New Zealand Equity Capital Markets

Trends and insights

February 2016

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This publication explores current trends in New Zealand's equity capital markets (*ECM*) after an intriguing 2015 and outlines our expectations for 2016.

Despite fewer IPOs in 2015 and some doom and gloom headlines about recent market turbulence, secondary capital raising and trading activity on the NZX was strong, with a 20.1% year-on-year increase in capital raised.

2016 – New Zealand equity capital markets at a glance

Although the New Zealand share market has experienced some of the volatility currently unsettling international markets, the impact here has been less severe so far and there are reasons to suggest that this resilience may continue. The NZX50 is coming off a strong performance last year – up 13.6% – and this year's reporting season has shown solid results.

Expected trends in 2016

- An upturn in IPO activity from last year, but not a return to 2013 and 2014 levels.
- A more circumspect retail investor audience for private equity IPOs, reflecting the fallout from Dick Smith Electronics.
- More innovative transactions through use of the increased scope provided by the Financial Markets Conduct Act (*FMCA*).
- Strong growth in secondary capital raisings following a buoyant year in 2015.
- Further block trades, with a number of major shareholders coming off escrow this year.
- Greater use of pre-registration advertising to reduce the information imbalance between retail and institutional investors – a possibility created by the FMCA and encouraged by the Financial Markets Authority (*FMA*).
- More use of dual NZX-ASX listings following the extension of ASX Foreign Exempt status to NZX Main Board listed issuers.
- NXT Market, launched last year and targeted at SMEs, looks to find its feet in its second year of trading.
- Growing popularity of exchange traded funds to continue with, perhaps, challengers emerging to NZX owned Smartshares.
- Busy regulatory programme by the Ministry of Business, Innovation & Employment (*MBIE*), the FMA and the NZX.

A look back at listings in 2015

IPO activity in New Zealand dropped back in 2015 after two extraordinary years in 2013 and 2014.

Three issuers were added to the NZX Main Board following IPOs in 2015: Fliway Group, CBL Insurance and AFT Pharmaceuticals. Other additions included the Senior Trust Retirement Village Listed Fund, 16 new exchange traded funds offered by Smartshares and a compliance listing by Mercantile Investment Company as an Overseas Listed Issuer.

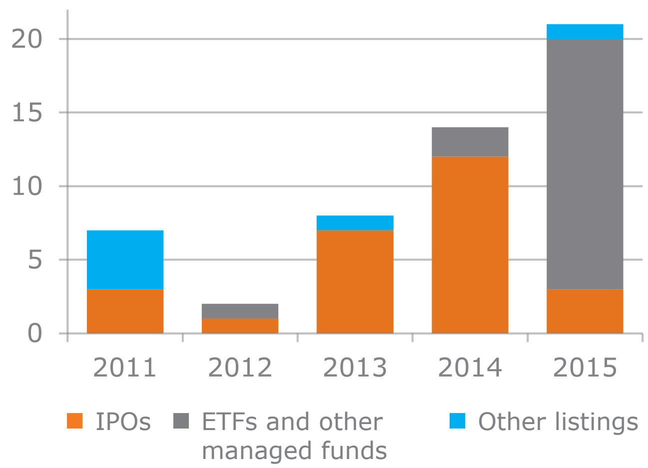
G3 Group became the first company listed on the new NXT Market.

However, a number of prospective issuers which had been contemplating IPOs in 2015 chose not to proceed, generally for commercial reasons relating either to the particular company or to general market conditions.

According to NZX CEO Tim Bennett, had New Zealand sustained the same IPO volume as Australia, after adjusting for market size, we would have had six to eight IPOs last year. So, although the two markets experienced similar conditions, Australia's IPO performance was relatively stronger.

We do not think the lag can be attributed to regulatory settings as the Financial Markets Conduct Act 2013 (*FMCA*), which came into full effect last year, provides a modern, fit for purpose regime which is designed to encourage investor confidence.

NZX Main Board IPOs and other listings



IPO prospects for 2016

We expect an upturn in domestic IPO activity this year relative to last year, but not a return to 2013 and 2014 levels.

