The Directors
New Zealand Rugby
100 Molesworth Street
Wellington 6011

29th January 2021

NZRPA RESPONSE TO NEW ZEALAND RUGBY'S PROPOSAL TO RESTRUCTURE AND SELL 15% OF INCOME GENERATING ASSETS

Dear Directors

We write with regard to your proposal to sell 15% of the income generating assets of New Zealand Rugby (NZR) to your preferred buyer, Silver Lake Partners (Silver Lake).

As you are aware, by virtue of requirements set out in NZR's Collective Employment Agreement with the professional rugby players of New Zealand, NZR requires the approval of the players, through their representative body, New Zealand Rugby Players Association (NZRPA), to the restructure of NZR and the sale of 15% of the income generating assets of NZR.

NZR has shared information with NZRPA and involved NZRPA in discussions regarding the potential restructure and sale. NZRPA has strictly maintained its position as an observer in these discussions and has communicated clearly to NZR that it is for NZR to develop a full and complete proposal to place in front of NZRPA for requested approval.

We had expected we would wait until the process had run its course and NZR had presented a full and complete proposal to NZRPA before assessing the proposal and granting approval or not. However, on the basis of information known to NZRPA today and the analysis and assessment of that information, we have concluded that we will not grant approval for the restructure and sale proposed by NZR and believe we should communicate that conclusion to you now.

The decision to not grant approval to the restructure and sale of a minority interest in New Zealand Rugby has been arrived at after careful consideration by the board of NZRPA. The Board of NZRPA consists of 3 independent directors, one executive director and 10 player representatives, drawn from the All Blacks, the Black Ferns, the All Black Sevens, the Black Fern Sevens and the Super Rugby franchises.

The remainder of this letter sets out our reasons for not approving the NZR proposal and outlines an alternative approach we believe NZR should investigate and pursue.

<u>Reasons for Not Approving NZR's Proposed Restructure and Sale of 15% of Income Generating Assets</u>

Our reasons for not approving the proposed restructure and sale are most easily grouped as reasons concerning capital and expertise, control and risk.

Capital and Expertise

NZR has said it believes it needs to raise new capital to replenish reserves and to have additional capital available for investment. We do not have a view on whether this is correct or not or the level of capital required, but we accept in principle it would be advantageous for NZR to raise additional capital.

We understand that as at 31st December 2019 NZR had cash reserves of $86.3m and a further $15m in equities. We understand that pre-covid NZR was forecasting an operating loss of $13.7m, and post-covid are now forecasting an operating loss of approximately $20m (excluding Sky impairment) for the 2020 financial year, with cash reserves to reduce to approx. $65m.

We note that the very point of building reserves is to utilise them in circumstances such as occurred in 2020. It may be that further losses are sustained in 2021 but it appears to us that NZR will retain material reserves through the end of the COVID-19 disruption. As we have said, we accept it would be advantageous for NZR to raise additional capital to expand reserves, but this is clearly not an emergency situation and we see no reason for NZR to raise excess capital and sit on large reserves simply because they can. In any event, the long-term job of building and rebuilding reserves as necessary must be undertaken by retaining earnings from profitable operations. The board and management of NZR needs to ensure NZR is a significantly profitable business regardless of its reserves position.

As we set out below, we believe reserves can be rebuilt at lower cost, with less constraint on future strategic decision-making and lower risk than the current proposal to sell 15% of income generating assets to a private equity firm.

Turning to capital for new investment. The requirement for new capital for investment depends on two things: the existence of value-enhancing opportunities in which to invest and the capacity of the organisation to execute on the available opportunities. NZR has been clear it believes the restructure and sale of 15% of income generating assets will both reveal attractive new opportunities for investment and, through the partner chosen, introduce the necessary skills, networks and relationships to execute on the opportunities. We make the following observations on these beliefs.

- Separating NZR's income generating assets into a separate company (CommercialCo) and providing funds for new investment to that company is logically separate from the sale of income generating assets. So long as capital for investment is raised in some form investment in new growth opportunities can be pursued. It is not clear to us that NZR's inability to drive growth from new investment is a structural issue, but a separate dedicated commercial entity owned by NZR, properly staffed and funded, addresses what we assume NZR is meaning with the rather opaque assertion that "a new Financial Framework" is necessary as "our current framework compromises investment choices and has created unsustainable outcomes."

- Silver Lake, NZR's preferred investor, is a private equity firm that invests in a wide range of businesses including sports businesses. Silver Lake itself does not have any distinctive sports management capability. Silver Lake hires the best talent it can find to work in its investee sports companies. It is open to NZR to hire, incentivise and remunerate the same calibre of executive, or engage the same sports consulting and service providers, as Silver Lake, especially if a separate 100% owned subsidiary such as CommercialCo is established.

