DIRECT CAPITAL

DIRECTIONS

NEWSLETTER OF DIRECT CAPITAL PARTNERS **FEBRUARY 199**

Airwork has Australian launch pad

Airwork (NZ) Limited is set to take off in Australia with the acquisition of the Hawker Pacific Turbine Group, the South Pacific's largest independent aircraft overhaul operation.

The acquisition has been funded by the equity provided when Direct Capital took a 44.5 per cent stake in Airwork during 1997.

Airwork managing director Hugh Jones says that Hawker, now known as Pacific Turbine, has a well established business base with excellent potential for growth.

"The company has a variety of contracts, including RAAF contracts, and we see the opportunity for expanding civil work in particular," he says.

Pacific Turbine services a complete range of international engine types, including General Electric, Pratt and Whitney, Arriel and Allied Signal, and there are opportunities to further develop key relationships with the major global engine manufacturers.

"The company also has a very good hydraulics shop which offers an engineering capability second-to-none for F-18 fighters and can even handle Boeing 747 landing gear," says Mr Jones.

The range of manufacturer and regulatory agency approvals held by Pacific Turbine, and the fact that it has facilities in Sydney, Brisbane and Perth, places the company in an exceptionally strong position to serve the Asia-Pacific region.

The Pacific Turbine acquisition has been an excellent example of how Direct Capital can directly assist its investee companies. Direct Capital worked closely with Airwork executives in setting up the acquisition opportunity, negotiating exclusivity, price and contract negotiations, due diligence and documentation for the acquisition.

Direct Capital managing director Ross George sees the acquisition as a major step forward for Airwork, adding significant value to the future earnings and growth for the combined Airwork-Pacific Turbine group.

"This development typifies the advantages direct investment can bring to companies," he says. "By providing expansion capital, we can add considerably to the value of companies and grow shareholder wealth all round."

Airwork and Pacific Turbine will have a combined turnover exceeding $70 million.

The chairman of Pacific Turbine, which employs 192 staff, is Harvey Parker, former managing director of New Zealand Post, a former group managing director with Telstra in Australia, and currently director of several other Australian companies.

The Pacific Turbine acquisition followed the joint purchase (with Seattle-based Helipro Corporation) of Houston helicopter maintenance company Transtar Aviation Services.

Airwork, New Zealand's largest airfreight and general aviation company, currently operates seven AirPost aircraft in an airfreight joint venture with New Zealand Post, and owns and operates 10 other aircraft and helicopters.

Winging its way across Australian skies, a corporate jet aircraft fitted with Garrett TFE-731 engines overhauled by Pacific Turbine Pty Limited, now a wholly owned subsidiary of Airwork (NZ) Limited.

Inside

Communication — the life of Riley

Media and communications have virtually filled the working life of Kevin Riley, now at the management helm of investee company Communicado.

So it will be from a base of considerable knowledge that he works on the next business plan of the company, to be implemented from April.

The new chief executive spent most of the nine years he had with Telecom running its Yellow Pages business, building sales and profits which were high by world standards and winning a national quality award in the process. He finished with a stint as managing director of Telecom's Australian subsidiary Pacific Star, which, among other things, was involved in Internet services.

Prior to his Telecom career he had been with New Zealand News Limited as marketing manager for its community newspapers group and before that with Jason Publishing, one of New Zealand's foremost tourism and entertainment directory publishers.

"Altogether, I've had something like 14 years in various forms of media, focused on the information and entertainment business," he says.

"The common thread has been the occupation of people's leisure time, and that certainly fits well with Communicado's business."

Mr Riley's arrival is another building block for the company following the appointment of Dr Lester Levy as chairman in April last year.

Kevin Riley, who is a graduate of the Harvard advanced management programme, believes Communicado has the advantages of a strong brand and of being seen in the industry as a successful business. In future he sees a lot more value coming from the content of its productions as it extends into various media.

There will be focus, for instance, on growing corporate communications packages beyond business video production. The breadth of the portfolio containing inflight and travel productions will also be extended, making more use of the material. Mr Riley believes that Communicado's greatest strength is its relative diversity, with four main business streams. Compared with other production houses it is more insulated from the vagaries of single lines of business.

"This diversity is also a strength for staff, who have the opportunity to move through different divisions," he adds.

Mr Riley sees one of his challenges as retaining the creativity of staff while operating in a businesslike way.

"We need to retain that pride of ownership which comes with their work, but also enable them to operate in a business structure. Getting an understanding of the business side of things will bring growth with it."

Kevin Riley, who commutes daily from the Kaukapakapa farm home he shares with wife Gael and three school-age children, is retaining the offshore operations of Communicado which centre on the Singapore office and the Continental-Micronesia Airlines operations, but doesn't yet plan to expand further overseas.