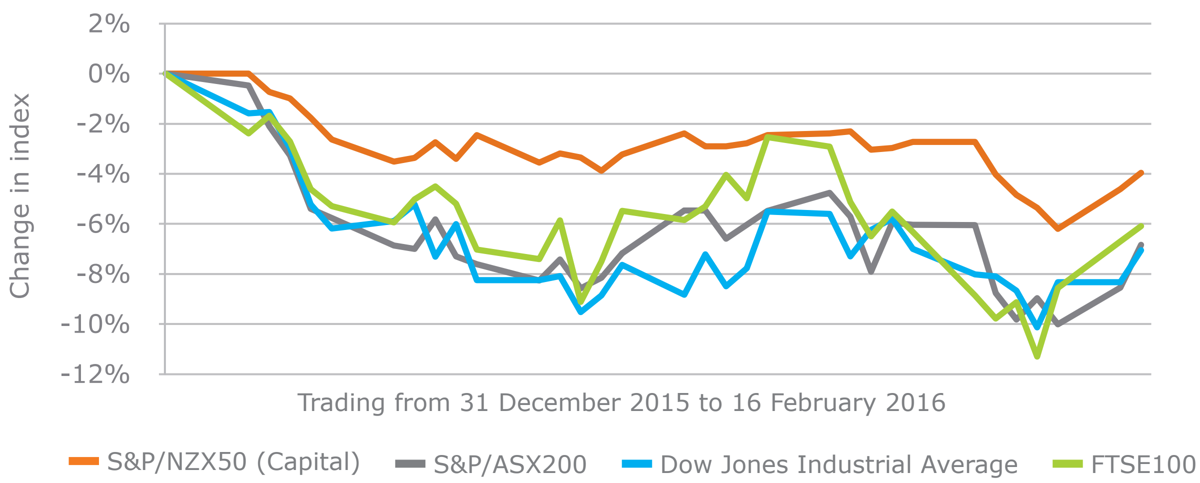
Current indications are that international conditions will remain challenging for some time and that this will bear on local market sentiment.

However, we are aware of a number of companies considering IPOs and anticipate that more will emerge as the year proceeds.

Although the New Zealand share market has experienced some of the volatility affecting international markets, the drop has been less sharp so far and there are reasons to suggest that this resilience may continue. The NZX50 is coming off a healthy performance last year – up 13.6% – so is relatively well-positioned and the upcoming reporting season is expected to show solid results.

Australia has got off to a good start with seven ASX listings as at publication, and upcoming IPOs around 40% higher by number than at the same time last year. This is in contrast to only four over the same period in the US and none at all in January – the first month since September 2011 in which no IPOs were launched.

Market performance in 2016



The "Dick Smith" effect on private equity IPOs?

A factor that may have an influence on private equity IPOs in 2016 is the fallout from the recent receivership of Dick Smith Electronics, heavily covered in the New Zealand media.

This may make it more challenging for vendors, particularly private equity vendors, to sell down their holdings as part of an IPO, given increased levels of scepticism about such exits.

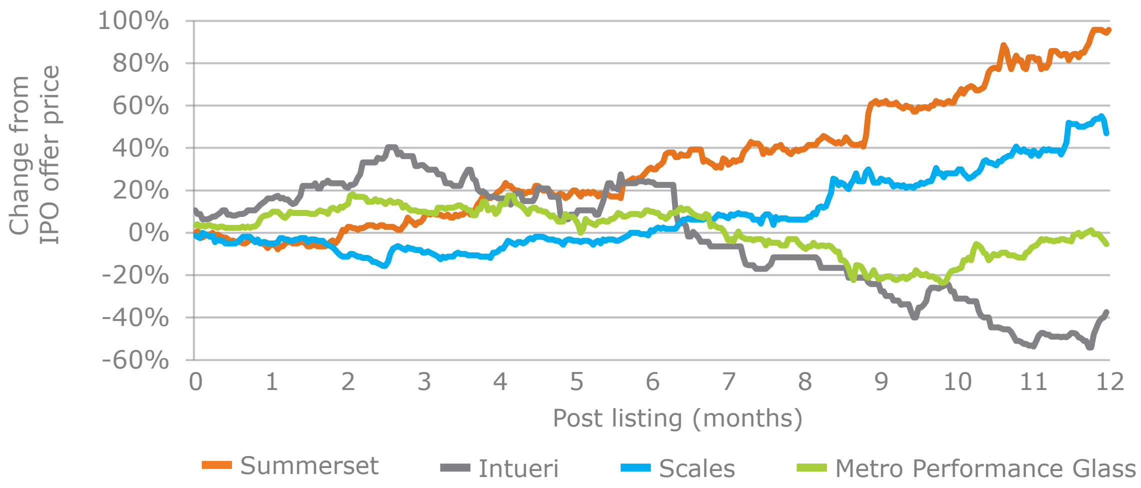
We could see a move to escrow arrangements that only allow a staggered sell down post-IPO with no sell down by the vendors at IPO, as is common in the US.

