THE TREASURY
Kaitohutohu Kaupapa Rawa

NEW ZEALAND

Supply Chain Scenario
Contract Bond Guarantee

HD Ltd is a small engineering company that specialises in hydraulics. One of their key customers is Export Cut which manufactures forest harvesting machines for export. HD helped design Export Cut's harvest system, and supplies the hydraulic system which is used to operate the forest harvesting machine.

Export Cut has secured a contract to sell a $2 million harvest system consisting of a winch, carriage and anchoring system, to one of Canada's largest forestry owners. HD will supply the hydraulics – a contract which will be worth $400,000.This contract will take 6 months to build and deliver, and the first challenge HD and Export Cut face is how to fund the delivery of this contract. Both Export Cut and HD negotiate advance and milestone payments to pay for the costs of delivering this contract.

Export Cut negotiates the following payment terms with the Canadian Buyer:
- 30% deposit upon contract signing;
- 40% payment upon shipment;
- 20% payment upon arrival at destination port (2-month shipping time);
- 10% retention which is held back for 1 year to guarantee performance.

In response the Canadian buyer requires a financial guarantee (called an advance payment bond) which equates to 50% of the first two milestones. This bank-issued guarantee protects the Canadian buyer from losses in the event the harvest system is not properly delivered. Export Cut is able to meet this advance payment bond, however it asks HD Ltd to provide it with a similar bank guarantee for 50% of the value of its subcontract.

The challenge for HD is that its bank is unable to issue the $200,000 bond because HD is almost fully drawn on its lending facility. If it cannot issue the bond, then it will not be able to receive the advance payments from Export Cut and therefore unable to finance this sub-contract. HD's bank refers them to the New Zealand Export Credit (NZEC) to see if they qualify for its **General Contract Bond Guarantee.**

NZEC's **General Contract Bond Guarantee** is provided to a Bank or Bond Provider to help a company provide a bond without tying up additional credit facilities. NZEC takes on the risk that the New Zealand firm will be able to successfully perform their contract. While NZEC typically only supports exporters, it has the ability to support NZ firms that are supplying goods or services integral to an exporting firm's delivery of exports.

Given that HD is the integral supplier of the hydraulics to Export Cut, which are critical components of the forest harvesting machines to be exported to Canada, NZEC is able to extend its support to HD. NZEC assess HD's financial and technical ability to deliver the contract, and then issues its Crown-backed guarantee to HD's bank as the security required for the bank to issue the Bond.