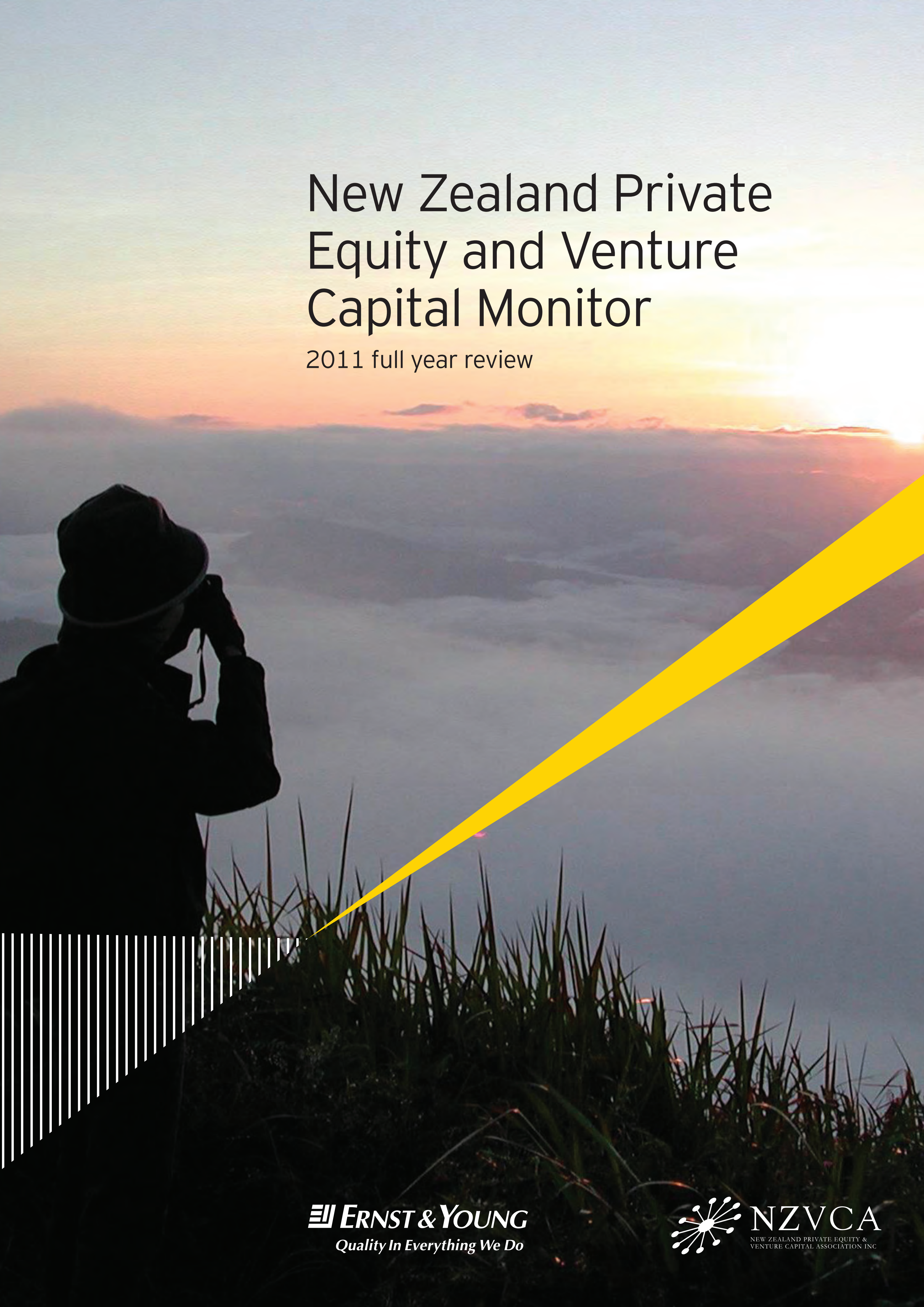
New Zealand Private Equity and Venture Capital Monitor

2011 full year review



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NZVCA
New Zealand Private Equity & Venture Capital Association Inc

Foreword

We are delighted to bring you the ninth full year edition of the New Zealand Private Equity and Venture Capital Monitor. This issue consolidates the findings from previous surveys and provides a more detailed review of the 2011 year including commentary on the industry from the New Zealand Private Equity and Venture Capital Association's (NZVCA) Chair.

