



Cameron Partners Insight Series

Surviving and Thriving in the New Order

Rob Cameron Partner | Toby King Director | December 2008

Outline

Five key messages

1. A tectonic shift is occurring in the environment
2. Certain sectors and tiers of the market look capable of 'weathering the storm', while others look extremely vulnerable
3. Possums in the headlights will become road kill
4. The good news is that there is still time
5. It is possible to thrive in this environment and leap frog competitors

1. A tectonic shift is occurring in the environment

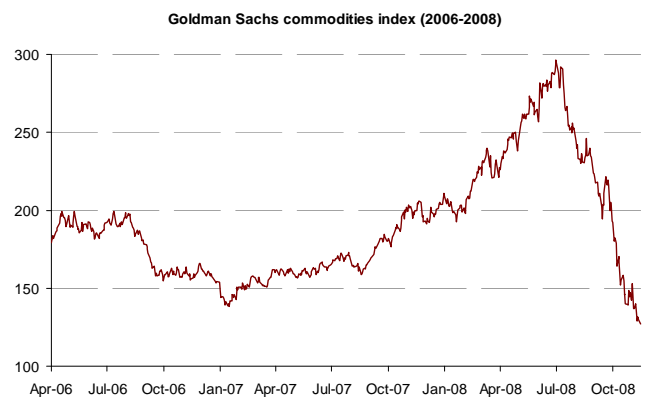
The global financial crisis is conforming to the anatomy of past crises ...

- The penultimate stage involves panic, the rush to liquidity and deleveraging.
- It feeds on itself until the government/lender of last resort intervenes, restores confidence and stabilises the market and/or asset prices fall to the point where investors return to the market.

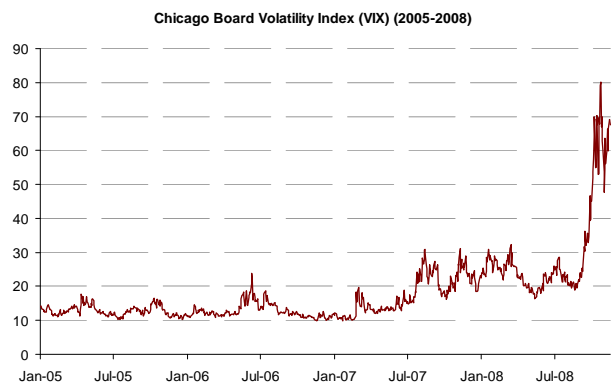
... but it involves unprecedented levels of leverage and 'contagion'

- The crisis has shifted rapidly from the US to other regions/markets.
- The speed and extent of change is dramatic

- Several commodity markets are down more than 50% from peak
- Baltic Dry Index is off more than 80%
- World sharemarket indices have fallen dramatically. Since 1 January 2008 the S&P500 has fallen 41%; ASX200 44%; NZX50 33%
- Volatility has risen dramatically



Source: Bloomberg

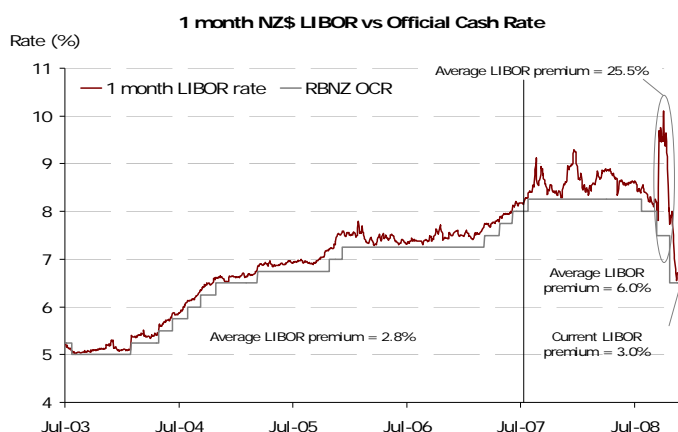


Source: Bloomberg

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... And it is profoundly constricting global credit availability and cost ...

