Foreign Ownership Survey
New Zealand 2016

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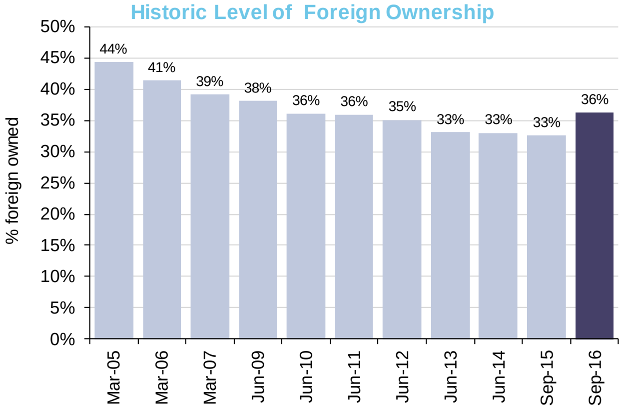
Offshore ownership hits a five year high

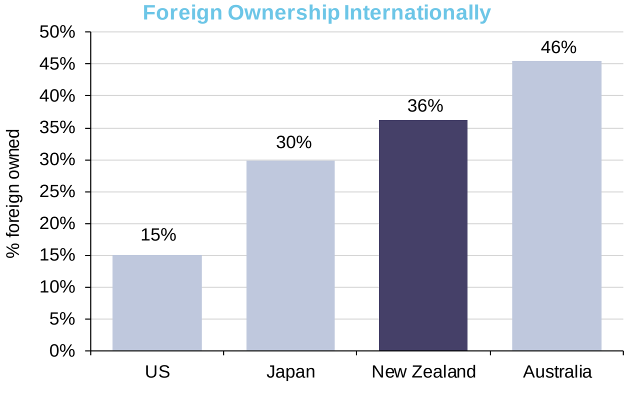
- **Foreign ownership of the New Zealand equity market increased to 36.3% from 32.6% in 2015. This is the highest level since 2011.**
- **NZ retail investment experienced the largest drop of the year, falling to 23% from 27%. Portfolio-style investment also fell. However, we observed an increase in strategic stake holdings.**
- **The Initial Public Offering (IPO) run-rate remains subdued, with just three IPOs in 2016. That said, some further new listings resulting from separations of existing assets shows corporate activity remains alive and well in New Zealand.**
- **New Zealand equity market capitalisation currently sits at 41% of GDP, the highest level since 2000. This is still low by international standards, but represents an increase from 2015 (37%).**
- **New Zealand's relatively high-yielding equity market has been a key beneficiary of the global 'hunt for yield' in recent years, which has driven the level of offshore ownership to its current level. Ironically, however, just as interest in our equity market has hit a multi-year high, it appears this underlying thematic is beginning to shift, with central bank stimulatory policies diminishing and more appealing yield alternatives for international investors emerging.**

Foreign ownership increases to 36.3%.

Foreign ownership of the NZ equity market increased to 36.3% during 2016, from 32.6% in 2015 (below, left). This year, our survey covered 70 companies, accounting for 96% of the S&P/NZX All index. In a relative sense, we note that the level of foreign ownership in NZ remains relatively high compared with many of our developed-market peers (below, right). This doesn't altogether surprise us given the NZ market consists of a number of high-quality, stable companies that, in many cases, pay attractive dividend yields.



Source: JBWere ISG, Company data, Computershare, Merlin IR



Source: JBWere ISG, Company data, Computershare, Merlin IR, Japan Exchange Group, Australian Bureau of Statistics

The most significant driver of the observed increase in foreign ownership was a reduction in the proportion of ownership by NZ retail investors in favour of offshore managed funds. We also observed a reduction in ownership by NZ managed funds and an increase in NZ strategic stakes (>10% ownership). This was a reversal from trends observed over recent years, which saw both NZ retail investors' and NZ managed funds' holdings increase. Ownership by portfolio-style investors (managed funds and NZ retail investors used as measure of non-strategic holders who are likely to trade more actively) in the NZ equity market decreased overall, however within this we saw a shift from NZ managed fund investment towards offshore managed funds. An increase in ownership by offshore managed funds is not surprising given the attractiveness of NZ's dividend yield-focused market in a world of record-low interest rates. We suspect that the NZ market has proven especially appealing to equity managers offshore with income-focused mandates.

