

New Zealand

Growth has decreased due to a slowing retail environment and increasing commodity prices. Private equity deals and transactions in general have reduced significantly

Current Environment

Annual GDP growth was 3.1% in the year to December 2007, an increase of 1.5% from the previous year. The Reserve Bank of New Zealand, however, expects growth to slow to 2% for 2008. Inflation has gained momentum, increasing to 3.4% in the year to March 2008. A key barometer of New Zealand's economic activity, the number of building consents applications, dropped rapidly, decreasing by 4.9% in the year to March 2008. Manufacturing activity weakened in the year to May 2008 by 4.3% and is the lowest recorded result since 2002. A global slowdown, a flat domestic market and a high New Zealand dollar all contributed to the decrease in manufacturing activity.

New Zealand's trade deficit narrowed to the smallest in more than three years as prices for dairy products buoyed export earnings. The total trade deficit decreased to NZ\$4.4 billion in the 12 months ended February 2008. There has been an increase in the import of goods, which was partially offset by an increase in exports. Increasing volumes for meat products have driven exports to a record, increasing by NZ\$245 million. Dairy prices increased by 19.7% (the largest quarterly increase since December 1971), but this was offset by a decrease in volumes.

Imports into New Zealand were NZ\$3.45 billion in February 2008, an increase of 16% for the year. Increases in the price of crude oil and machinery contributed to this growth.

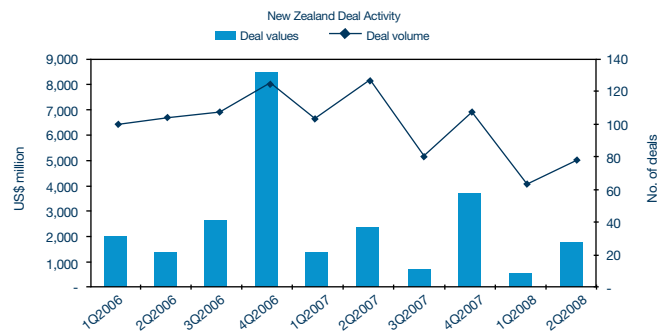
The New Zealand dollar traded between a low of US\$0.7463 on 22 January 2008 to a high of US\$0.8192 on 27 February 2008 settling to US\$0.7612 by 30 June 2008. The trade weighted index decreased by 1.7% in the month of June 2008 and has decreased by 4.9% in the first half of the year. This indicates that the volatility in the bilateral exchange rate has been primarily driven by weakness in the US dollar, rather than news specific to New Zealand.

Domestic spending activity has slowed rapidly. In addition, house sales activity has also decreased resulting in annual house price inflation turning negative. In the year to March 2008, the number of house sales dropped by 23.5% over the equivalent period in 2007. Total retail sales fell 1.2% in the March 2008 quarter and is the largest fall in retail sales since March 1997. Supermarket and grocery store sales increased by 4.7%. However motor vehicle retailing sales dropped by 6.9%. Food prices in New Zealand have increased by 6.0% since the start of the year to March 2008, with increases in the price of vegetables the key driver.

In June 2008, the Reserve Bank maintained the benchmark interest rate at 8.25%, saying that inflationary pressures remained persistent. However, Governor Bollard admitted that future decreases in interest rates would not be improbable. The Bank raised interest rates four times in 2007 in a bid to contain housing demand, which the Bank has named as the chief contributor to inflation. Inflation risks remain strong, due to a number of factors such as a record milk payout from Fonterra Co-operative Group, the higher probability of increased fiscal expenditure in the lead-up to the general election later in 2008, the government's decision to nationalise TranzRail in May 2008 and increases in oil and food prices.

The NZX50 index has experienced a sharp decline of almost 25% in the six months to June 2008, with the index reaching a three-year low of 3,182 on 30 June 2008. Share prices have come under pressure due to volatile international markets, the impact of the high interest rate environment on international earnings as well as a slowing retail environment. The full impact of the credit crunch in the United States seems to be also flowing onto the New Zealand economy. Retailers have suffered the most, with The Warehouse downgrading its profit forecast by 10%, Briscoes falling to a low of NZ\$0.90 (lower than IPO issue price), Hallensteins Glassons falling to a three-year low of NZ\$2.53 and Michael Hill falling by more than 10% to NZ\$0.74.

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 30 June 2008

Deal activity in New Zealand has slowed significantly, as value plummeted by 82% to NZ\$530 million during the first quarter of 2008 with the number of deals also decreasing by 44%. As well as this, many deals that had been announced in the quarter of December 2007 have not been completed. A firm bid for Sky City did not eventuate, and the Canadian Pension Plan Investment Board's ("CPPIB") bid for Auckland International Airport Limited ("AIAL") was rejected by the government. The Warehouse Group shares increased on the news of the High Court decision to allow Foodstuffs and Woolworths to bid for The Warehouse but fell back when the Commerce Commission appealed. The Court of Appeal has yet to announce its decision.