- This will continue for the next several quarters:
 - Credit terms and conditions will continue to tighten
 - Inter-bank lending has iced up but it is thawing slowly
 - Credit rating agencies will tighten and more rigorously apply ratings criteria
 - Banks will continue to monitor and actively reduce exposure to companies and their shareholders
 - 'Acceptable' levels of leverage for any given level of cash flow/asset base will reduce significantly



- It has a way to go in terms of government intervention, financial system 'stabilisation' and the deleveraging process
 - Unprecedented government/central bank action in the financial system
 - Financial distress and credit defaults will gather momentum
 - As the recession bites the operating cash flows of most businesses will continue to contract and debt levels will need to fall further
 - Failures will follow

- It will impact on all asset prices and yields
 - Risk premiums are being radically revised
 - Assumptions about the capital appreciation component of total return are being revised
 - Required cash yields will rise
 - Asset prices will adjust to reflect 'fundamentals' – but nobody knows what they are yet

This will lead to a 'new order' for the global financial system

- Consolidation, deleveraging of the banking sector
- 'Reversal' of the role of banks from financial innovator to conservative lender
- Overhaul of the regulatory system (good, bad and ugly regulation will ensue)

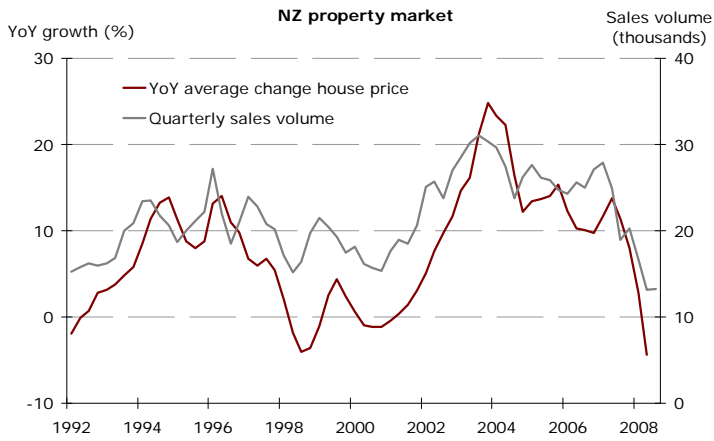
... and it will result in a significant and prolonged impact on the global economy

- Global recession (negative growth) is underway and the outlook is for no growth recovery until 2010
- Consumers are retrenching hard (US consumer credit fell by record \$7.9b in August)
- No-one yet knows how this crisis will play out

It is impacting on a New Zealand economy which had already been weakening and will result in a deep recession or worse ...

- Consumer demand is falling driven by:
 - Consumers with high debt levels deleveraging
 - Rising living expenses (food, energy)
 - Wealth effects of property and share market declines.

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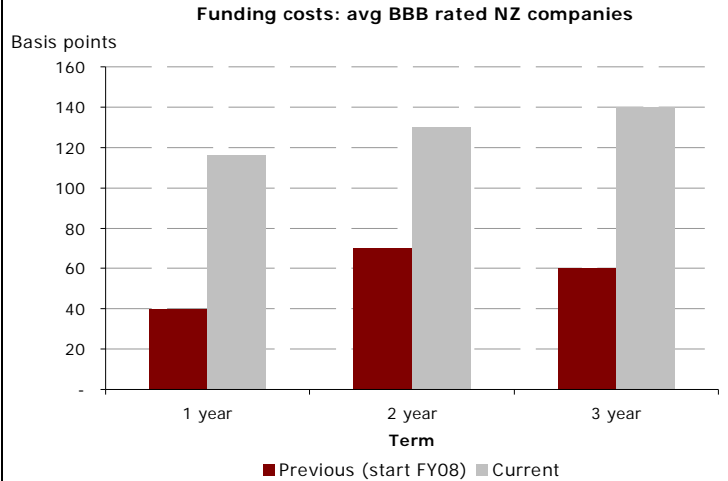
Source: REINZ