Interestingly, the first four IPOs in the US this year were venture capital backed, which raised new capital, with substantially all of the existing shareholders subject to a 180 day lock up period during which they were unable to sell their shares.

In New Zealand, there have been four private equity backed IPOs over the past five years. As the graph shows, Scales and Summerset have performed well since listing while Intueri and Metro Performance Glass have experienced more mixed returns.

Institutional investors should be sophisticated enough to analyse each offering on its own merits, but there is a risk that retail investors will discount too heavily the involvement of a private equity vendor.

Private equity IPO performance



Secondary capital raising on the ascendant

A large growth area in 2015 was in secondary capital raisings, with 29 offers across a variety of types made during the year. We expect a similar level of activity this year.

Optimal structuring for a capital raising remains hotly debated. We agree with the view of the New Zealand Shareholders' Association that the most equitable method is a renounceable rights issue, although there are circumstances in which this may not be practicable or appropriate.

Under the FMCA same class offer regime, all secondary capital raisings are treated equally, so regulatory incentives that previously led issuers to prefer share purchase plans (*SPP*) over rights issues have been removed.

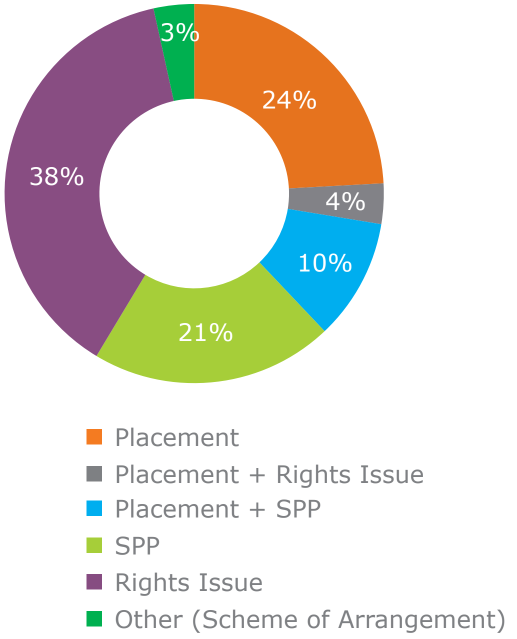
The FMCA makes it significantly easier, quicker and cheaper for listed issuers to raise capital and we expect this trend to continue.

Over time, we also expect to see the number of SPPs continue to drop, given the removal of the regulatory incentives to use SPPs instead of rights issues and because SPPs are less equitable to all shareholders than rights issues.

2015 saw two AREOs – a type of rights offer that enables the accelerated receipt of proceeds from institutional investors – and we expect that, with the flexibility introduced by the FMCA, there may be further innovative capital raising structures used in the future.

Rights issues would also become more attractive if NZX shortened minimum offering periods, to match recent ASX changes, and encouraged issuers to prefer electronic acceptance facilities.

Types of secondary capital raisings in 2015



Block trades the new black?

Another key feature of 2015 was a resurgence in block trades, with five occurring – up from one issuer assisted sell-down in 2014.

Previous law actively discouraged issuer involvement in sell-downs, unless a full prospectus and investment statement were prepared, but the FMCA has removed this barrier. However, it does impose sales restrictions following off-market sell downs by a controller but these can be side-stepped through the use of the FMCA same class offer regime.

This flexibility was demonstrated in the widely subscribed Contact Energy block trade, an issuer assisted sale which used the same class offer provision to implement an off market block trade by a controller without the on sale restrictions that would otherwise have applied.

