

# New Zealand

*Record exports support the economy, while several major deals remain in limbo*

## Current Environment

Economic activity increased 0.5% in the September 2007 quarter, compared with a 0.8% increase in the June 2007 quarter. Annual GDP growth was 2.7% in the year to September 2007. This softening in GDP growth was primarily due to an easing in household spending activity. Household spending growth increased by 0.3%, following an increase of 0.5% in the previous quarter. Manufacturing activity decreased by 2.2% in the September quarter, and the electricity, gas and water sector contracted by 3.8%.

The recently released trade balance report reveals that New Zealand's trade deficit has narrowed to its smallest level in more than two years. Soaring prices for dairy products have driven exports to a record, reducing the trade deficit for the year to 30 November 2007 to NZ\$5.3 billion (US\$4.2 billion). Fonterra Co-operative group, the world's largest dairy exporter, said that supplies from dairy farmers had increased, allowing it to take advantage of high prices. At the new Tui oil field, output increased to 48,000 barrels per day, following modifications to the production plant. Oil receipts were NZ\$254 million (US\$197 million), a significant increase from NZ\$25 million (US\$19 million) a year earlier (New Zealand remains a significant net importer of crude oil and the Tui field is expected to have a short lifespan).

Imports into New Zealand were NZ\$3.64 billion (US\$2.83 billion) in December 2007, an increase of 11% over December 2006. Purchases of fuel and trucks contributed to the increase.

For the September 2007 quarter, foreign direct investment ("FDI") into New Zealand totalled NZ\$1.1 billion (US\$0.9 billion), a significant fluctuation from the June quarter total of NZ\$1.9 billion (US\$1.5 billion). FDI income from dividends and interest totalled NZ\$2.1 billion (US\$1.6 billion) in the September quarter, which represented a significant contribution to the current account deficit.

The New Zealand Dollar reached a high of US\$0.8078 on 24 July 2007. It then fell sharply, reaching a low point of US\$0.6734 on 17 August 2007. Following this, it climbed back to the US\$0.76 level by September, and has traded between US\$0.76 and US\$0.79 since. The trade weighted index remained relatively flat, decreasing from 71.3 in May 2007 to 71.6 in December 2007. 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.

Overall, the strong growth in exports in spite of a persistently high New Zealand Dollar is encouraging. The export-led growth has greatly helped New Zealand's economic situation, offsetting declining domestic business and consumer spending.

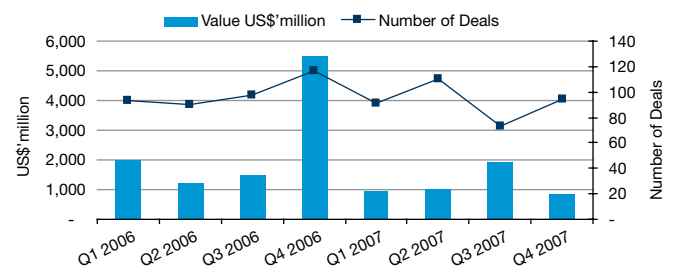
On 24 January, the Reserve Bank held the benchmark interest rate at 8.25%, saying that inflation pressures remained persistent. The Bank raised interest rates four times in 2007 in a bid to contain housing demand, which the Bank has named as the chief contributor to inflation. However, inflation risks remain strong, due to a forecast record milk payout from Fonterra Co-operative Group Ltd, and the higher probability of increased fiscal expenditure in the lead-up to the general election later in 2008.

The NZX50 index declined from 4,302 at 31 May 2007 to 3,680 at 31 January 2008, a 14.4% decline. In the first half of January 2008 the market declined sharply, following large falls in many overseas markets. Share prices have come under pressure due to full valuations and the impact of the high interest rate environment on domestic earnings. In the December quarter the telecoms, healthcare, property and energy sectors, which all can be described as defensive, outperformed the overall market. The investment and tourism sectors underperformed.

## Deal Activity

Although the graph shows announced deal activity of approximately US\$2 billion in the third quarter of 2007, several major deals have not been completed; this put further pressure on share prices. A firm bid for Sky City did not eventuate, and the Canadian Pension Plan Investment Board bid for Auckland International Airport is subject to political approval. 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.