Kevin Riley, new chief executive of Communicado, looks forward to implementing a creative new business plan for the company in the new year.

EFT-POS NZ sees Point of Sale off shore

In August last year Direct Capital took a stake in the booming electronic funds transfer business with a $7.4m investment in EFT-POS New Zealand Ltd, New Zealand leaders in the rental, installation and service of EFTPOS terminals and whose management systems are increasingly in demand by major overseas players.

Electronic Funds Transfer at Point of Sale, or EFTPOS, has been available in New Zealand since mid 1982, but it really only took off in the early 1990s, mainly as a result of the introduction of the ability to get cash out via the EFTPOS terminal as well as pay for goods.

EFTPOS is quite simply a network linking retailers, banks and cards, which combines to provide retailers and customers with a process to use debit and credit cards to buy and sell goods and receive cash.

The components which comprise the EFTPOS network are the EFTPOS cards, the EFTPOS terminals, the networks through which the transactions are processed, the banks, and the card operating companies.

EFT-POS NZ Ltd, the company, works closely at all stages of the sale and installation process with banks, who were performing the sales and installation role themselves until a few years ago. Two, ANZ and ASB, still do so for some or all of their customers.

Director of EFT-POS NZ Mark Thomson said New Zealand is extremely successful at the electronic funds transfer business and has the highest penetration of EFTPOS terminals in the world, with one terminal for every 72 people.

It is estimated that $13.85 billion, or 32 per cent of all retail sales went through EFTPOS terminals in New Zealand last year - an increase of approximately 25 per cent on the year before, compared with total retail sales growth of 3.7 per cent.

"EFT-POS NZ's market share of new EFTPOS terminal installations in the last 12 months is approximately 60 per cent," he said. For 1998 we are looking strategically at possibilities off-shore, following registrations of interest from banks, service providers, technical manufacturers, and investors in Australia, Asia and the USA.

"Our systems and processes comprise a model that is relatively easily transferred to and customised for other markets, and can give significant leverage within those markets.

"The 'system' comprises an integrated sales, sales management, finance, operations, accounts, service and support, and terminal management programme.

Mobile EFTPOS NZ golf buggies equipped with eftpos machines are proving popular for hire at events such as rugby or cricket games, or as used here at the National Field Days in Mystery Creek, Hamilton

"It is a system that manages the entire hardware facilitation process in an electronic format," Mr Thomson added.

According to Mr Thomson, the software modules are not something that can be bought off the shelf.

"We are currently working through various options as to the best way to capitalise on what is a clearly considerable opportunity in the global market. A recent trip to the US confirmed our research, and the task now is to determine the best strategic direction for the company." The other developing market for the company is in mobile terminals, installed in taxis or vans for tradespeople.

"We are looking to firm up our relationship with our merchant base and will provide some value added opportunities for our customers, especially in the area of ancillary products and services, such as different point of sale products, terminal software and consumables." EFT-POS NZ Ltd was founded in 1994 by its joint managing directors, Peter Marshall and Mark Thomson, who each hold a one-third stake in the business.

New director sees capital future

New Direct Capital Partners director Geoff Cumming believes the company has made a good start in the first three years of its life, and over time will consolidate its position as the pre-eminent provider of private equity investment in New Zealand.

Mr Cumming is the joint founder of Emerald Capital Limited, Direct Capital's newest, and now largest shareholder, with an 18 per cent stake. Emerald Capital is part of Gardiner Group Capital Limited, a Toronto-based private company, which is one of North America's largest direct investment industry players.

Mr Cumming's early career was as a partner in a merchant bank in Canada, primarily managing mergers and acquisitions. Subsequent to that he was made President and CEO of Gardiner Oil and Gas, an exploration and production company, which he ran for five years.

Mr Cumming also managed the international side of Gardiner Group Capital Limited. With the founder of that company, George Gardiner, he established in New Zealand Emerald Capital Limited, as the international investment arm of the Gardiner Group.

Gardiner Group Capital is a long term equity investment company with significant assets in North America and overseas. It has a varied portfolio of investments in manufacturing, service, and oil and gas companies.

"The key aspect of Emerald Capital is that we take minority interests in companies, up to 40 per cent, and hold those interests for a 10 to 15 year period," said Mr Cumming.

Sadly, George Gardiner passed away in December 1997.

"George was an outstanding Canadian businessman and philanthropist," said Mr Cumming. "Aside from being a former Chairman of the Toronto Stock Exchange, he was also the founder of Kentucky Fried Chicken in Canada. He formed Scott's Hospitality Limited, a transportation and fast foods company, which among other things was the largest holder in the world of KFC outlets, and also 92 Holiday Inns."

He has left a legacy of robust companies in both Canada and New Zealand.

Geoff Cumming, new Direct Capital director, sees a strong future for the company.

