 October 2014 which has generated an extensive sale pipeline validating management's view that the up front cash outlay for solar installations had been an impediment to growth.

With the introduction of the SolarZero (solar-as-a-service) offering, SolarCity has progressed rapidly from a cash sales business to one building up an attractive book of 20-year receivables of residential installations and the target is to achieve 15,000 of these within five years and an initial target of 1,000 by June 2016.



ARANZ Geo is well placed to leverage international markets and make further acquisitions to broaden its geosciences offering

### 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, four of which are currently under investigation.

Following Pencarrow's investment, AGL acquired several of its global distributors and one of the leading geological consulting companies based in Perth, QG. These acquisitions will enable it to achieve a higher margin through direct sales and distribution and allow it to provide high-end complementary consulting, an important part of the sale process.

ARANZ Geo is focussing its growth in three core areas:

- Ongoing growth and further development of additional modules for the flagship product, Leapfrog 3D.
- Rollout of Leapfrog 4D, an enterprise-based product, that will be server and cloud enabled. Early Access Partner (leading global mining companies) feedback has been very enthusiastic.
- Expansion of ARANZ Geo intellectual property into new vertical markets such as civil engineering and oil & gas.



Umbrellar is the leading domestic domain name company and has strong position in the web hosting sector

### Umbrellar (previously 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 is to execute and realise these synergies.

The combination of these three businesses represent the first part of a consolidation strategy in the domain names and web hosting industry in New Zealand. 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 the low customer churn.

In September 2015 Umbrellar undertook further consolidation of the industry via the acquisition of Freeparking. The Freeparking business is based in New Plymouth and provides web hosting, e-commerce, domain registration and hosting and other supplementary services under two brands, WebFarm and Freeparking. Since 1997, Freeparking has grown to become one of New Zealand's largest web hosting and domain name registrars. This growth has been achieved organically and through the acquisition of 2Day.com in 2005.

The combination of Umbrellar and Freeparking represents an imminent opportunity to further consolidate the New Zealand domain name and web hosting sectors mirroring similar consolidations in the United States, Australia, Canada and the UK. Freeparking is one of the few remaining acquisition targets of scale. The combined business will have 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 has also joined with other leading New Zealand businesses to partner Air New Zealand in their newly launched airpoints rewards programme called Airpoints for Business. The launch of this new programme coincided with the rename of the Digiweb business to Umbrellar.

## Market Environment

The last six months has seen some interesting economic developments both within NZ and further afield.

The current market conditions are creating positive momentum for private equity

Probably the single most important development from a NZ perspective has been the fall in dairy product prices which has been a big factor in the fall in the NZ dollar from approximately US75 cents to US63 cents over the past six months. While the fall in dairy prices is bad news for dairy farmers and will inevitably feed through to a broader cross-section of the economy such as agribusiness service companies and a lower level of GDP growth over the coming quarters, it is good news for non-dairy exporters and will allow some re-balancing to occur in the tradeable sectors of the economy away from dairy. In particular from the Fund's perspective the fall in the NZ dollar is positive for ARANZ Geo which has 99% of its revenues generated from export of software and services mainly priced in US dollars.

Over the coming quarter, in addition to continuing to progress the portfolio companies in line with their original investment theses, we will continue to investigate new investment opportunities for the Fund.



**Shipping container in Auckland:** The recently reduced NZ dollar is favourable for non-dairy exporters.



## Our Team

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### The Pencarrow team



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