- In its proposal Silver Lake lists the following initiatives it will pursue should it purchase 15% of NZR's income generating assets:
  - Substantially increase the NZR fan base and engagement
  - Develop world-leading innovative content
  - Develop new direct channels to fans: owned OTT platform, OTT aggregators and social platforms
  - Gather fan data and personalise experiences to increase fan engagement
  - Invest in technology
  - Execute better on the current core revenue streams of media rights, sponsorship, licensing, merchandising and adjacent areas

  We accept that executing on these issues will require capital and new talent, skills and relationships but note that all of these initiatives, should they be pursued, are open to development by NZR without selling 15% of income generating assets.

- Cost of capital is a fundamental question in all capital raisings. The cost of capital in a debt raising is simply the interest rate paid over the term of the loan. The cost of capital in an equity raising is the in-perpetuity foregone return on the amount of the business sold. Private Equity firms such as Silver Lake typically target a gross return of 30% per annum, 20% pa is the target return to their investors and 10% pa is taken in fees. The 'going-in' assumption in the proposed sale to Silver Lake is that NZR will forego a 30% return on 15% of its income generating assets in-perpetuity. This is an extraordinarily high cost of capital.

- Within the boundaries of the process NZR has undertaken, the highest bidder is preferred, so within this process NZR is maximising the value of the assets being sold. However, we note there has never been and is not now a market for national rugby union income generating assets and neither buyer nor seller really knows if the value proposed is high, low or fair. We address a crucial element of foregone future value below in the section on Risk.

In summary, we believe NZR does not need to sell 15% of income generating assets, especially at a very high cost of capital, to rebuild reserves, establish a new 'financial framework', access capital for growth or access the skills necessary to execute on new growth opportunities. All of these ends can be achieved by accessing much cheaper capital, proceeding with the creation of a separate CommercialCo, hiring and incentivising world class talent and engaging sports service providers directly.

Control

The proposed transaction is structured such that Silver Lake will own 15% of the income generating assets of NZR and will have customary minority investor protections and certain other rights consistent with minority investments of this nature. We do not assert that the rights Silver Lake will have are anything other than 'market' or typical for transactions of this nature. However, it is our view that the 'negative control' or veto rights Silver Lake will have over the operations of 100% of NZR's income-generating assets is not acceptable.

As in all transactions of this nature, the majority party, in this case NZR, cedes much greater control than the shareholdings imply. Given Silver Lake will be driving the growth plan and its execution, in practise Silver Lake or employees loyal to Silver Lake will be running all of NZR's income generating assets. Increasingly NZR management will become distanced from key strategic and commercial relationships and the domain knowledge associated with managing NZR's income generating assets. The NZR Board, which is rotational by constitution, will become less and less in control of its destiny.

In the future, it is certain there will be divergence of interests between Silver Lake and NZR. If the parties did not believe this to be the case, they would hardly need to put in place such extensive and heavily negotiated contractual agreements to ensure each party is forced to act in the interests of the other party when interests diverge. We are not saying this documentation is unusual or inappropriate for this type of transaction. We are saying that parties whose interests are inherently aligned do not need to control each other through heavily negotiated contracts.

Risk

Three risks in particular have contributed to our view that the restructuring and sale to Silver Lake should not proceed. The risks all arise because of the irrevocability of a sale of equity in NZR's income generating assets. It is clear that once a share in the assets is sold it will never be bought back.

Loss of the special and distinctive relationship between New Zealanders and New Zealand's representative rugby teams

The relationship between New Zealanders and the All Blacks, the Black Ferns and other representative rugby teams is difficult to put into words, but we all understand it to be a special bond related to New Zealand pride and identity. New Zealand's rugby players play for themselves, their family and their country with a commitment to success that is demanded by history and required by legacy. New Zealand's rugby fans understand this commitment and see in it the essence of what, from one perspective, it means to be a New Zealander. This, above all, is what NZR is selling and Silver Lake are buying. 129 years of history and talent and results that record extraordinary success, achieved only because of who we are and what rugby means to us. No one else has done it. No one else could have done it. We believe there is a risk that this special bond and the nature of what rugby means to New Zealanders, players and spectators alike, is at risk in the proposed transaction.

In addition, as you know, Maori and Pacifica culture is woven deeply through the fabric of New Zealand rugby's brands, reputation and revenue generating assets. We know many players are, and believe many other New Zealanders would be, uncomfortable with the thought that NZR was selling income generating assets that relied, in part, upon cultural practises and understandings that they consider not for sale under any circumstances. There is an inherent risk of real or perceived cultural misappropriation given Silver Lake is an Anglo-American private equity firm.