Foreign ownership significant movers since 2015

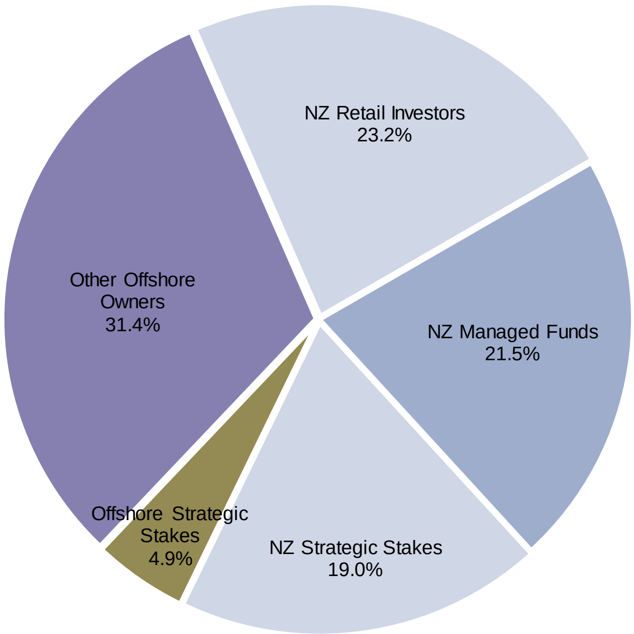
General trend of increased foreign ownership in many of New Zealand's largest companies

Of the 70 companies we surveyed, there were 17 companies that saw foreign ownership decreases of greater than 1%, 28 that saw increases over 1%, and 14 that were recorded as essentially unchanged (i.e. within a +/-1% range). There were 11 companies included in this year's survey that were not included in the 2015 survey.

Offshore exits of strategic stakes accounted for some of the reductions in foreign ownership, for example in the case of New Zealand Refining and Metro Performance Glass. However, from an overall perspective, we saw a general trend of increased foreign ownership in many of New Zealand's largest companies, which drove the headline increase.

Market Structure: NZ retail and portfolio-style down, strategic stakes up

Ownership structure of the New Zealand Market



Source: JBWere ISG, RBNZ, ACC, IRESS, Company data, Computershare, Merlin IR

Ownership structure of NZX primary listed stocks since 2005

	Mar-05	Mar-06	Mar-07	Jun-09	Jun-10	Jun-11	Jun-12	Jun-13	Jun-14	Sep-15	Sep-16
NZ Managed Funds	15.6%	16.7%	15.8%	19.1%	20.5%	22.3%	23.5%	23.2%	22.1%	22.4%	21.5%
NZ Strategic Stakes	17.1%	16.0%	16.6%	21.1%	21.3%	18.4%	18.0%	17.9%	18.5%	18.1%	19.0%
Offshore Strategic Stakes	15.9%	12.0%	13.2%	15.2%	13.1%	13.2%	13.0%	8.6%	7.3%	4.9%	4.9%
Other Offshore Owners	28.4%	29.4%	25.9%	22.9%	23.0%	22.7%	22.1%	24.4%	25.8%	27.7%	31.4%
NZ Retail Investors	23.0%	26.0%	28.4%	21.7%	22.1%	23.4%	23.3%	25.9%	26.4%	26.9%	23.2%
Total Foreign Ownership	**44.3%**	**41.4%**	**39.1%**	**38.1%**	**36.1%**	**35.9%**	**35.1%**	**33.1%**	**33.0%**	**32.6%**	**36.3%**

Source: JBWere ISG, RBNZ, ACC, IRESS, DataStream, Company data, Computershare, Merlin IR

Hunt for yield shines through

Hunt for yield has been the key thematic driving our market, but this appears to be changing.

It is a well-established narrative that low interest rates around the globe have forced investors into higher-yielding equities. New Zealand's stock market is rather unique amongst its peers in that it offers attractive dividend yields while, at the same time, being comprised of a number of strong, stable companies. As such, our market has been a key beneficiary of this thematic. We can clearly see this in the level of 'Other Offshore Owners' in the table on the previous page, which has steadily increased for each of the last five years – from 22.1% in 2012 to 31.4% in 2016, and reflects the increasing participation of offshore fund managers in the New Zealand market. This trend has been the primary driving force behind our market reaching historical highs.

