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FEATURING

LOCK Finance

World Cup and National Pride

A Word from the GM

The advent of the FIFA World Cup has provided us with a fascinating display of national pride, football skills and theatrics.

It also reminds us that football is a truly global game; participants from different socio-economic and political backgrounds from all over the world come together with one goal: to win the 2014 FIFA World Cup. I am looking forward to my sweepstakes team, the Netherlands, holding the trophy aloft.

Back in good old NZ what have we got to look forward to in addition to our "Rock Star" economy ? We have increases in the OCR and the election. So interesting times for us all.

Although initially you may not see many parallels between the World Cup and Lock Finance, putting aside football skill (and theatrics!) we do have two core similarities:

- **National Pride:** Lock Finance have been around since 1889 and is 100% NZ owned and operated.
- **Our Global products:** The lending facilities that we provide are used in 73 countries that have approximately 3000 providers of Invoice Financing type products. Total reported Global turnover in these products for 2013 reached $2.2 trillion Euro.

So the invoice lending and purchase order financing products we offer are truly global facilities that we put a local flavour on. If a client of yours is needing some additional working capital funding then do remember us.

Good luck to those that support a team remaining in the World Cup and I hope that your office sweepstake is worth the early mornings.

Craig Brown
General Manager Lending

P.S. We have refreshed our website so please have a look.

Do you know the Value of Your Family Business?

It wasn't raining when Noah built the Ark (Anonymous)

Shareholder value is a phrase which is often mentioned in discussions involving business management issues. At one end of the spectrum, listed public companies consume tremendous resources focussing on recording, explaining and improving value to shareholders; such value is displayed for all to see each day in the company's share price. A public company director's fortunes can depend on how successful the company is, or is not, in its attempts to add to that value.

On the other hand, it's not uncommon for family-owned businesses to go about the day to day operations with little or no regard to the value of the business, let alone what could be done to improve that value. One reason for this is that there is no perceived need to know what the value is. This occurs particularly when the current owner's plan to pass ownership to the next generation of the family; that is, no external sale is being contemplated. Unfortunately, on many occasions such a transfer never eventuates, often due to family disputes, many of which actually occur over valuation issues.

Even where the family business owners are open-minded about the possibility of selling to a third party, they are typically under-prepared when such offers come along; the best price will only be obtained if prospective buyers can clearly see an established pattern of performance, and that appropriate management and systems have been in place for a reasonable period of time, before the due diligence begins. These issues need to be addressed for a significant period beforehand, ideally three years or more, in order to get the business sale-ready.

A number of the issues that family businesses commonly struggle with can have a negative impact on value, for example:

- Lack of succession planning for directors and CEO
- Lack of independent Board members
- Family members inappropriately employed in senior positions
- Systems and procedures not properly documented
- Lack of robust financial reporting
- Inadequate family/business governance, e.g. family council and family charter.

Another relevant aspect is that directors of a family business have a legal duty to act responsibly and protect the company's assets, which would include a duty to ensure that the value of a business is not allowed to dissipate due to the director's inaction. At the very least, directors are charged with the obligation to ensure that shareholder value is not damaged, and is preserved and enhanced as much as possible for the benefit of the current shareholders, and where those family shareholders regard themselves as custodians, the next generation of owners.

How is value arrived at?

While there are many different valuation methodologies available, for profitable businesses with a reasonable track record, the capitalisation of maintainable earnings is a commonly used methodology.

This is a three-step process involving:

1. Calculation of a dollar amount of future maintainable earnings (FME), which is normally an average of current and anticipated net profits, adjusted for abnormal and non-recurring items;
2. Identifying an appropriate capitalisation rate, i.e. a multiple;
3. These two factors are multiplied to obtain the dollar value of the business.

While calculation of FME is rarely straight forward and can involve some degree of subjectiveness for a valuer, selection of an appropriate multiple generally tends to be more problematic, and in the case of family business, some common deficiencies tend to crop up which can suppress the multiple and therefore, suppress value. The multiple arrived at will have an inverse relationship to the perceived risk of investing in the business; that is, the higher the risk, the lower the multiple, and vice versa. The aim of a family business owner should therefore be to identify as clearly as possible those factors which can be improved enough to reduce the risk to a potential investor. Factors which influence the multiple can be classified into four broad categories:

1. Products and Distribution
Does the business have time-tested products? Is the business reliant on one or two major customers or suppliers? Do contractual arrangements exist with key customers and suppliers? Is the business operating at full capacity or does a 'blue sky' element exist?

2. Management
Is there an effective Board of Directors? Does the Board and management team include non-family members where appropriate? Is there a succession plan for key management positions? Are job descriptions properly documented?

3. Market Position

How much of the market does the business control, and what is the scope to increase? Can a separate (saleable) value be attributed to existing brands? How susceptible is the business to factors beyond its control, such as exchange rate movements? Is there a threat of offshore competition? Are there merger or takeover opportunities?

4. Systems

Does the management information system produce relevant, accurate and timely reports? Are the financial statements audited? Are all relevant systems properly documented and regularly reviewed and updated? Is there a properly documented strategic plan? Is there a properly documented business recovery plan?