Financial underperformance of CommercialCo

If CommercialCo underperforms financially, NZR will rightly be able to claim Silver Lake overpaid for 15% of the income generating assets of NZR. It will be no cause for celebration. Yes, "the money will be in the bank", but 15% of NZR's income generating assets will be gone forever, NZR will be reduced to income of 85% of whatever income CommercialCo produces and the negative control provisions will prevent the 85% owner making changes they think necessary without the agreement of Silver Lake. If, at this point, NZR seek to change the Shareholders Agreement to attain more control, Silver Lake will seek to extract significant value. In the event of underperformance, Silver Lake will be an unhappy partner and will seek to find other ways to improve the value of their investment. Chief among these will be the restructuring and sale of their stake into another venture, which we discuss in more detail in the following section.

Conflicts of interest and loss of future value

It is clear to us the establishment of an unbreakable partnership with one private equity firm will place constraints on the ability of NZR to maximise value independent of that private equity partner in the future. NZR's future options will be materially reduced by committing itself to deal only in circumstances that satisfy Silver Lake as well as NZR. It is therefore likely NZR will forego future value as a result of its commitment to Silver Lake.

As an example of value foregone because of prior alignment to a private equity party we give the failure of the Nations Championship.

"Last year, World Rugby was forced to drop a £6bn deal with *In front*, a Swiss marketing agency, to create a new annual tournament dubbed the Nations Championship. The concept failed partly because it would have forced the countries that compete in the Six Nations to abandon their deal with CVC[1]."

We accept that many other issues needed to be resolved for the Nations Championship to proceed but the conflict of interest between the national rugby unions and CVC was clearly a contributing factor.

We believe it is inevitable in the future that Silver Lake and CVC will work together to maximise the value of their investments in rugby properties in the southern and northern hemispheres respectively. Each private equity firm will seek to maximise its own value in any transaction, independent of the value of its investee companies. In this case, Silver Lake, owning 15% of NZR (and presumably some share of Rugby Australia in the future) and CVC will be in a position to structure competitions and negotiate shares of income from media rights, match day and sponsorship in a manner that maximises their value as investors ahead of individual investee companies. We believe the option value associated with NZR being able to deal 100% of its assets in an unfettered manner as the global game evolves is high and may be very high.

It seems Silver Lake understand there is an inherent conflict of interest in their plans to invest in NZR and in other national unions and competitions. Accordingly, they have proposed they will establish a separate entity called Global Rugby Equity Holdings (GREH) that will make investments in other country's CommercialCos (excluding Rugby Australia and South Africa). The countries they reference as examples are Fiji, USA and Japan. Northern Hemisphere nations are not mentioned but given all the large Northern Hemisphere unions are well funded through the Six Nations and other sources, they are very unlikely to ever contemplate selling any part of their national union. The proposal is NZR will be gifted 10% of common equity in GREH and the necessary capital for

[1] Murad Ahmed, Kaye Wiggins and Sammy Mnggosini, Financial Times, February 24, 2020

investment in other country's CommercialCos will be provided by Silver Lake "in a way that preserves NZR's 10% of common equity". The most common way of preserving common equity shares while funding growth is to fund acquisitions and other costs with convertible preference shares or notes that pay a coupon and sit senior to common equity. If this was the case, value would be extracted by Silver Lake through these notes before common equity holders saw any return. In our view it is most unlikely this vehicle will have any material value for NZR. We believe it is unlikely national rugby unions will want to sell part of their income generating assets to another national rugby union. Furthermore, it is not NZR's business to be making small minority investments in other national unions, (10% of 15% of another union is 1.5%), which could in many cases be a drain on NZR cash reserves. In our view GREH is a disingenuous 'carrot' of quite possibly negative value to NZR, hung out by Silver Lake to improve their chances of winning the deal.

It is customary when assessing and managing risks to 'map' risks according to likelihood of occurrence and severity of impact. Likelihood of occurrence is assessed as Low, Medium, High or Very High; severity of outcome is assessed as Low, Medium, High or Catastrophic. We do not know the specific likelihood of occurrence of any of the three major risks we have identified above, but we do know each of them has the capacity to deliver a catastrophic outcome for New Zealand rugby. Each of these risks is best managed by not proceeding with the sale of 15% of NZR's income generating assets to Silver Lake.

An Alternative Approach

We appreciate NZR is responsible for the funding and management of rugby in New Zealand. However, given we agree it would be advantageous for NZR to raise capital at this time to increase reserves and invest in growth, and we will not approve NZR's preferred approach to doing so, we feel obliged to contribute what we can to help NZR achieve these ends.

Capital raising

We believe low cost, long term patient debt capital can be raised from two sources – the green/social/sustainability bond market and from the New Zealand public. We discuss each of these sources of capital below.

Long term environmental, social, and governance (ESG) bonds

Money can be borrowed at historically low interest rates today and there is increasing appetite amongst lenders to lend long term at rates less than pure commercial rates for ESG purposes. This is now a big market.