Strategic stakes slightly higher

Overall, strategic stakes in the NZ equity market have increased.

Overall, strategic stakes (i.e. >10% ownership in a company) in the NZ equity market have remained relatively flat, increasing just under 1% to 23.9% (versus 23.0% in 2015). However, within this, we see some interesting dynamics at play:

- While offshore strategic stakes have remained flat (at 4.9%) over the last year, we have seen a material downwards trend over the past eight years – from over 15% in 2009. Offshore sell-downs of large holdings in NZ Refining (Caltex) and Contact Energy (Origin Energy) are examples of this. In our view, the increasing importance of our equity market relative to the size of our economy (see overleaf, bottom right) and significantly improved liquidity (overleaf, top left) has facilitated this trend.
- We observed a notable decrease in strategic stakes held by NZ fund managers, from 3.3% to 0.6% (see table below). Reductions in strategic holdings in companies such as Z Energy have helped drive this movement.

NZ retail ownership falls

NZ retail participation falls to 23.2%.

New Zealand retail participation fell from 26.9% in 2015 to 23.2% in 2016 (see table on the previous page). This drop off signals a reversal of a four year upward trend, which was partially driven by flow-on benefits from the NZ Government's mixed ownership model (i.e. the public listing of SOEs). Furthermore, a lack of retail bond issues in New Zealand over the past few years, we suspect, also contributed to the increase in NZ retail participation up until last year. As we signaled in our 2015 survey, this trend has reversed in 2016 following a significant number of retail bond issues in 2016. We have seen the gap left by NZ retail investors replaced by offshore investors, whereby low (and in some cases negative) bond yields around the world have highlighted the appeal of NZ's relatively generous dividend yields. We wouldn't be surprised to see NZ retail ownership fall further in 2017 if bond yields continue to rise as we expect.

Portfolio-style investor ownership decreases

Portfolio-style investors' ownership falls slightly, but market turnover improves.

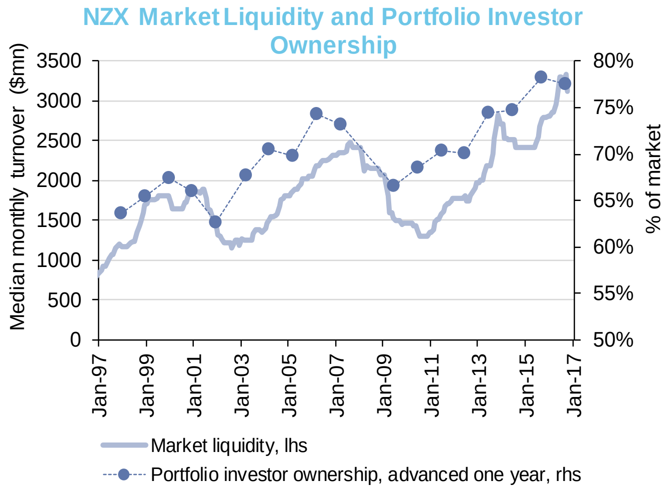
Portfolio-style investors' (managed funds and NZ retail investors, a measure of non-strategic holders who are likely to trade more actively) ownership has fallen slightly to 77.5%, from 78.3% in 2015 (see table below), but remains well above post-GFC lows. Despite this decrease, we have observed median monthly market turnover continue to improve, and is now sitting at around NZ$3.1bn over the year (see chart overleaf, top left). This increase most likely reflects offshore flows, which has been a significant driver of the NZ equity market in 2016.

