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Fiona Mackenzie head of investments for the NZ Super Fund

I'm invested in WHAT?

Petfood, honey, a real estate agent, menswear, tea & coffee — you might not know it, but thanks to the Super Fund, you've got a stake in them all, reports **Lesley Springall**

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K9 NATURAL'S chief executive, Calvin Smith, roars with laughter when asked if he knows all of New Zealand has a stake in his raw petfood company. Do I ever, he says. "I kind of use it as a little marketing thing when I'm talking to people. I say 'you own a piece of this so you may as well listen to what I have to say'."

The reason every Kiwi has a stake in K9 is because of the NZ Superannuation Fund. As well as its other investments, at home and overseas, the fund has a strategy of using some of its money to buy stakes in privately-owned NZ companies.

In the past nine years it has invested nearly $200 million in private companies. Though not all the money is allocated yet, most of the fund's latest private equity investment is earmarked for expansion capital — smaller, high-growth companies which have proven they've got something the rest of the world wants, but need a large dollop of capital to make their aspirations a reality. Like K9, for example.

Smith, a former managing director of investment bank Credit Suisse First Boston in Britain, says the Super Fund's expansion capital strategy is a no-brainer, as there is a serious funding gap in New Zealand for high growth companies.

"The Super Fund is all about growth and yield over the long term . . . and if you look at our economy, it's the small- to medium-sized businesses that are growing the fastest so they should be offering the best investment return."

Though it's common for long-term investors such as superannuation funds to invest in private equity overseas, the scale of things in New Zealand makes the investments a little more unusual and, for some, a little more emotional, admits Randal Barrett of Pioneer Capital, one of the companies the Super Fund uses to manage its private equity investments.

"New Zealand's listed market is a very small part of our GDP, so statistics show New Zealand is the most private economy in the OECD," he says. "Private companies in New Zealand make up about 90 per cent of our GDP."

New Zealand has about 145,000 private businesses and the top 1000 of those generate about 30 per cent of the country's revenue. "So if you want to invest in New Zealand equity, you have to invest in private companies here," says Gavin Lonergan, investment director at Direct Capital, another of the Fund's private equity managers. "For me it's simple: the jobs that we want for our kids and the taxes we need to fund the standard of living we want in New Zealand can only come from growing our companies . . . and the vast majority are privately owned companies, each with their own capital requirements for funding growth, acquisitions or facilitating a succession plan for owners."

The Super Fund's private equity holdings are are only a small slice of the $3.7 billion or so it has invested in New Zealand, but they include a diverse range of businesses.

According to the fund's own estimates, there are about 3500 private companies with annual revenue of $10 million to $150 million. About 2500 of those businesses have revenue between $10 million and $50 million, and thus fall into what the fund calls its "expansion capital" strategy.

There's nothing emotional about its decision to focus on this pool of economic potential, says Fiona Mackenzie, the fund's head of investments. Nor does it have anything to do with the government's 2009 directive to boost the fund's involvement in New Zealand's economic base.

"That's the least important part of it, to be honest. The reality is, back in 2009 we saw an opportunity in the New Zealand market where there are lots of great Kiwi companies that are high growth and have great expansion potential but needed equity capital to grow."

Thus there's a disconnect in New Zealand that's fairly unusual, says Mackenzie. "There's quite a lot of capital and expertise at the startup end and quite a lot at the larger end, but

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NEW ZEALAND SUPERANNUATION FUND

Super Fund invested in what?

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not every entrepreneur has the ability to take their company from a $10 million revenue company to a $200 million revenue company.

"That's what we call the expansion capital level. So it's a great opportunity for us, but not something we could do in-house because you've got to look at a lot of companies before you find one that makes sense, and then you've got to agree on price and all that, so it's quite a labour-intensive process."

New Zealand private equity has featured since the fund's early days, but four years ago it changed its approach, from following the traditional asset allocation model employed by most pension funds, to an innovative strategy that focuses on the underlying opportunities within each asset class.