The illustration opposite lists nine companies where major shareholders will come off escrow in part or in full during 2016.

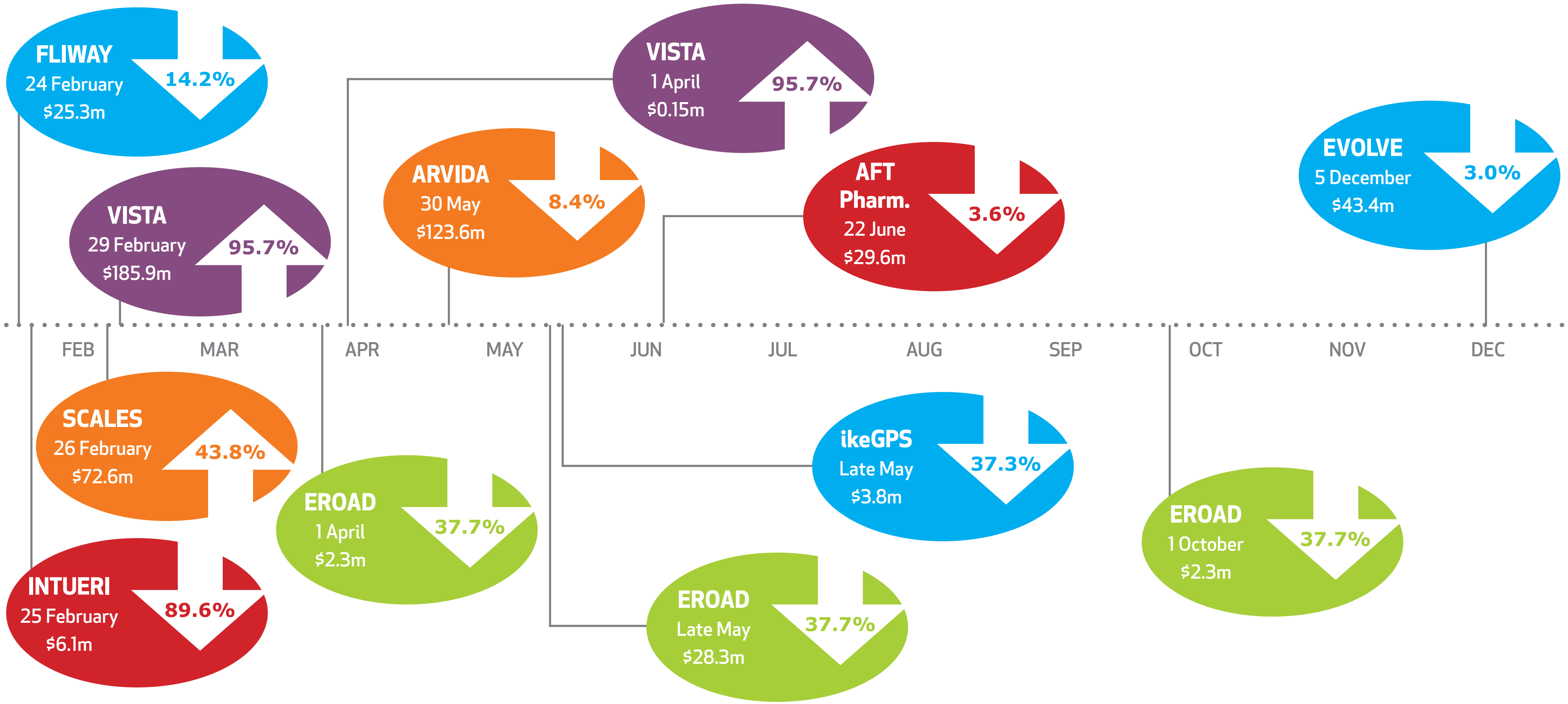
Provided the market plays ball and vendors are able to receive a reasonable price, we expect that these additional escrow removals, combined with some of the shareholders that came off escrow in 2015, will result in a continued strong flow of block trades in 2016.

One trend to watch is the deal structure employed – in all but one block trade last year, a "bought deal" was used. This is preferable for the vendor, as it means that the sale is completed immediately upon execution of the block trade agreement with the investment bank that has agreed to purchase any shares it is unable to sell.