Announced Mergers & Acquisitions – New Zealand



Source: Thomson Financial

Casino operator Sky City first attempted to sell only its Adelaide casino. However, it announced in September that it was accepting offers for the whole company after receiving an approach from an interested party, rumoured to be PE fund TPG. Sky City then announced that it has received a second approach, and that both parties were conducting due diligence. However, no firm bid emerged, with the global credit crunch making it difficult for buyers to secure funding. Contemporaneously with the sale process, Sky City searched for a new CEO following the resignation of the previous CEO Evan Davies in June. In December, the company announced that it had appointed Nigel Morrison, a gaming executive from Macau, to the position.



In the previous edition, we reported that Dubai Aerospace Enterprise (“DAE”) had made a partial takeover offer of Auckland International Airport (“AIA”). DAE has now withdrawn its offer. Another bidder, Canadian Pension Plan Investment Board (“CPPIB”), made a partial takeover offer for 40% of AIA. The Board of AIA firstly recommended that shareholders reject the offer, expressing concern that CPPIB had no airport expertise. However, following a large decline in AIA’s share price, (in line with the rest of the New Zealand sharemarket), the CPPIB offer price became more attractive and the AIA Board reversed its recommendation. CPPIB has received acceptances from greater than 40% of shareholders in AIA. Nevertheless, the offer is still subject to Overseas Investment Office (“OIO”) approval. The OIO decision is due by 11 April.

The High Court has overturned the takeover ban imposed by New Zealand’s competition regulator, the Commerce Commission. The ban prevented supermarket operators Woolworths and Foodstuffs from each making a takeover bid for general merchandise retailer The Warehouse Group. However, the Commerce Commission has appealed the ruling. The Commerce Commission’s case will be heard in the Court of Appeal from 29 April.

Australian PE 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% shareholding for the offer to succeed. 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 has not yet made any announcement about whether it will initiate a new takeover offer or not.

Although incomplete deals made headlines, there have been several successfully completed deals. Billionaire Graeme Hart’s Rank Group has purchased American firm Alcoa’s packaging business for US\$3.5 billion. Rank Group now has a large packaging empire, which includes Carter Holt Harvey, Evergreen Packaging and Swiss firm SIG. Rank has issued a US\$1.6 billion syndicated loan to help fund the purchase.

State owned bank Kiwibank acquired the New Zealand residential mortgage book of HSBC for NZ\$720 million (US\$500 million).

Arab-owned Haumi has bought 19.9% of property investor AMP NZ Office Trust for NZ\$180 million (US\$140 million). Haumi is owned by Abu Dhabi Investment Authority of the United Arab Emirates, the largest sovereign wealth fund in the world.

## Outlook

The incomplete takeover offers for Auckland Airport and The Warehouse will continue to unfold. However, a successful bid for Sky City appears increasingly unlikely.

If CPPIB’s partial offer is not approved by the OIO, it is likely that AIA will try and seek out a cornerstone investor who has aeronautical expertise, and can build the route network connected to the airport and develop tourism. Three major Middle Eastern airlines have been suggested by an AIA analyst as having this ability. The airlines – Etihad, Qatar Airways and Emirates, have an ability to develop new international routes for AIA which are not in direct competition with its major customer Air New Zealand.

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 general merchandise retailer. The Court of Appeal hearing is expected to take place in February; therefore a takeover offer for The Warehouse could be made by March or April.

Sky City Group’s new CEO Nigel Morrison’s personal view is to hold on to the Adelaide casino, so it is unlikely to be offered for sale again. The US housing slump and decline in credit markets has made an offer for Sky City Group much less likely.

Electricity lines and gas network company Vector has offered its Wellington electricity network for sale, and is currently dealing with five or six interested parties. These are thought to be Hastings Funds Management, Babcock and Brown, the Australian Infrastructure Fund, an Allco and Electra joint venture and Christchurch lines company Orion. These parties are currently conducting due diligence, and final bids are due by mid April. Vector is reported to be seeking at least NZ\$1 billion for the network. However, this target may prove optimistic due to high interest costs and a regulatory regime that has recently become much more intrusive.

PE executives have commented that the boom in aggressive deals is over, and PE funds will be more cautious in 2008. The cautious mood has been put down to the credit crisis, which has increased the cost of buyouts, together with the turbulence in world equity markets.