In New Zealand private equity, that opportunity was largest in the expansion capital end of the market, says Mackenzie. "We just think it's a better way to invest. It is slightly more challenging, but it's entirely logical ... you look through the investment structure, ignoring if it's a private equity manager or a hedge fund or a listed equity, and try to understand what the underlying driver of the expected returns are that you think you'll get."

Though understandably cagey about those expected returns, Mackenzie acknowledges that globally, private equity investors tend to expect returns of 20 per cent plus to compensate for the illiquid nature of the investments.

Given the size of New Zealand's listed market and lack of listed funds, there isn't a cheaper, more liquid or more straightforward way for the fund to get access to New Zealand's expansion capital opportunity, she says.

"Our mission is very clear — to maximise return without undue risk. All of our investments have to stack up on a global basis. So the short answer is no, there's no emotion to this because emotion isn't a great way or a very disciplined way to invest."

As to whether the fund should invest more in this area, Mackenzie says she believes it has the right level of exposure to the sector. Any more could have a negative impact, she says. "For the size of New Zealand, we have the right number of New Zealand managers to have a great perspective on the market, but not so many that it's too many to manage or we've created a risk that they will compete on price, which wouldn't be a good outcome."

The Super Fund's investment in the local private equity market is vital for the health of New Zealand's economy, says Pencarrow Private Equity's Rod Gethen. "These companies are the heart of the economy. Companies need capital to grow and finding that outside the private equity market is hard to do, so we need a buoyant, successful private equity market and if we didn't have the support of the Super Fund and other larger institutions it would be harder to attract other institutional or overseas investors," he says.

The Super Fund's investment in this sector has definitely encouraged other institutions to get more involved in private equity and expansion capital, says Colin McKinnon, executive director of the NZ Venture Capital and Private Equity Association.

"I think the Super Fund should be congratulated for its leadership role in New Zealand because as a result of what it's doing, there's certainly an increased inclination among the smaller institutional funds, trusts and foundations to look at illiquid assets, including private equity."

Mackenzie agrees the New Zealand investment market is maturing and if the Super Fund has been even a tiny part of that, that's great, she says. "I'm a New Zealander so of course I want the New Zealand market to do well. It's an exciting place to invest because you get to see some amazing and very cool New Zealand companies doing great stuff and, in particular, expanding offshore. So it's great to be a part of helping those companies to grow."

Lesley Springall is an Auckland freelance writer


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K9 Natural: Raw food power

Calvin Smith came across the K9 company in 2006, after returning to New Zealand and buying a couple of border collie pups for the family. Back then it was more a good idea than a viable proposition, but the fledgling firm’s focus on dog and cat food made from unprocessed meat still made sense.

“It makes sense for a dog to eat meat and even more sense for a cat to eat meat,” argues Smith.

K9’s founders — former police dog handler Geoff Bowers and dog breeder Bruce Mayhew — formed the company after Bowers returned from studying wolves in Alaska and seeing how they thrived on raw meat, offal, bones and blood.

The problem was how to make the food palatable for squeamish pet owners and convenient to ship, store, sell and use. Once they cracked that — producing their meat products in frozen pellet and freeze dried form, rather than large blocks — Smith and his friend Chris Stewart jumped in to invest in the company.

By the end of 2012, after just six years, exports accounted for 70 per cent of sales. But Smith was concerned the company still wasn’t growing fast enough. “We could’ve continued just chugging along, but I saw the risk of other people copying us and then our competitive advantage would disappear.”

Smith approached private equity firm Pioneer Capital. As luck would have it, Pioneer was in the process of establishing its second fund, a $150 million expansion capital fund, PCPII, that had just attracted the Super Fund as a $40 million investor.

Persuaded by Smith’s argument about the growing international “humanisation of pets” and K9’s impressive evolution, Pioneer bought out the original founders and became the company’s largest shareholder in October last year for more than $10 million.