Source: Dept. of Statistics

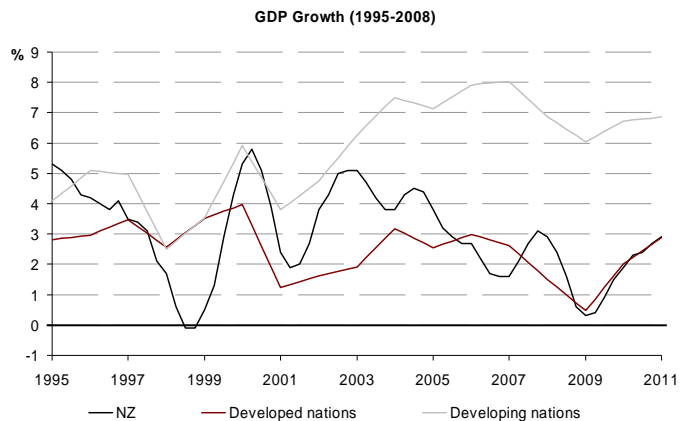


Source: Bloomberg, Cameron Partners' retail index



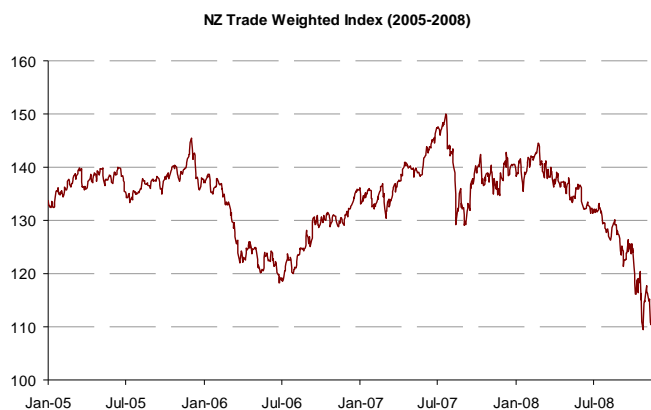
Source: ANZ National

- In New Zealand, impacts already are clearly being seen
 - Inflation concerns “yesterday’s news”
 - Rapid decline in OCR
 - Recessionary environment likely to remain for some time
- Falling NZ dollar will help exporters. But domestically focussed businesses face rapidly declining demand and higher input costs



Source: RBNZ, IMF

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Source: Bloomberg

- Outlook is similar globally
 - Growth recovering in 2010
 - Emerging markets projected to hold global growth
 - China growth also slowing but may hold commodity prices at reasonable levels

2. Many New Zealand businesses are not 'combat ready'

Large listed companies in good shape; question over medium size companies and SMEs

- Top tier listed companies have strong balance sheets. Top 10 by capitalisation (average):
 - Net debt / Total assets = 31.6%
 - Net debt / EBITDA = 2.5x
 - EBITDA / net interest = 8.7x
- Top tier continues to have access to capital; albeit on a limited basis
 - Strong support for Auckland Airport retail bond issue - \$80 million fully subscribed within 1 week

- Potential demand for other 'quality' bond issues

- The picture for smaller companies is more variable and less certain

- Wide range of financial conditions
 - Several companies with low or negative EBITDA
- Several private equity investments very highly leveraged and breaching covenants
- Anecdotal commentary from trading banks that "problem children" on the rise – balance sheets under severe pressure

- Capital markets are effectively closed to this tier

- Banks seeking to reduce lending and tighten credit
- Equity (public and private) market is closed or "vulture" like

3. Possums in the head lights will become road kill

Faced with this environment businesses will move into four categories in the next 12 months

1. "Road kill"

- Sub-scale
- Poor market position
- Over-leveraged
- Weak capabilities
- Failure to respond quickly to the new environment

2. The "walking dead"

- As above but able to survive by avoiding full-scale financial distress
- However, inability to take advantage of market opportunities. Outlook dominated by:
 - Sustained period of lower cash flows from operations

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- Inability to raise capital on reasonable terms and in a timely manner
- Increased focus on avoiding financial distress rather than building value. Spending more time with banks!