Open Group opens doors across the Tasman

Operating in the rapidly deregulating world-wide telecommunications market, OPEN Group Limited is a Wellington based company that is focused on the supply and support of telecommunication hardware solutions to telecommunications service providers (telcos).

It is one of a number of companies based in Australasia positioned to meet the global demand for knowledge and technology by telcos, as they adapt to the changing market requirements.

OPEN Group was established in 1989 and its main business is the sale and support of equipment, software and services to companies such as Telecom and Telstra, enabling them to provide high speed digital services to their customers.

Specifically it sells equipment to telcos which is primarily used to provide digital network services to leased line customers. These services include ISDN, DDS, Frame Relay and ATM.

The equipment is located in the telephone exchange and at the customer's premises, and provides the high speed connection over the line between the two locations. In conjunction with the equipment, management software is also provided to enable the telco to ensure a high reliability service to its customers.

It is these services, many of which are being driven by increasing demand for Internet services, that are now highly sought after by countries deregulating their telecommunications services and form the base of an exciting future for OPEN Group.

As part of the push into international markets, OPEN Group established its first Australian office in Melbourne in November, to support its expanding business relationship with Telstra in Australia.

Managing director Derek Campbell said the Group would be expanding staff numbers in Melbourne during 1998 in line with increasing Telstra requirements.

"While the company has been focused on the Australasian market, increasing attention is being given to other international markets, and we will be looking to capitalise in 1998 on the two years of marketing investment we have made in Asia," he said.

Key to this expansion is the investment made by Direct Capital in September of $7.5 million to acquire a one-third share-holding, as well as receiving an ISO 9001 accreditation later in that month.

Mr Campbell added that New Zealand based research and development would continue to be the driving force behind continued success off-shore.

Stop Press

More Wine from Palliser vines

Palliser Estate Wines of Martinborough Limited, the leading exporter among a handful of highly successful vineyards which have earned the tiny wine region an international reputation, recently announced a rights issue to shareholders to raise $2 million to complete the purchase of 53 hectares of land in Martinborough.

The land is in two properties and represents almost the last land available for vineyards in Martinborough. One property, of 25 hectares, is already producing grapes, the other, is bare land.

The rights issue represents another significant step for Palliser, and is the second such vineyard expansion since Direct Capital became a 10 per cent shareholder early last year.

The company was established in 1984 and produces two labels, Palliser Estate and Palliser Bay, which last year received many accolades, including the gold medal at the Air New Zealand Wine Awards for the 1997 Palliser Estate Sauvignon Blanc and the top pinot noir award at the Liquorland Top 100 International Wine Competition.

Robinson restructures and rebrands

For Robinson Industries, 1997 has been a year of revitalisation.

The company, New Zealand's largest manufacturer of rangehoods and laundry supertubs (its third product category, bench top ovens, has been licensed to a manufacturer off-shore), has gone through both a restructuring and re-branding process in the last six months.

Based in Manukau City, Robinson was formerly the exclusive New Zealand distributor for a number of major international appliance brands. The distribution part of the business was sold at the end of July to an international trading company, Hagemeyer NZ Ltd (wholly owned subsidiary of Hagemeyer NV Ltd), a Dutch group with a primary business of distribution.

"Basically we had grown too large too quickly, and we had interests in all sorts of areas," said managing director Steve Bootten. "When we looked at our real strengths, we realised they lay in the manufacturing side of the business and the decision was made to restructure, selling the distribution business and concentrating on manufacturing."

Robinson Industries manufactures two main product categories - laundry supertubs and rangehoods. This year has seen the company increase its market share in the manufacture of supertubs by marketing the opportunities available for people redeveloping and upgrading their laundries.

"In the same way people were encouraged several years ago to upgrade their kitchens, we are now encouraging them to upgrade their laundries, by installing things like built in laundry tubs and ironing centres," said Mr Bootten.

In rangehoods, Robinson has held its market share, but undertook a major re-branding exercise at the beginning of November, selling all its rangehood products under the Robinhood brand, the name under which they have become well known in Australia.

"Trading under the Robinhood brand means we now have access to a wider range of products previously only available in Australia, and we are also reaffirming our position as New Zealand's top rangehood manufacturer," he said.

Robinson Industries has two major objectives for 1998:

Firstly, to concentrate its manufacturing on being a flexible, low volume producer, to counter imports from large manufacturers in Italy, who will only provide container loads of products, often not suitable for distributors.

And secondly, to establish the Robinhood brand in New Zealand, while strengthening the brand in Australia, so it retains its position as the market leader in Australasia.

Robinson Industries staff working at the Manukau City manufacturing plant.

Ryman develops North and South

Ryman Healthcare, reported as being on the move in the previous issue of Directions, is steaming ahead with exciting developments in 1998.