The capital allows the company to move much faster, says Smith.

“We’ve been able to put people in market in the US and Australia; we’ve employed a professional sales and marketing manager; rebranded our products; and we’ve doubled our product offering this year.” The company is also eyeing up China and has been able to net a large US-wide retail partner.

“The attractiveness of Pioneer’s investment is not just the money. It gives us a lot of credibility and has opened a lot of doors for us. The retailer in the US was a classic example. They asked us how we knew we weren’t going to be capital constrained if the product took off and we could just turn around and show them who’s backing us.

“We should be a $30 million company in three years,” says Smith. “That’s what Pioneer’s investment has enabled us to do. And that’s what the government needs us to do; take New Zealand’s competitive advantages, one of which is the production of meat, and add value to it. And we’re adding four to five times the value and then exporting it.”

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Manuka Health: Sweet investment

Honey and healthcare company Manuka Health is another business that had outgrown friends, family and other individual investors, and needed a big enough dollop of capital to allow it get on with growing the operation. With a year-on-year compound growth rate of more than 50 per cent, and distribution in 40-plus countries, Manuka Health attracted a 20 per cent investment from private equity firm Waterman Capital's $75 million second fund, which includes a hefty $30 million investment from the Super Fund.

That capital has allowed the company to build beehives, develop its plant in Te Awamutu, invest in R&D and launch new products.

Basically it has allowed the management team to focus on the business rather than on raising capital, says Kerry Paul, Manuka Health's co-founder and chief executive (pictured left).

"Managing a fast growing business requires continual focus," he says.

For Paul, the Super Fund's involvement with Waterman was important as in his eyes it gave the private equity firm a lot of credibility.

It's also important from a New Zealand perspective, and an investment perspective, for the fund to be investing in the bedrock of New Zealand's economy, he says.

"New Zealand relies on the continual development of a number of companies like ours that provide the stimulus for the economy long-term. We're adding value to a New Zealand raw material and we're doing that right across the North Island and the success of our business is flowing into all those communities. So the Super Fund is not just investing purely for a financial return, they are actually helping to contribute to the development of local economies."

Wherescape: Managing the world's data

Another PCPII fund investment, data warehousing company Wherescape, also needed capital to speed its progress overseas.

Formerly a consultancy, Wherescape's founders built a software tool to automate the process of planning and building data warehouses for various platforms, after realising much of their work was repetitive.

A data warehouse is a big database where an organisation collects information, which it can then use to analyse things such as sales trends.

"Market research showed there were a lot of potential customers for the software, but we didn't know what you had to do to build an international software company," says Michael Whitehead, Wherescape's co-founder and chief executive (pictured left). Early success, both locally and internationally, helped the team gain confidence, but data warehousing was becoming a hot market and capital was needed to stay ahead of the competition.

Pioneer again invested "north of $10 million", which Wherescape used on overseas offices and employing internationally experienced people to handle marketing, sales and product development. But seeking Pioneer's help was about more than just the money. It was about gaining expertise on governance, managing growth and sharing the risks.

"Their involvement gives us the confidence to go for things. It's a big change from being a tightly held private company because then, even when you're profitable, the risk is still very personal: you have personal guarantees on overdrafts, personal guarantees on rent or leases.

"External capital gives you that ability to go, 'okay, right, I should take risks, I should push more,' so it's about a mindset as much as anything." Wherescape has a turnover of about $21 million and employs 70 people, compared with 44 in 2012, and it's hunting for more. Its forecast growth is twice what it expected before the PCPII investment. But the company would have forgone that capital injection if it hadn't found the right investor. It was the fact that Pioneer was a Kiwi company, and backed by the biggest Kiwi investor of them all, that tipped the balance, says Whitehead.

"We didn't want the culture we'd developed to be changed by big money guys coming in and making us do stuff differently."