Portfolio-style investor breakdown of NZX primary listed stocks

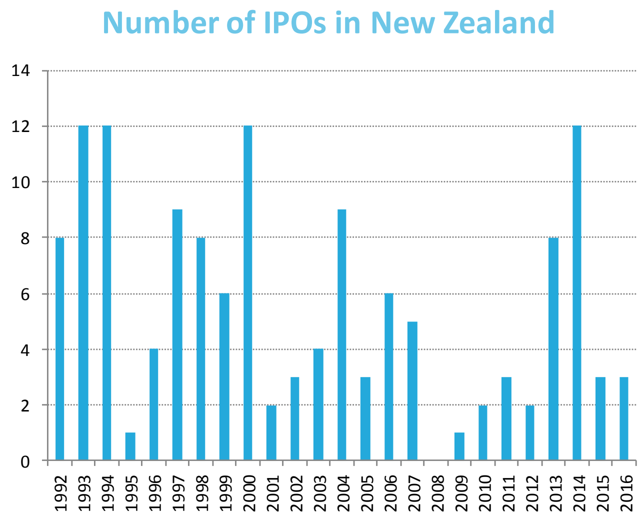
	Mar-05	Mar-06	Mar-07	Jun-09	Jun-10	Jun-11	Jun-12	Jun-13	Jun-14	Sep-15	Sep-16
Strategic Stakes: Offshore Managed Funds	3.0%	2.2%	3.1%	2.9%	3.0%	2.0%	1.2%	0.9%	0.5%	1.2%	1.4%
Other Offshore Owners[1]	28.4%	29.4%	25.9%	22.9%	23.0%	22.7%	22.1%	24.4%	25.8%	27.7%	31.4%
Strategic Stakes: NZ Managed Funds	1.4%	2.1%	2.6%	1.3%	0.7%	0.8%	1.1%	0.7%	1.2%	3.3%	0.6%
Other NZ Managed Funds	14.3%	14.6%	13.3%	17.7%	19.7%	21.5%	22.4%	22.5%	20.9%	19.1%	20.9%
Total Managed Funds	47.0%	48.2%	44.8%	44.9%	46.5%	47.0%	46.8%	48.5%	48.3%	51.4%	54.3%
Managed Funds + NZ Retail	**70.0%**	**74.2%**	**73.2%**	**66.6%**	**68.6%**	**70.4%**	**70.1%**	**74.4%**	**74.7%**	**78.3%**	**77.5%**

[1] Mainly managed funds, but a small portion are retail investors.

Source: JBWere ISG, RBNZ, ACC, IRESS, DataStream, Company data, Computershare, Merlin IR



Source: JBWere ISG, DataStream



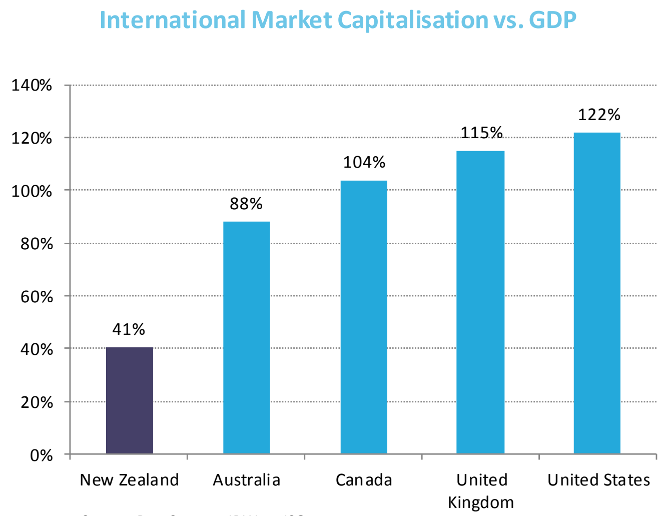
Source: JBWere ISG

IPOs still subdued, but increasing prominence of NZ's capital market

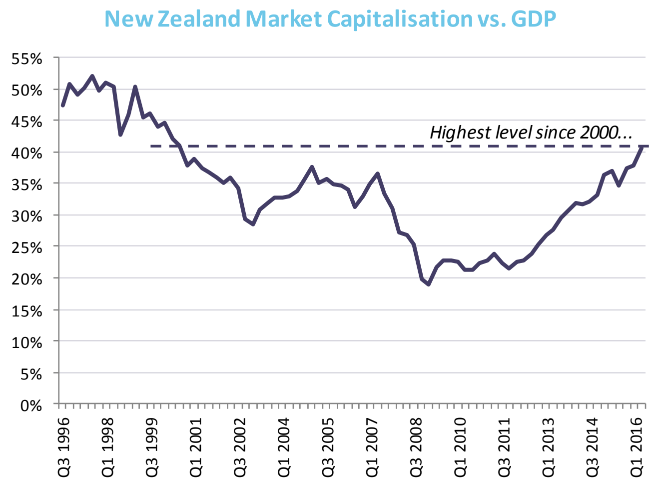
Only three equity IPOs in 2016; market capitalisation as a share of the economy back to levels not seen since 2000.