Given current market volatility, the banks may lead a shift to best endeavours deals where they are not committed to buy all of the shares.

2016 Escrow Releases

This chart shows escrow release dates for 2016 together with the current value of the escrowed stock as at 16 February 2016. It also shows the percentage change in value of the escrowed stock since IPO.



Throw out the rule book for disclosure

A trend from 2015 which we believe will be continued in 2016 is the innovative use of pre-registration advertising to reach a broader range of investors prior to lodging formal offer documents – and, again, the FMCA is the main factor.

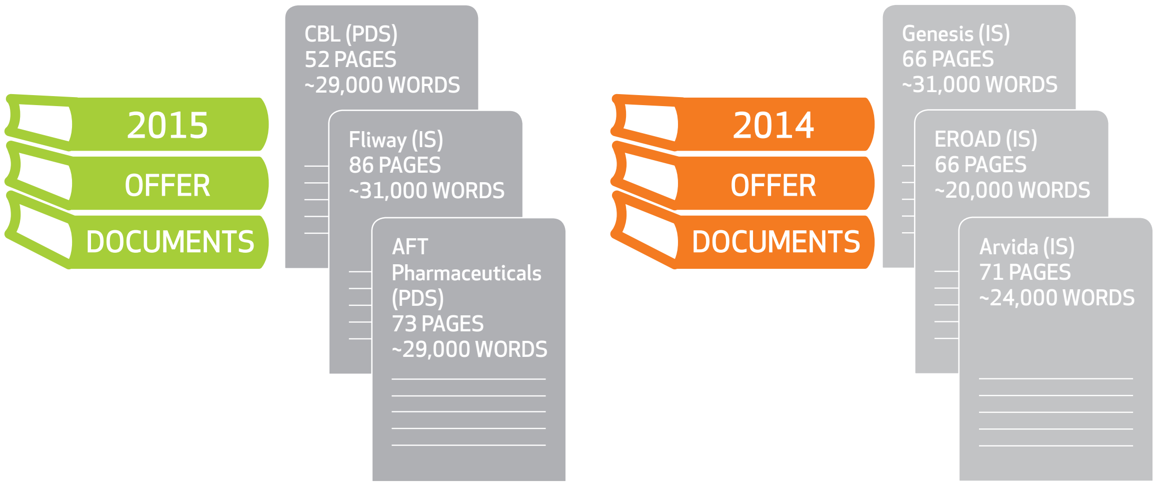
AFT Pharmaceuticals produced a 12 page fact sheet which was distributed prior to lodgement of the product disclosure statement (*PDS*) to retail investors (through their brokers), giving them access to data at the same time as institutional investors. This would not have been possible pre-FMCA and is an approach which is being actively encouraged by the New Zealand Financial Markets Authority (*FMA*), alongside the wider distribution of research reports, as a way of addressing the imbalance of information available to different investor groups.

The FMA has emphasised that, unlike the US securities market, New Zealand law does not contain "black out" restrictions on research published ahead of an IPO.

Instead, the broad FMCA obligations on fair dealing and the more flexible advertising regime it provides encourage the fair, efficient and transparent promotion of financial products. This gives those in the industry an opportunity to re-examine how and when they share research reports.

We expect issuers and their advisers will continue to seek out new ways of advertising IPOs prior to launch to improve engagement with the "prudent but non-expert investor".

So far, however, there has been less appetite for change in the presentation of the formal offer documents for equity IPOs – several of which have been significantly longer by word count than some of the 2014 investment statements prepared under the repealed Securities Act.



The FMCA requires an equity PDS to be no more than 60 pages or no more than 30,000 words. We believe that issuers and their advisers should be able to prepare documents that are shorter than this, particularly for relatively simple businesses. The page/word length is a limit, not a target.

Long boilerplate disclosure of generic risks is not permitted under the FMCA. Rather, the Key Information Summary at the front of the PDS requires the issuer to describe what it considers to be the key drivers of returns, and the most significant risk factors.

The more detailed risk disclosure section needs to provide context for circumstances that will assist investors to assess the likelihood of a risk arising, and the magnitude of the impact if the risk comes home to roost. Describing the effect of a risk as "low to severe", for example, is unlikely to be very helpful.

