NZX heads for shareholder showdown

Elevation Capital managing director Chris Swasbrook

Five famous film stars are running energetically on screens displaying looped movie clips on the whitewashed wall behind fund manager Chris Swasbrook's desk.

He leans forward in his chair.

"Essentially what we're saying is they're not moving fast enough," he says.

He's talking about stock exchange operator NZX, a company 2.3% owned by his Elevation Capital funds.

In a blistering analysis published on Tuesday, supported by 100 pages of detail, Mr Swasbrook laid out his dissatisfaction with NZX's performance and put forward a three-point plan for its turnaround.

The underperformance is clear. Over one year, three years and five years the NZX total return has lagged the NZX50 index, the global peer average and the ASX by a considerable margin.

ASX by a considerable margin.

He estimates the returns foregone by shareholders between 2012 and 2017 total $235 million.

Dividends have been flat at near 6c a share since 2012 and Mr Swasbrook highlights a change to its dividend policy since the departure of chief executive Mark Weldon that year.

The policy approved in 2010 committed NZX to increase its dividend by not less than 1c a share each year and its abandonment allowed poor capital management and financial discipline, he says, and the company's decision to send 11 directors and executives to New York for the signing of a memorandum of understanding with Nasdaq last month is an example of its loss of perspective.

"This strikes me as a junket on shareholders' backs," he says. "It's symptomatic of a culture that needs to change."

The trip seems to be a sore point with NZX. Asked whether it was paid for by NZX a spokesperson at first ignored the question, then said, "NZX will not be commenting further," before finally providing a statement saying: "Deepening the relationship with Nasdaq is a significant opportunity for NZX, and we have invested in that relationship."

Another market source, who asked not to be named, was unconcerned about the cost of the trip but said the NZX's defensiveness showed up its poor communication.

"That's the problem when you aren't on the front foot," he said.

Another symptom is the Wealth Technologies business, focused on an asset administration software platform formerly known as Apteryx, acquired for $1.5m in 2015.

Elevation estimates NZX has spent a further $6.8m on the system but has yet to bring on a significant new client. The project has drained management resources that should be deployed elsewhere, it says.

Lost patience

From his underground bunker in Newmarket Mr Swasbrook says he's been talking to NZX about raising its game for long enough.

"I've sat around for two years saying this stuff to them ... I've been helpful to a point but now I've had enough."

The Elevation plan has three elements.

One, set clear financial targets. Two, spin-off non-core businesses such as fund management. Three, shrink the organisation to cut costs and improve productivity.

"If they [the NZX board and management] don't want to expedite this plan, we'll be putting it to shareholders to change the board so we can execute this

plan," says Mr Swasbrook.

"We want a response in a suitably short period of time. We're talking days, not weeks."

Under the NZX constitution a special shareholder meeting can be called by shareholders representing 5% of the stock. Mr Swasbrook is confident he can get the numbers.

"I believe we have enough support to call an EGM," he says.

So far the NZX response has been diplomatic but non-committal, saying it welcomes investor feedback and Elevation raises several good points.

"We are pleased to see that in many places these views align closely with NZX's own and our delivery against strategy to date. Elevation Capital has been a long-term shareholder of NZX, and we will continue to engage with Chris on the points raised.

"The team at NZX is working hard to build a collaborative New Zealand capital market and is focused on providing more value for all its shareholders. As noted in Chris' report, NZX is addressing many of the points raised by Elevation Capital, divesting our non-core assets, improving our customer service and business efficiency, increasing liquidity in the secondary market, and progressing plans to simplify the New Zealand market's structure and rule set.

"We appreciate Chris' point that it is important to deliver progress as quickly as possible, and our team look forward to updating investors, and the broader market, on our progress with the release of our full-year results in February 2019."

Support

Judging by Mr Swasbrook's comments February 2019 may be far too late.

Several other shareholders contacted by *NBR* strongly supported Elevation Capital's position.

Manawatu farmer David Odlin, the owner of a 2.2% stake, said he would definitely support the call for a special meeting.

"I don't know whether I would attend the meeting but I can give my votes to him [Mr Swasbrook]," he said.

"I have always been a fan of a merger [with the ASX] but this is not possible until the 10% cap is uplifted."

Another shareholder, who asked not to be named, also said he would support a call for a special meeting.

"My view is Chris hasn't gone far enough," he said.

"An organisation is only as good as its people. An organisation underperforming by definition must have below-average people. They should

be looking at the quality of the people."

Asked whether he would support a special meeting, Sam Stubbs of passive fund manager Simplicity said he would. "We need to see a lot more than words."

"The biggest problem with the stock exchange is I don't see them having to meet any metrics and no hard targets. Dividends are flat and employee compensation is going up as a percentage of revenue. It has all the hallmarks of an organisation out of touch.

"This is not just another company it's a vital part of the national infrastructure."

Mr Swasbrook is careful to emphasise he is not suggesting any kind of a merger or sale of NZX.

"That's not on the agenda," he says. "We believe in the future of NZX and the imperative of a vibrant capital market. What we are wanting is actually change."

Elevation Capital proposals for NZX

1. Set clear targets

50% ebitda margin by 2020; $0.4m revenue per employee by 2020; 1-2% organic revenue growth; 0-1% organic expense growth; double-digit total shareholder return.

2. Divest core businesses

Spin off funds services businesses Smartshares, Superlife and Wealth Technologies through in specie distribution to shareholders. Estimated value $76.6m-$83.5m, Spinoff would allow NZX to focus on core business and become New Zealand's marketplace for capital, expanding horizontally into unlisted trading and crowdfunding to create integrated ecosystem.

3. *Shrink the structure*

Reduce NZX board from seven to five. Consolidate executive team from 16 to eight. Use joint ventures, such as its previous TZ1 project with Markit, to develop businesses more cost-effectively. A prime candidate would be to share the development of dairy derivatives with a major global commodities business such as the Chicago Mercantile Exchange.