Following a strong couple of years of Initial Public Offering (IPO) activity in 2013 and 2014 (driven by positive momentum off the back of SOE listings under the government's mixed ownership model), activity in 2016 continued 2015's relatively slow pace (see chart above, right). So far in 2016, we have seen only three traditional IPOs to the NZX's Main Board, namely The New Zealand King Salmon Co Ltd., Tegel Foods Limited, and Investore Property Limited, which split out of Stride Property Limited, raising equity in the process. That said, we have seen other corporate activity (e.g. separations of existing assets), which has resulted in further listings. Examples include NZME, which separated out of APN, and Tilt Renewables Limited, out of Trustpower. The number of traditional IPOs in 2016 is in line with 2015, but below both the average annual number of IPOs over the last ten years, and the historical average dating back to 1992. That said, the additional new listings demonstrate that corporate activity remains alive and well in New Zealand.

Despite increased government partial privatisation in recent years, as well as further IPOs since, the New Zealand equity market still (as at 30 June 2016) remains behind developed-market peers as a proportion of the economy (measured by GDP, below left). That said, our market has seen an increase to 41% from 37% last year, and has seen relatively steady increases since 2008 (below, right). Importantly, NZ's market capitalisation to GDP is back to levels not seen since 2000. Furthermore, in 2016, the gap between New Zealand's and Australia's Market Cap to GDP has fallen back to close to post-GFC lows. This demonstrates the increasing prominence of our equity market, and is positive for its ongoing health.



Source: DataStream, JBWere ISG



Source: DataStream, JBWere ISG

Outlook

Headwinds ahead for the NZ market as global bond yields rise.

As we observed in our recent US election article, the past few months have highlighted a characteristic of the NZ equity market that cannot be ignored: our high sensitivity to global bond yields. As at the time of writing, New Zealand equities trade at a ~23% premium to global equities, with low interest rates a key driver. Any change here could see our premium eroded.

During October, for example, a ~23bps rise in US 10-year Treasury yields saw our equity market weaken ~5.5%, and during November an additional ~56bps rise in US 10-year Treasury yields saw our market weaken a further ~1%. Accordingly, further increases in bond yields will likely be a headwind for the NZ equity market. At the same time, an obvious by-product of higher bond yields is a more attractive fixed income market.

Given this, we would not be surprised to see further reductions in NZ retail investors' ownership of our market (i.e. as a result of an asset allocation decision). We also expect that the level of foreign ownership of our market could very well fall in 2017 (i.e. as a result of a country allocation decision) as the global 'hunt for yield' thematic continues to drift out of fashion.

Survey Methodology

Construction of average	The survey is done as a weighted average, i.e. treating the New Zealand market as a pool of generic equity supply apportioned amongst a group of investors. This means that even if no significant trading was done, changes in overall ownership levels could still be influenced by the changing prices of individual stocks.
Survey coverage	Weights for the headline offshore ownership estimate are based on the S&P/NZX All index. This index covers all companies that have NZ as their home exchange, ie it excludes Telstra, AMP and other offshore-based stocks. This year, 70 companies were included in the survey, comprising 95.7% of the S&P/NZX All index.
Layers of ownership	We calculate "first round" levels of ownership only. For example, IFT has partial offshore ownership as a stand alone company. IFT in turn owns 19.7% of MET (at the time of the survey). However, we treat this 19.7% as a domestic stake, rather than calculating through the "beneficial" offshore ownership in MET via IFT's holding in it.
Data timeliness	The data used to compile the overall averages comes from various sources with variable lags. In this respect it is appropriate to view the data as a September Quarter "weighted average", rather than as a precise point estimate.
Revisions	Revisions are made to historical estimates from time to time. Unless these are judged to have a material impact on the survey, we will not explicitly highlight historical revisions. These can be made available on request.

Source: JBWere ISG, DataStream, IRESS

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