A risk register that the issuer takes ownership of is a good first step, but it is important to translate that into disclosure that provides useful information for the prudent but non-expert investor.

To achieve truly clear, concise and effective disclosure will require throwing out the "rule book" that applied when preparing the dense documentation commonly produced under the Securities Act.

The FMA has indicated that the aim for issuers in disclosure documents should be providing high quality information to investors rather than seeing them as "lawyer-led risk control mechanisms" for the directors.

> "We expect issuers and their advisers will continue to seek out new ways of advertising IPOs prior to launch to improve engagement with the "prudent but non-expert investor"."

Cosying up to Australia

Two of the three NZX IPOs in 2015 also undertook ASX listings (AFT Pharmaceuticals and CBL Corporation). We expect this trend to continue.

Key to this is the ASX decision last year to provide NZX Main Board listed issuers with preferential access to an "ASX Foreign Exempt" Listing. This significantly reduces the compliance burden of a dual listing for NZX listed companies by removing the requirement to comply with nearly all of the ASX Listing Rules.

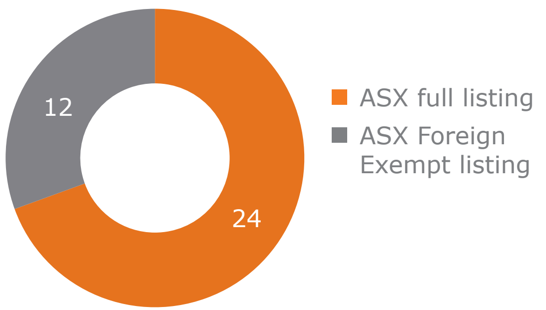
Although the new rules have been in place only since September, 12 of the 36 dual ASX-NZX listed issuers on the NZX Main Board have elected to become Foreign Exempt Listings – a take-up rate which has been assisted by a pragmatic and helpful approach from ASIC.

Trans-Tasman mutual recognition (*T-TMR*) offers continued to feature in 2015. Again, of the three New Zealand IPOs in 2015, two extended the offer into Australia under T-TMR (AFT Pharmaceuticals and CBL Corporation).

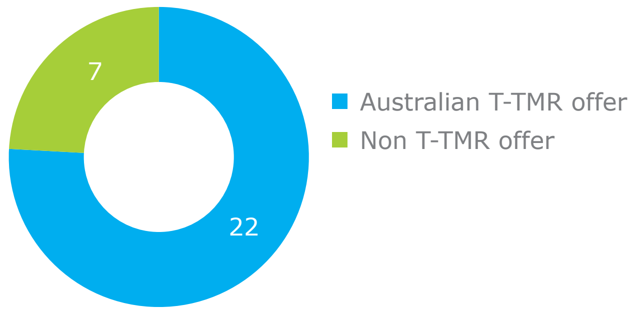
Reflecting the stronger deal flow out of the Australian market, the New Zealand Disclose register has been swamped with Australian offers. The chart opposite shows that over 75% of the offers of equity securities registered at time of publication (including both listed and non-listed issuers) were Australian T-TMR offers.

We expect T-TMR to continue to be a feature of deals in 2016 given the strong links between New Zealand and Australia.

ASX listing type of NZX Main Board listed issuers



Equity offers on *Disclose*



New Zealand's NXT top market?

2015 saw the launch of the NXT Market by NZX, aimed at small and mid-sized businesses. It has a number of features which are attractive to such issuers, including a more structured disclosure regime, the provision of independent research, and a market maker that aims to improve liquidity in NXT Market quoted shares.

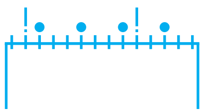
Despite these attractive features, the NXT Market has so far only attracted two listings – G3 Group, which undertook a compliance listing, and Snakk Media, which migrated from the NZX Alternative Market (*NZAX*).

Our view is that this is primarily because any public offering or compliance listing will incur costs and expenses for the issuer (both external and internal in terms of the time commitment placed upon management). While these costs are lower on the NXT Market, they cannot be eliminated.

Another challenge was that trading volumes on the NXT Market were very low for much of 2015. This reflected some hurdles to trading, such as investors having to sign up for an "NZX Reference Number", and the fact that some brokers are not yet offering online trading on the NXT Market. These problems will diminish as the market becomes better known and more established– for example Snakk Media has experienced an increase in trading after an initial drop when migrating from the NZAX.