"Since the creation of the United Nations-sponsored "Principles for Responsible Investment" in 2006, the number of global financial institutions who are signatories has grown twenty-fold, to over 2,000. They have some $80 trillion in assets under management[2]."

[2] Marcelo Giugale, Director of Financial Advisory and Banking at The World Bank

https://www.worldbank.org/en/news/opinion/2018/10/10/the-pros-and-cons-of-green-bonds

ESG bonds, to use a general term to cover all these types of bonds, are loans made for specific climate, social, sustainability, poverty alleviation or other non-purely commercial activities. We believe NZR will be able to access money from this market. The four major New Zealand banks and Kiwibank are the most obvious lenders. The interest rate attached to a loan typically depends on the credit rating of the borrower. NZR should ask the New Zealand Government to guarantee the loan. We believe with a New Zealand Government guarantee all of the banks will be very keen to lend to NZR. Even without a government guarantee we believe it is likely the banks will extend long term loans, albeit at a slightly higher interest rate, to NZR. $50 million from each of the four major banks provides funding of $200 million to NZR, which we believe is more than enough to provide ample reserves and capital for investment in growth. The interest rate would likely be in the range of 2.0-2.5% for an interest cost per annum of $4-5m a year. This is manageable, especially in the context of the high returns expected on new investment. A loan of $100 million, which may be a more appropriate amount to raise, would cost just $2-2.5 million a year to service. With a government guarantee even cheaper money would be available from international sources although exchange rate risk would then need to be managed.

<u>Non-interest paying bonds issued to the New Zealand public</u>

The second source of funding we draw NZR's attention to is non-interest paying bonds issued to the New Zealand public. We identify two types of such bonds.

The first is akin to New Zealand bonus bonds or premium bonds issued in the UK. NZR as the borrower would issue the bonds in low individual bond amounts - $20 or $50 per bond – and bond holders (people who have loaned money to NZR) would enter a regular draw to win prizes. These types of bonds, rather than paying interest, provide the right to enter a lottery to receive prizes, some of which are monetary and some of which are money-can't-buy experiences involving, for instance, the national rugby teams. The cost of the loan to NZR is the prize money paid out, the cost of administration and the cost of delivering other prizes. This cost would be set at a total of around 2% of the total amount of money raised.

The second is an extension of the payment-in-kind approach outlined above. Bonds, each priced at $20 or $50, would be issued as above to the New Zealand public and rather than receive an interest rate return, which would be very low, the holders of the bonds would receive, for instance, a discount on the price of a ticket to watch All Black Test matches. The discount could be tiered, 5%, 10%, 15%, depending on the number of bonds purchased and be transferrable to family members and last for (say) 15 years with no repayment obligation. Merchandise, free entry to the All Black Experience and other money-can't-buy experiences are other examples of the non-monetary benefits of owning All Black Bonds. These bonds would have no interest payment expense for NZR but would create costs in administration and the fulfillment of experiences. Again, this could be set at a small percentage (<2%) of the total amount of money raised. The discount on tickets is likely to drive additional ticket sales and be a net positive for NZR finances.

Importantly, capital raising by the issuing of ESG bonds or 'All Black Bonds' can be dialled up or down as circumstances change. NZR will be able to optimise capital structure and cost of funding as circumstances dictate. The diametric opposite is true of a very high cost of capital, once-and-forever sale of 15% of income generating assets.

All of this, of course, requires a good deal of research and planning and the optimal balance between ESG bond funding and All Black Bond type funding requires a good deal of analysis. We merely wish to point to two credible, low-cost, flexible ways of raising capital as alternatives to selling 15% of the income generating assets of NZR.

Structure and Governance

As we have said, we are not opposed to NZR's proposal to create, capitalise and staff a separate subsidiary to manage all its commercial activities. A separate Chair and board of highly qualified directors with appropriate experience and skills should be put in place. The Chair and CEO of NZR would sit on the board of the new entity. Most importantly, the very best talent and capability that can be hired globally should be engaged. Remuneration arrangements would need to reflect the calibre and expectations of the new appointments and the senior employees of CommercialCo would share in the equity value created for NZR.

In closing, we wish to make it clear we remain very supportive of NZR and its aim to strengthen its financial position and financial performance. The board and management of NZRPA is available to discuss the issues raised in this letter at any time and to assist NZR as we are able.

Yours sincerely,

David Kirk	Rob Nichol
Chair, NZRPA	Chief Executive Officer, NZRPA

On behalf of the Board of NZRPA:
Sam Cane, Sam Whitelock, Sarah Hirini, Lesley Elder, James Parsons, Dane Coles, Selica Winiata, Tammy Wilson Uluinayau, Doug Wilson, Scott Curry and Aaron Smith.

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