Knowing every New Zealander has a stake in your company is "pretty cool," he says. "It's great New Zealanders are investing in New Zealand companies. It makes you stand up a bit straighter. But it brings with it a responsibility to deliver too."


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Are you a contender?

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Bell Tea: Staying Kiwi

Another company that was attracted by the chance to be part of all our futures is a real Kiwi identity — the Bell Tea and Coffee Company. More than 50 suitors, many from overseas, sought more information when Bell's former owner, supermarket group Foodstuffs, put the company on the block last year. However the New Zealand factor was key for those in management who were keen to become investors in the company. "It was a really big thing that [Pencarrow Private Equity] was New Zealand-owned . . . and was predominantly backed by the NZ Super Fund and ACC," says chief executive and shareholder Mark Hamilton (pictured left). "It was a cultural fit because we've always been New Zealand-owned and we've been around for 100 years so we felt more comfortable with it and our staff felt more comfortable. So it differentiated them from other potential private equity investors in Australia."

Bell Tea is the first investment for Pencarrow's IV fund, which has a cornerstone investment of $30 million from the Super Fund. But not all the companies approached knew the fund, and thus all New Zealanders, has a stake in their future. Menswear firm Rodd & Gunn's managing director Mike Beagley and online retailer Fishpond's general manager Ben Powles were both unaware of the fund's involvement in their companies. Both have stakes owned by Direct Capital's III fund, which includes a $20 million investment from the Super Fund.

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In 9 years, the NZ Super Fund's private equity investments have injected nearly $200 million into NZ companies.

Through Pencarrow Private Equity

Bell Tea and Coffee Long established hot drinks company
NZ Crane Group Cranes & specialised transport
Rishworth Aviation Aviation recruitment, crew training & leasing
SolarCity Designs, manufactures & installs solar-power systems, in NZ & overseas

Through Direct Capital

Bayleys Property services & real estate agency
Cavalier Wool NZ's largest wool scouring operator
Energyworks Services to oil & gas, power generation and petrochemical industries
Fishpond Online retailer
Hiway Group Ground stabilisation and roading contractor
NZ King Salmon King Salmon producer & exporter
NZ Pharmaceuticals Biopharmaceutical manufacturer
PF Olsen Forestry management services
Rodd & Gunn Menswear retailer
Scales Corp Horticulture and primary sector processing, export & logistics
Stratex Group Specialty packaging materials manufacturer
Transaction Services Payment processing

Fiona Mackenzie, NZ Superannuation Fund's head of investments

Through Waterman Capital

Academic Colleges Group Private school operator
Healthcare Holdings Healthcare group, includes Mercy Ascot hospitals
HealthLink Group Communications systems & messaging for health industry
Manuka Health Manuka honey-related functional foods & dietary supplements
Partners Life Life insurance

Through Pioneer Capital

K9 Natural Raw petfood manufacturer & exporter
Pet Doctors Chain of veterinary clinics & catteries
Waikato Milking Systems Milking technology developer & manufacturer
Wherescape Software for data warehousing

Other notable NZ investments

Datacom IT services, including data centres, payroll management & software development
Z Energy Fuel retailer (now listed on NZ & Australian stock exchanges)

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Today the fund's size sits at about

$26 billion

Its NZ investments include stakes in many listed companies, forestry, rural land, fixed income, property and private equity

The NZ Super Fund, or "Cullen Fund", was established in 2001 by the Labour Government, to help meet the growing cost of providing pensions for future retirees. Between 2003 and 2009 the government contributed $14.88 billion to the fund before contributions were halted by the National Government, which was more concerned about New Zealand's current debt problem, than more distant issues. Contributions are scheduled to re-start from 2020-21, and withdrawals from the fund are expected to begin in 2029.

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Private equity is an exciting place to invest, says the Superannuation Fund's Fiona Mackenzie. PICTURE / DEAN PURCELL