3. The “survivors”

- Foresee financial risks
- Respond early with capital management measures
- *A ‘hunker down’ and ‘weather the storm’ approach will survive the recession in good shape*
- *Without a proactive strategic approach risk losing leadership or moving ‘back in the pack’*

4. The “thrivers”

- Respond early with capital management measures
- Review and revise business and financial strategy
- Identify threats and opportunities
- Be proactive
- Grow and acquire
- Eg. Goldman Sachs / Warren Buffett
 - *Exploit outstanding opportunities to build or enhance leadership positions*
 - *Acquisitions at fire-sale prices or with limited competition (eg. Fletcher Building – Fielders Australia)*
 - *Invest in proactive marketing strategies*
 - *Launch new products clearly focused on the demand environment*

4. There is still time to prepare!

Though the economy is expected to take some time to recover, the full effect of the slowdown may take another 6 – 12 months

- According to a recent IMF study, it takes about 2 -2.5 years for the economy to fully recover from a banking crisis
- Equity markets typically trough about a year into the crisis, about 5 – 6 months before GDP troughs
- Earnings usually trough 5 – 6 months after GDP troughs (i.e. almost 12 months after equity market troughs)
 - Over 80% of global fund managers view consensus earnings estimates as “too high”, whilst 61% of managers expect a global economic recession in the next 12 months. Downward revisions to forecasts are likely
- On this basis, if equity markets reach their lows this year and begin to turn early next year GDP and earnings will not reach their lows until late 2009/early 2010

5. It is possible to thrive in this environment...

“Getting fit” now is absolutely critical. Strong leadership and analysis is called for



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Review strategy and position

- Product and service offering
- Assess market attractiveness and competitive position (in light of current environment!)
- Assess business model alternatives
- Consider whether current capabilities can execute plan
- **Consider choices – boards must test alternatives with management** (including M&A, outsourcing, channel partnerships, alliances)
- **Be clear about where value is being created and destroyed**

Capital structure alignment

- Consider whether the current capital structure supports the business model
- Seek capital now to increase flexibility
- Consider hybrid securities to provide additional flexibility
- **New capital will not endorse a “more of the same but push harder” strategy**

...and the opportunity to “leap frog” competitors is real

To take advantage of opportunities, establish in advance a clear strategy of how and when to act

- Economic downturns create more opportunities for companies to move from the middle of the pack into leadership positions that any other time in business. Bain & Company analysis of 2,500 companies suggests:
 - 24% more firms moved from the back of the pack to the front in the 2001 downturn compared with the subsequent period of economic calm

- 20% of “leadership companies” fell to the bottom quartile
- Winners in recessions tend to react quickly heading into a downturn, focusing on what the company does best, reinforcing the core business and spending to gain share: over-delivering on the things that customers really value
- Recession provides the opportunity to make bargain acquisitions to build up the core – even when it means taking risks
 - Bank of America’s acquisition of Merrill Lynch: “Strategic opportunity of a lifetime” – Ken Lewis, CEO
 - McKinsey & Co:
 - M&A in a downturn likely to increase value relative to M&A in boom times
 - In a recession, 60% of companies simply “freeze” – make no business portfolio moves
 - Of the potential growth strategies in a downturn – divest, acquire, invest to gain share – an aggressive acquisition strategy creates the most value for shareholders
- M&A drivers continue to be real:
 - Globalisation of trade
 - Rising prosperity in Asia and India.
 - The integration of world capital markets
 - The ICT ‘revolution’
 - At a regional level, the integration of the NZ and Australian economies and goods and services markets
- These forces continue to reward consolidation initiatives and scale with superior competitiveness and higher profitability

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Cameron Partners Limited

Auckland level 16, vero centre, 48 shortland street, po box 1277, tel +64 9 912 8580

Wellington level 12, hp tower, 171 featherston street, po box 10 307, tel +64 4 499 6650