IPO Commentary and Tegel

April 2016

Many NZSA members will have been mulling over whether they should invest in the upcoming Tegel IPO. Since this is being floated by a private equity firm, Affinity (which owns the major Tegel shareholder Claris Investments), the issue has attracted considerable media attention.

A number of members have asked NZSA to comment. While we are aware it is late in the process, we have put together some thoughts around a range of matters to consider. These apply to all IPO's, but to increase the relevance, we have used Tegel to illustrate some of these.

Tegel has been in business for over 50 years and has a track record of developing the chicken meat (and value added products) market in NZ and more recently offshore. This long history sets it apart from many new issues.

Concentrate on the quality of the offering

- Remember that during the market cycle, IPO's that occur earlier on will often be more attractive in terms of value. We have been in a "bull" market now since 2009. Remember also that as things heat up, the emotional worry of "missing out" can sometimes cloud your judgement.
- Consider why the seller is selling. Evaluate the reasons for the sale – if additional equity is needed to fund growth and the potential growth is credible, this is likely to be more promising than if the listing is to provide an exit strategy for pre IPO holders. This information is well set out in the Tegel PDS, and in this case is a mixture of all three reasons.
- What are the company's future prospects? Is this a business that can grow and build value over time. Certainly the per-head consumption of chicken has been increasing. It is also seen by consumers as a healthy and cost effective meat source. Tegel is well known and has a very strong and diversified market share in NZ. This ensures strong operating cashflow. However, further real local market share (above population growth) may be harder to achieve given this dominant position. More value added products may be a driver and are clearly targeted by the company.
- Remember that forecasts are just that. They are not a guaranteed outcome. How credible are the forecasts contained in the IPO? In Tegel's case, will export sales be as strong as the company predicts and will the margins be satisfactory? Tegel has only been exporting for about 10 years (much less in several

markets). Currently, offshore sales account for 16% of revenue. Australia is still growing, but the second largest market in the Pacific islands has declined recently. Other markets are very small contributors.

- Are the forecasts reasonable, especially when compared with actual performance over the past two or three years. If they are over optimistic and forecasts are not achieved, then it is likely that the share price will be sharply marked down at that time. Tegel's projections around revenue and EBITDA seem quite aggressive when compared to actual results in 2013-2015.
- Read the PDS thoroughly, not just the summary on the first few pages. For example, there is a useful table on Page 57 of the Tegel PDS which sets out key financials (actual and forecast) over a 5 year period. The business risks section that follows is well set out and includes ways the company mitigates these - much more readable and helpful than the old prospectus format.
- Is the price reasonable in relation to the company's prospects. Tegel's price will not be known until the book build is complete, and the indicative price range is very broad. The final price should be available about the time that you receive this commentary. Institutions determine the price and will have done analysis. This helps, but remember that supply and demand can push the issue price up beyond good value.
- Are you happy with the people who will be running the company? Tegel's key executives will remain and the board appears to have a range of skills and experience relevant to the operation.

Then there are factors particular to this float.

- There has been a lot of discussion about the fact this is float is coming out of private equity. certainly there have been a range of PE IPO's that have not gone well. Dick Smith and Feltex are two examples. However, there have been others that have been extremely successful. Scales corporation, Summerset and Freightways come to mind. It all comes down to the quality and value of the offering.
- In Tegel's case, The pre-float capital structure is made up of approximately 75% by redeemable preference shares and 25% by ordinary shares. Pre-float the company is carrying net debt of around $252m and has shareholders equity of around $315 m. Objectives of the proposed float include redeeming the preference shares and reducing net debt to around $120 m. Redeeming the preference shares requires around $264 m (they were the main source of pre-float equity).
- Management has committed to reinvesting the total proceeds from their preference shares into additional Tegel ordinary shares at the final issue price arrived at in the float (ie they are not reducing their exposure). Claris will reinvest sufficient of the proceeds from the preference share redemption to

ensure that they have 45% of the ordinary shares at the completion of the listing process. So the major private equity owner is retaining a large holding which they will wish to protect and grow.

- There is only one existing shareholder who is selling down their complete position,11.1% holder (through subsidiaries) Intermediate Capital Group.
- Another factor is whether selling shareholders intend to retain a holding over the longer term. This usually gives some guidance to how they view future prospects. In Tegel's case, Claris has a 13 to 14 month escrow period on its shares, depending on the timing of the release of results for the financial year ended 30 April 2017. If they want to sell earlier, they are limited to 50% of their holding and there is a requirement that the volume weighted average trading price of the shares, over a consecutive ten day period, must have been at least 20% higher than the issue price. If that is achieved, it is unlikely that shareholders will be complaining!
- It is possible that the overhang of 45% may drag on the share price until such time as the escrow period finishes and Claris decides whether to continue its holding or to exit, either in part or in total. This is impossible to quantify. In any event, it is in Claris's interests that the company perform, and the share price increases as detailed above.
- There has been comment about the high cost ($22.5m) of the float. However, this includes an $8m management bonus that is paid out of funds Affinity will get from the redemption of its preference shares. While the costs do seem relatively high, they are not material in the longer term.

NZSA cannot provide buy or sell advice - that is something that each investor must decide (with the help of their financial advisor if necessary). This commentary simply highlights a range of matters that long term investors should consider when making this decision. Speculators looking to stag the stock for a quick profit will have a different set of imperatives.

NZ Shareholders' Assn. Inc