FACTORING AND DISCOUNTING IN NEW ZEALAND

SIMON THOMPSON
General Manager Operations – S H Lock (NZ) Limited
t/a LOCK FINANCE

Introduction

One year can be a very long time in the New Zealand economy. This time last year we faced a climbing exchange rate, high interest rates and a strong economy based around record dairy prices. Today the environment is very different with many key indicators heading down, falling markets and a badly damaged local finance company sector after a collapse of confidence. The future looks even more challenging.

Industry Environment

In the last 12 months the New Zealand finance market landscape has changed, 28 financial institutions have either failed or frozen investor funds! The background is quite a long story but the market had developed to a point where a large number of privately owned finance companies offered retail investors the opportunity to invest in retail interest bearing debenture funds, which were then used to fund higher risk finance company lending. When some of this lending became impaired the retail investors fled the market creating a rush on funds which the finance companies could not meet. The property finance sector was the worst affected. Only a handful of finance companies remain, either very substantial firms or ones not relying on retail investors. Collectively the failed companies do not register a major portion of the total NZ debt market but nevertheless they added an important level of liquidity, especially in the second tier markets.

Our markets have changed significantly. Last year the NZ dollar peaked at 82c to the US dollar, more recently it has been near 62c and is expected to go below 60c Economically the country still relies heavily on the dairy sector which has had a record year in 2007 but suffered from an early season drought in 2008 and the signs show an easing for 2009, even with an improvement in the exchange rate. Unemployment remains low at 4% but all indicators point to a rise. In recent years the housing market has been very bullish (up 11.7%) and our Reserve

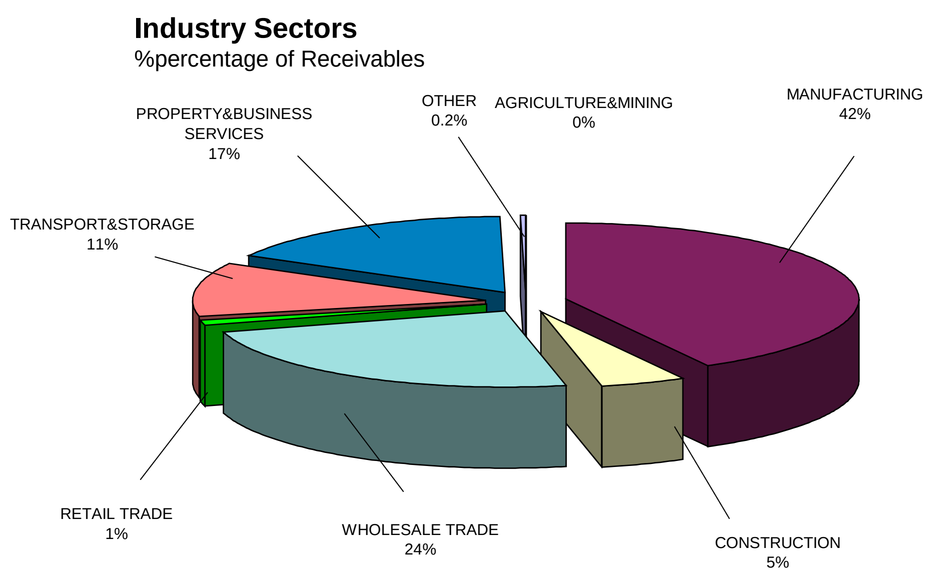
Bank kept interest rates high to restrict growth. Today the markets are in reverse, house prices are falling and some experts suggest this may continue from the current modest levels to a 30% fall over the next 2 years.

The Official Cash Rate (OCR) is now 7.5% having eased by 0.75% in 3 months and instead of rapid growth we are now in recession. Further large cuts to the OCR are expected. At the time of writing world markets are undergoing further turmoil from the US credit crisis and this is having an impact on NZ markets. The question remains whether our relative distance from the turbulence will allow us to escape the worst of the financial storm.