NZVCA continues to work closely with government officials on behalf of the industry across a range of policy initiatives. The Financial Markets Conduct Bill is an example of our work leading to a world class legal and tax environment.

During 2011 NZVCA published recommendations for the Venture Capital industry and our dialogue with Ministers has been well received. In 2012 NZVCA will review our Regulatory and Tax Recommendations.

We are grateful for the continuing support of Ernst & Young as the NZVCA Research Partner and, in particular, their significant commitment of resources to the New Zealand Private Equity and Venture Capital Monitor. NZVCA members are committed to develop a world class private capital environment for the benefit of investors and entrepreneurs in New Zealand. The New Zealand Private Equity and Venture Capital Monitor is an important measure of the industry and the activity of its members.

Colin McKinnon
Executive Director, NZVCA

Contents

Executive summary

Total activity of $1.4b was similar to 2007 with the highest recorded level of investment and divestment activity in mid-market, whilst venture and early stage investment levels declined.

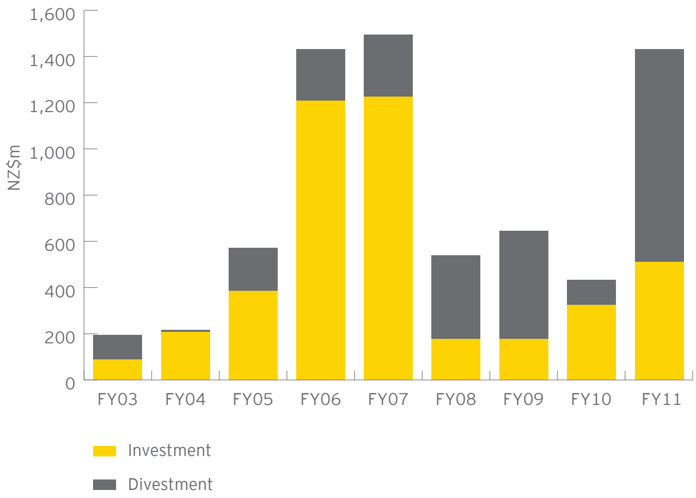
Investments

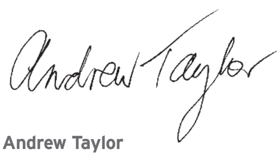
- Total investment value in 2011 was $554.0m spread across 84 deals, an increase of 88% on the prior year.
- This increase in activity was driven by growth in buy-out private equity activity which grew from $70.0m in 2010 to $294.5m in 2011 and mid-market private equity activity which grew from $130.0m in 2010 to $223.0m in 2011.
- Venture and early stage investment activity fell from $94.4m in 2010 to $36.6m in 2011.
- Buy-out investments included the secondary private equity deal for Tegel Foods.
- A total of 84 investments occurred in 2011, two up on the 82 in 2010, with average deal value increasing from $3.6m to $6.6m, reflecting the continued upswing in mid-market from 2010 and two buy-out transactions. Average deal value excluding the two large buyout deals was $3.2m.

Divestments

- Total divestment value increased to $907.9m in 2011, up significantly from 2010 due to four large divestments with a combined equity value for these deals of $891.8m.
- Mid-market divestment activity was strong, with value increasing by $8.1m on the prior year. Respondents to the survey indicated that there were no venture capital divestments.
- A total of ten divestments across all categories were recorded in 2011, up on the five in 2010, including a mixture of trade sales, secondary private equity buy-outs and an Initial Public Offering (IPO).