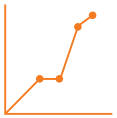
One pipeline of potential candidates for the NXT Market is issuers who have undertaken an equity crowd funding offer. Such issuers are likely to have a relatively sophisticated, internet-savvy investor base that will fit well with the characteristics of the NXT Market and may want to realise a return on their investment (given that early-stage companies are unlikely to pay dividends).

Key features of the NXT Market



Disclosure

NXT companies provide quarterly business updates to the market, and immediately disclose events detailed in a prescribed list.



Guidance

NXT companies forecast and report against key operating milestones (*KOMs*).

Market making

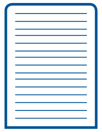
All NXT companies receive market making services to promote liquidity.

Directors

Boards with up to seven directors must have at least two independent directors.

Shareholders

NXT companies must have at least 50 shareholders.



Research

Independent research on their company is published on the NXT website and available publicly.

Smarter investment options

A strong feature of 2015 was the sharp growth in the number of exchange traded funds (*ETF*) offered by Smartshares (owned by NZX).

As at the end of January 2016, total funds under management by Smartshares had increased 187% year-on-year and we expect another increase this year given the increased focus by NZX on its ETF business.

Worldwide ETF inflows for the year were just below the record breaking total of 2014, so the continued development of these products in New Zealand reflects a global trend.

The most prominent listed managed fund remains the Fonterra Shareholders Fund, which offers investors an exposure to economic rights in Fonterra Co-operative Group shareholdings.

But the Senior Trust Retirement Village Listed Fund provided a new investment opportunity in 2015, more akin to an ETF or debt security than other NZX Main Board listed issuers. And, as more managed investment scheme managers become licensed under the FMCA and turn their attention to taking advantage of the innovative possibilities the Act provides, we expect more investment instruments to become available – such as quoted actively managed funds, which are already offered in the Australian market.

The ASX has a set of Listing Rules for ETFs and other exchange traded products which reflect that these investments are not like equity securities in a company and should be subject to a different regulatory regime.

A similar set of rules in New Zealand for managed investment schemes would remove a current area of tension between the FMCA, which encourages product innovation, and the NZX Listing Rules, which typically require significant waivers for the listing of ETFs and like products.

Although New Zealand faces challenges of scale, it would be possible for other providers to launch ETFs and other exchange traded products that provide access to other underlying assets, or that compete with the existing Smartshares funds.

In Australia, there are multiple ETFs which track the same index, providing a competitive dynamic between providers.

"Worldwide ETF inflows for the year were just below the record breaking total of 2014, so the continued development of these products in New Zealand reflects a global trend."

Keeping the policy settings sharp

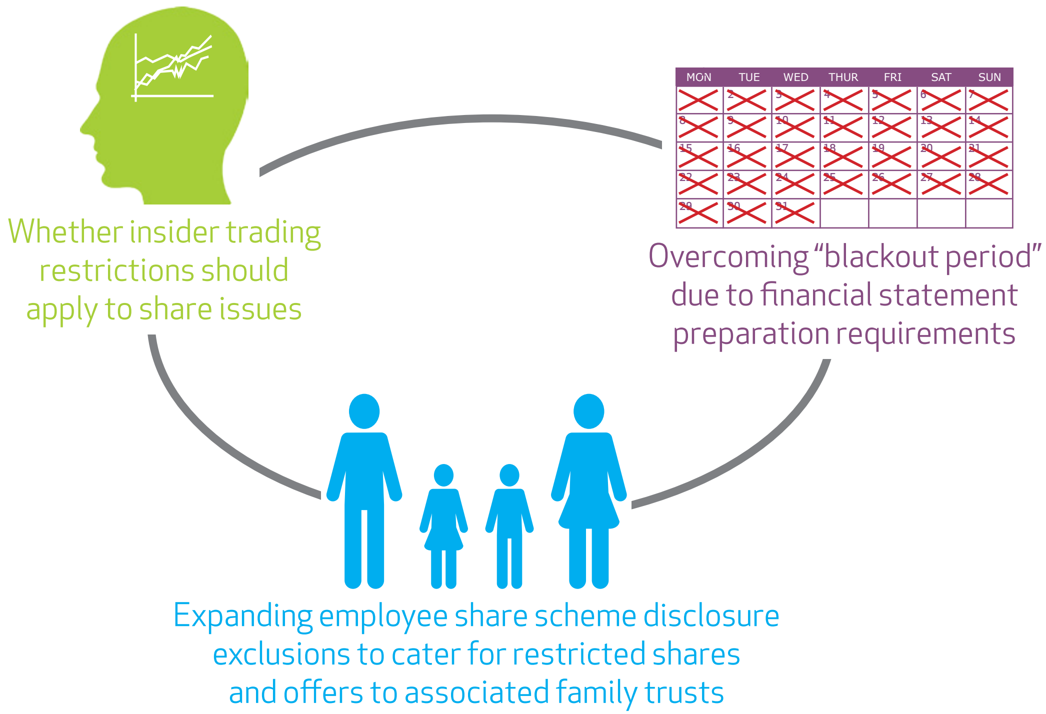
The MBIE and the FMA have a busy policy work programme planned for 2016 developing further amendment regulations and fine tuning amendments to the FMCA, product designations and exemptions.