New Zealand's biggest rural services company, PGG Wrightson ("PGGW"), is proposing to take a 50% stake in meat processor Silver Fern Farms for NZ\$220 million in a deal that will partially restructure the country's meat industry. PGGW has indicated that it wants this to be the first step in the consolidation of the red meat industry in New Zealand which will help drive up returns to farmers. The meat industry in New Zealand has suffered over the past few years as Northern Hemisphere supermarkets have used the rivalry among New Zealand meat processors to keep prices low. As meat prices across the world are increasing rapidly, this is an ideal opportunity for consolidation in the industry to take advantage of these price increases. Silver Fern Farms has indicated that the proceeds from the sale would be used to upgrade existing facilities.

In the previous edition, we reported that CPPIB had made a partial takeover offer for 40% of AIAL. The Board of AIAL firstly recommended that shareholders reject the offer, expressing concern that CPPIB had no airport expertise. However, following a large decline in AIAL's share price (in line with the rest of the New Zealand sharemarket) the CPPIB offer price became more attractive and the AIAL Board reversed its recommendation. The CPPIB received acceptances from the majority of shareholders in AIAL, but the deal collapsed due to the government blocking a purchase by an overseas investor under the Overseas Investment Act into what it perceived to be a "strategic asset".

Australian private equity fund Crescent Capital recently made a takeover offer for listed healthcare firm Abano. The offer failed, with acceptances (including Crescent's initial shareholding) of 38.2%, 11.9% short of the required 50.1%. A major factor that influenced this outcome was the purchase of a 20% blocking stake in Abano by a group of audiologists who believed that the Crescent offer undervalued the company. Abano's businesses include dentistry, audiology, rehabilitation services and laboratory services. Crescent is unlikely to make a further offer after Masthead Investments has sold its 19.9% stake to Healthcare Industry.

Toll Holdings has sold its New Zealand TranzRail rail and ferry assets to the government for NZ\$665 million after purchasing the assets in 2004 for approximately NZ\$400 million. Toll Holdings also retains the profitable road freight business. The deal will amalgamate the rail assets with the government's ownership of the tracks (operated by crown entity OnTrack) and allow the government to make strategic decisions and investments into the New Zealand rail network.

In direct comparison to the government's refusal to allow investment into AIAL as a strategic asset, Vector Energy's Wellington lines networks were approved to be sold to Hong Kong-based Cheung Kong Infrastructure Holdings for NZ\$785 million, soon after a Free Trade Agreement was signed with the Chinese government. The government did not display any opposition to the deal as the assets did not include sensitive land. Vector has indicated that the significant capital expenditure required to upgrade the lines, as well as lower growth in the Wellington area prompted it to sell the assets. Vector will record a gain on sale of approximately NZ\$195 million.

Billionaire Graeme Hart's Rank Group successfully acquired the Australian arm of United States timber producer and processor Weyerhaeuser for an undisclosed price in May 2008. This was a surprise as Rank had originally put Carter Holt Harvey's wood processing assets on the market. The acquisition will give Rank about 35% of the market in Australia. The acquisition is expected to be finalised in September. Carter Holt Harvey's own wood products business had attracted a buyer in Japan's Sumimoto Forestry Company but the deal was declined by the Commerce Commission in March.

Private equity has not participated in any big deals in New Zealand in the first half of 2008 as access to debt has become more expensive and more selective. As a result, private equity players are constricted in their ability to offer prices to vendors.

Outlook

As a result of the government declining a bid by CPPIB for AIAL, it is unlikely that there will be any further investments in "strategic assets" in New Zealand in the foreseeable future. Even if there is a change in government in November, asset sales are unlikely to occur as the Opposition National Party has indicated that there will be no sell down of assets in the medium-term.

If the Commerce Commission's appeal does not succeed, then it is highly likely that either Foodstuffs, Woolworths, or both companies will make a takeover offer for The Warehouse. The Court of Appeal hearing took place in April and a decision is expected soon.

Further consolidation in the meat industry is likely if the proposal by PGGW for Silver Fern Farms is successful. New Zealand has a surfeit of meat processors which have struggled as a result of heavy competition and low capital expenditure.

New Zealand's Masthead Investments is continuing its push into the healthcare sector, increasing its stake in Wakefield Health to 19.31%, which is just below the takeover trigger point of 20%. This is fuelling speculation that a takeover offer is imminent, after Masthead employed the same tactic in its failed takeover attempt of Abano Healthcare.