The two areas which family businesses tend to struggle with most are management and systems. Recent research found that over two-thirds of family-owned businesses do not have a formal board of directors; only 4% of family-owned businesses have a non-family director; and only 3% of family-owned businesses have a non-family CEO. In addition, less than 20% of family-owned businesses have a succession plan for the CEO, and only 11% have a succession plan for other senior management positions. In relation to planning, the survey reported that 66% of family-owned businesses do not have a business recovery (including disaster recover) plan. These are the areas which family business owners would be well advised to invest their initial efforts to improving, in order to have the most immediate positive impact on value.

Directors of family businesses should conduct a valuation exercise internally or engage the assistance of a business valuation specialist if required. This could identify which of the key factors have the most potential impact on the valuation multiple. This valuation should then be periodically revisited, if not by way of a full re-calculation, then by assessment of whether improvement of the relevant key factors has been achieved. The process of examining the key factors would necessarily focus attention on those weaknesses which the business should be addressing in any case, and the directors would be able to sleep more soundly at night, having gone further down the path to satisfying their legal and moral obligations to the company's shareholders.

Please contact either Steve Cammish or Jonathan Wilgermein should you wish to discuss.

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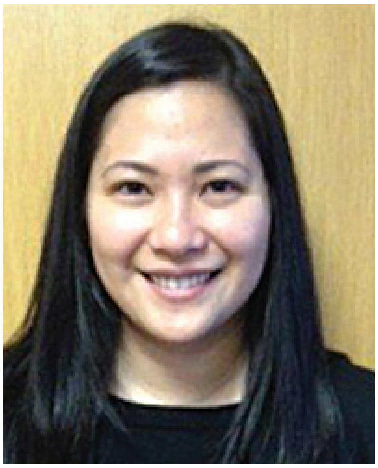
New Staff Member



Welcome to Monica Nuguid

We warmly welcome Monica to the Lock Finance team. With over 10 years experience in Financial Operations and Office Administration, Monica has extensive knowledge of both financial and customer service.

"My previous roles required the ability to communicate well with others, manage multiple tasks seamlessly and maintain the organisation of many complex systems and accounts. These roles have provided a strong foundation to my chosen career today. Having recently joined Lock Finance, my previous qualifications and efficiency are assets that I'm bringing to the team."

In her spare time, Monica enjoys reading books, photography and travel. Monica looks forward to meeting you and working with you in the future.

Financial Commentary

Rodney Dickens

All parts of the economy are important, but when it comes to driving economic upturns and downturns, interest rates and the exchange rate some parts play a much larger role and export prices play a surprisingly small part.

The following is from the June Monetary Policy Statement: "The exchange rate has not yet adjusted to weakening commodity prices, but is expected to do so." This misguided view played a part in shaping the governor's more hawkish stance.

Some decades ago flows of money driven by international trade and export prices dominated exchange rate transactions, but since deregulation in the 1980s they have been dominated by investment and speculative flows. The critical question is what role export prices play in shaping the speculative buying and selling of the NZD?

Traders love hot economies and dump currencies of weak economies so a good starting point is to look at the role export prices play in driving economic growth. This is partly because strong economic growth means higher interest rates, but it is a self-fulfilling prophesy. Early-bird traders who buy the currency of a hot economy get rewarded mainly when "the crowd" do the same and drive the exchange rate up.

Since 2000 there has been an inverse relationship between GDP growth and export price inflation with a correlation of -0.29. Falling export prices are more often associated with strong than weak economic growth and rising export prices are more often associated with weak than strong economic growth. Even if we allow for the old adage that it takes a year for changes in export prices to filter through to domestic spending the correlation is still negative (-0.24).

Net migration, Canterbury rebuilding, interest rates and the government initiatives to boost residential building will swamp the impact of export prices on economic growth, the exchange rate and interest rates as Governor Wheeler should be starting to learn.

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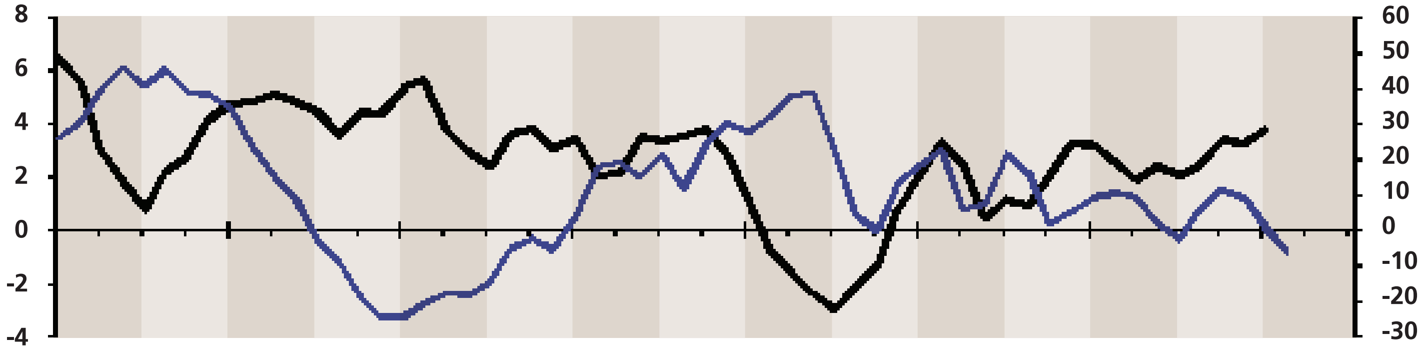

The chart shows the relationship between annual GDP growth and the annual per cent change in the ANZ Commodity Price Index. The ANZ Index is measured in NZ dollars, which is what is relevant to exporter incomes.

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