Currently four FMA papers and a corporate governance paper from NZX are out for consultation and submissions have just closed on a regulatory reform discussion document from MBIE.

In addition, the FMCA allows regulators to more readily create bespoke disclosure and governance regimes for particular types of product.

Continued regulatory change can create costs and some uncertainty but the upside is that it should ensure that New Zealand's regulatory settings remain current and coherent.

Further ECM related reform issues being considered by MBIE in 2016



Chapman Tripp's equity capital markets team

Chapman Tripp's national ECM team is the largest and most highly regarded in New Zealand with a reputation for acting on the country's most significant and complex deals.

Our experience ranges across all aspects of ECM transactions including pre-offer structuring, IPOs and secondary capital raisings. Our deep relationships with issuers, lead managers, underwriters, regulators, and government departments and agencies allow us to advise on all securities and capital markets matters – from capital raising to regulation and market supervision.

Chapman Tripp has acted on most of New Zealand's recent ECM transactions, including acting on 14 (12 as issuer counsel) of the 22 IPOs and NZX Main Board listings in New Zealand since 2013.

These include the IPOs and NZX Main Board listings of Arvida Group, EROAD, Vista Group International, Scales Corporation, ikeGPS, Intueri Education Group, Genesis Energy, Airwork Holdings, Z Energy, Wynyard, SLI Systems and Mighty River Power.

Our unrivalled ECM track record means that we are best placed to help clients avoid the risks and obstacles with any capital markets transaction – such as choosing the wrong offer structure or a due diligence process that is not fit for purpose – as we work together towards a successful outcome.

Chapman Tripp recent equity capital markets highlights

In 2015, we advised:

- First NZ Capital as sole lead manager of AFT Pharmaceuticals' NZ$40m IPO and NZX Main Board listing
- Senior Trust Retirement Village Listed Fund on its NZX Main Board listing
- Wellard on its $A300m IPO and ASX listing extended into New Zealand under the Trans-Tasman mutual recognition regime
- Snakk Media on its NXT listing and associated capital raising
- Property for Industry on its NZ$49.5m underwritten pro rata rights issue
- Mercantile Investment Company on its NZX Main Board listing as an Overseas Listed Issuer
- Arvida Group on its NZ$30m placement, and NZ$5m share purchase plan, as part of the funding for its NZ$62m acquisition of the Aria retirement villages
- Deutsche Craigs as bookrunner and underwriter for Chevron New Zealand's "block trade" sale of its 11.3% stake in The New Zealand Refining Company for NZ$82m
- First NZ Capital as underwriter of Pacific Edge's NZ$35m rights issue
- G3 Group on its NZ$40m compliance listing, the first company to list on NZX's new NXT market
- First NZ Capital and Credit Suisse (Australia) as underwriters of Kiwi Property Group's NZ$152m accelerated renounceable entitlement issue
- Deutsche Craigs as underwriter and arranger of AWF Group's NZ$14m rights issue

"They are excellent: their focus on client service is fantastic and the commercial nature of their advice is appreciated."
Chambers Asia Pacific 2016

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