Last year Direct Capital and Ngai Tahu Holding Corporation each took a 25 per cent shareholding in the company, which is one of New Zealand's leading operators and developers of facilities for the long stay care of the elderly.

The investment coincided with major additions to one of its facilities, based in the centre of Christchurch, Beckenham Courts.

Ryman has now acquired land in Grants Road, Christchurch, for a new facility which will include a 40 bed hospital, 60 bed rest home, 50 serviced studio apartments, 50 two bedroomed apartments, a bowling green, indoor swimming pool, gymnasium, bar and club lounge. Construction on the Grants Road site is due to commence in April this year.

And in another big move for the company, Ryman has procured what was formerly known as the Burma Lodge, a hotel and conference facility close to Khandallah, Wellington, as its first development outside the South Island.

"Khandallah is a very exciting development for us," said John Ryder, executive chairman of Ryman. "The site was ideal with eight conferencing rooms and 60 bedrooms, but we will be doing some rebuilding to create 40 studio units and 12 one bedroom units. We will also build 50 two bedroomed apartments, a 60 bed rest home and a 60 bed hospital on adjoining land."

"We anticipate construction will start in May. We believe this is a real bonus for Wellington, as there are currently no substantial retirement villages in Wellington itself - they all tend to be up the coast or located in places like the Hutt."

Meanwhile, Beckenham Courts in Christchurch has created positive feedback for its innovative design. "It is unlike any other retirement village in the country," said Mr Ryder. "It is built more like a mall or a hotel, studio units surround an atrium with a glassed roof and a central garden with waterfalls. The view is internal, as opposed to external as you would usually find in villages of this sort."

Ryman currently owns and operates five retirement villages, five rest homes and two hospitals throughout the South Island.

Residents enjoy the uniquely designed atrium area at the Ryman Healthcare facility, Beckenham Courts, in Christchurch.

Development Capital Companies, and Industry, on Growth Curve

Direct investment funds such as Direct Capital Partners are part of a rapidly growing global industry.

The total dollar amount of funds under management for private equity investment has significantly increased in Australia and Asia in the last two years, and this is only following a trend previously experienced in the US.

Global accounting firm Arthur Andersen reported recently that investors pumped A$190 million into 69 unlisted Australian companies, and A$120 million into existing investee companies in the last year, bringing total funds under management to A$2.6 billion. Private equity funds have investments in approximately 310 companies in Australia.

"There is a lot of momentum building behind the industry at the moment and you will see a boom over the next few years," according to John Dyson, head of the Australian arm of Singapore development capital company Nomura Jafco.

According to Garry Weaven, whose Industry Fund Services advises fast-growing industry superannuation funds in Australia, development capital is an essential and growing part of an overall investment portfolio.

A Coopers & Lybrand report in the US says that the logic of private equity capital is well proven. The report showed that US companies backed with development capital grew revenues by 30 per cent a year between 1991 and 1995. In comparison, Fortune 500 companies grew revenues by 3.5 per cent on average.

A similar disparity showed up in employment growth in the same period - companies with private expansion capital lifted employment by 34 per cent a year, while Fortune 500 companies actually shed jobs at 4 per cent a year.

A Coopers & Lybrand survey of 104 Australian companies backed by A$718 million in development capital found that between 1992 and 1996 these companies grew by 42 per cent a year, increased profits by 59 per cent a year and raised employment by 20 per cent a year.

Harvard Business School has also confirmed that such companies grow faster, reach the public market sooner and continue to outperform non development capital backed companies.

Direct Capital's Ross George points out that one of the attractions is that companies backed by development capital have been outperforming the big listed corporates.

"The major Australian institutions have doubled their contributions to the private capital industry in recent years," he says. "And this asset allocation to private equity is forecast to increase further still. There are still a lot of deals here for a relatively small pool of capital to handle.

"The industry will grow. It is as essential a part of the capital markets here as in any country."

Offshore, private equity managers include such notable names as Credit Suisse First Boston, Rothschild, Morgan Stanley, Merrill Lynch, Fidelity, Hongkong Bank, Macquarie Bank and AMP. Big funders include AMP, National Mutual, Prudential, Rockefeller and Fidelity.

Ross George recently described the ideal investee company to the Society of Investment Analysts as one characterised by:

- Motivated and highly competent managers
- Being in a sector highly rated offshore
- Having no or few listed equivalents in New Zealand
- Being a large player in its industry
- Having all shareholders working towards the same end goal.

"You will see a boom over the next few years"

DIRECT CAPITAL

Direct Capital Management Limited
Level 7, Tower Two, Shortland Centre
55 – 65 Shortland Street
PO Box 4450, Auckland
Telephone: 09 307 2562
Facsimile: 09 307 2349
Email: dcm@ihug.co.nz