Market Performance and Supply

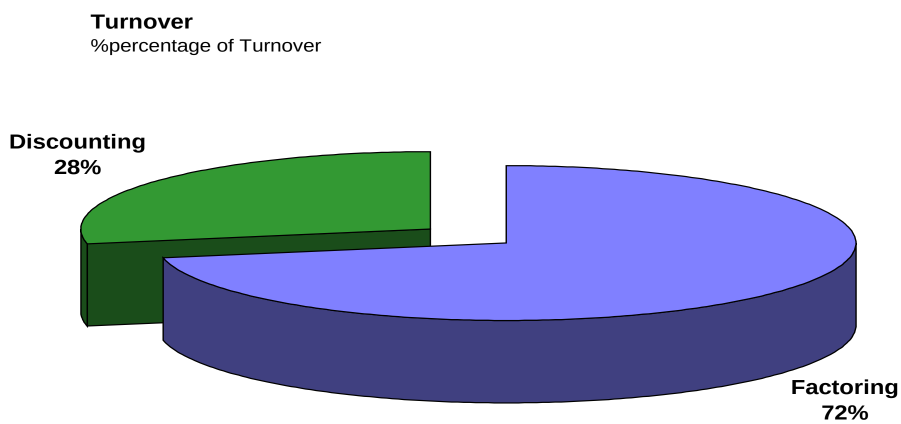
While the economic environment has changed dramatically the same cannot be said for the local factoring sector. Most of the local banks do not offer Factoring and finance companies have filled this gap. Despite the extensive shake-out of the finance sector it is pleasing to report that the local factoring companies appear to have survived and business continues as usual. However the international credit issues are expected to raise the cost of funds for all banks and finance institutions. The client market is domestic and comprises manufacturers, importers and service businesses, but is still under-developed by comparison to international markets.

Unfortunately the precise market statistics remain unavailable as some new entrants in the market have not joined the Institute of Factors and Discounters and some existing members have also declined to contribute. The graphs included below are based on the latest available statistics.



In the banking sector the Bank of New Zealand has an established Invoice Discounting product but, despite some predictions of more banks entering the market, there is no other serious bank competition for them yet. The banks were still very active in SME cash flow financing last year, utilizing traditional overdraft and asset backed facilities. This has continued in 2008 but more cautiously.

Dissection of Market



Future Trends

The signals for the future are mixed, with some SME businesses genuinely struggling as the economy contracts, while others continue to perform, especially in the revitalized export sector.

Economically after a rather hectic period of change, it was expected the New Zealand markets would enter a more stable period. However recent international financial crisis has meant this is unlikely and another roller-coaster year lies ahead. Most analysts expect the currency to remain near to current levels, which is closer to historical levels, and falling interest rates are also forecast. Like most central banks the NZ reserve Bank is expected to cut their official rates significantly. There is an election due with polls showing that change of government is expected, plus a series of budgeted tax cuts due to commence late in 2008. In ordinary times these impacts would stimulate the economy but after the setbacks of 2008 the changes are more likely to slow the decline or result in modest growth at best. International market volatility will continue to impact our economy but the core dairy sector may help smooth the bumps out.

It is difficult to foresee any significant changes in the local factoring markets but the overdue and expected entry of more major banks could finally eventuate. In higher risk markets this is considered a safer form of financing. Looking at broader finance markets the damaged lending sector will continue to reduce liquidity, funding costs will be higher and make borrowing more difficult for many SMEs. This tightened market could create more opportunity for those asset based lenders who can maintain liquidity and handle the expected higher cost of funds.

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Directory of New Zealand Factoring Companies

Simon Sheen Head of Debtor Finance	Bank of New Zealand BNZ Tower 125 Queen Street Auckland	Ph (09) 375 1300 Fax (09) 976 5008 *www.bnz.co.nz*
Edward McKee Wright Director	Capital + Merchant Business Finance Level 22, Number 1 Queen St. Auckland	Ph (09) 307 5223 Fax (09) 307 5218 www.capitalmerchant.co.nz
Terry Haydon Managing Director	Commercial Factors & Finance Ltd Stanway House 644 Great South Road Penrose Auckland	Ph (09) 579 4204 Fax (09) 525 3598 *www.factor.co.nz*
Gerard Van Tilborg Managing Director	Easy Factors International Ltd Level 14, The Tower Centre Corner Queen & Customs Street Auckland	Ph (09) 375 4244 Fax (09) 375 4245 *www.easyfactors.com*
Simon Thompson GM Operations	Lock Finance Level 5 The Tower Centre 45 Queen Street Auckland	Ph (09) 375 8500 Fax (09) 375 8529 *www.shlock.co.nz*
David Battersby Managing Director	MARAC Finance MARAC House Cnr Gillies Ave & Teed Street Newmarket Auckland	Ph (09) 520 0097 Fax (09) 520 3709 *www.marac.co.nz*
Michael Bushell Managing Director	Pacific Factors (NZ) Ltd Level 10 52 Swanson Street Auckland	Ph (09) 377 8490 Fax (09) 913 3363 *www.pacificfactors.co.nz*
Dave Cooper National Managing Director	Scottish Pacific Business Finance Ltd Level 12, Quay Tower 29 Custom Street Wes Auckland	Ph (09) 309 0771 Fax (09) 917 3219 *www.scotpac.co.nz*

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