Overall activity summary 2003 to 2011





Andrew Taylor
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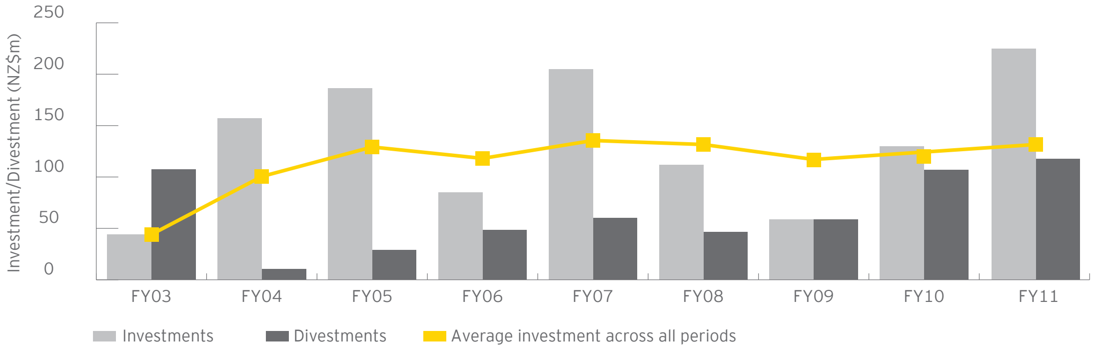
Mid-market private equity

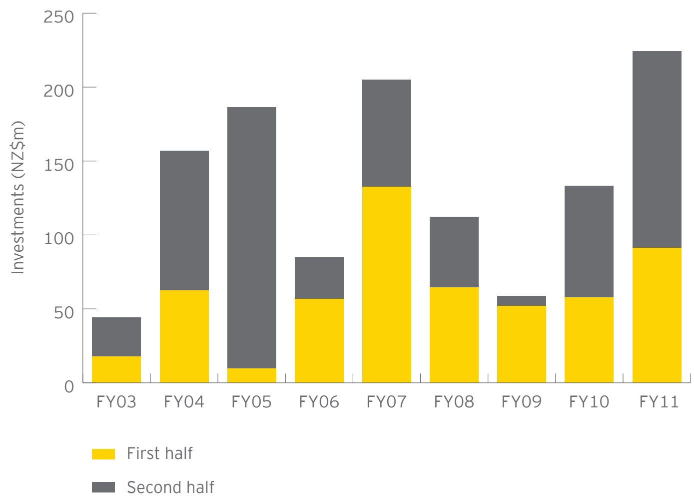
Mid-market private equity investment/divestment summary 2003 to 2011



Mid-market investment

- The level of mid-market investment from deals with disclosed values continued the year on year increase going from $130.0m in 2010 to $223.0m in 2011.
- 2011 investment value was the highest on record, driven by significant activity by New Zealand domiciled funds.
- While the number of deals decreased from 14 to 12, the average deal value increased to $18.6m from $9.3m in 2010.

Mid-market investments – half year split



“Secondaries have been a notable global trend throughout 2011, where GP’s expect to add value at different stages in a business’ life cycle.”

Kerry McIntosh, Chair, NZVCA

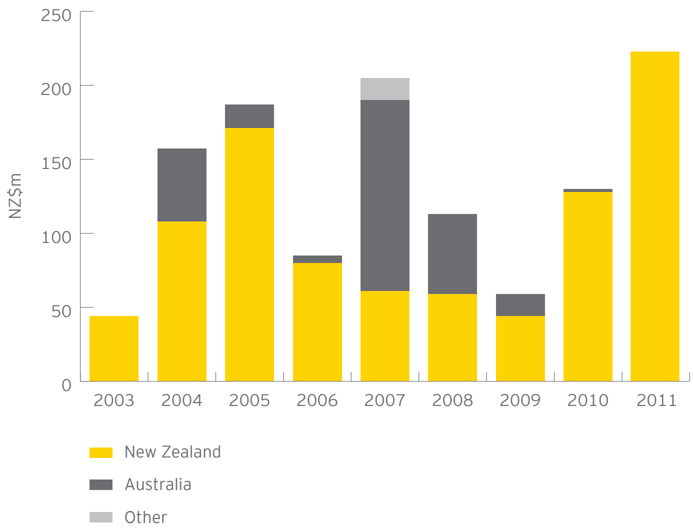
Mid-market domicile

- 2011 mid-market investment activity has continued to be underpinned by strong New Zealand domiciled fund activity, which grew from $127.8m in 2010 to $223.0m in 2011.
- New Zealand domiciled investment activity was at the highest level since data was first collected in 2003.
- While we are aware of deal activity by Australian-domiciled funds in New Zealand no deal values were available.

Mid-market divestment

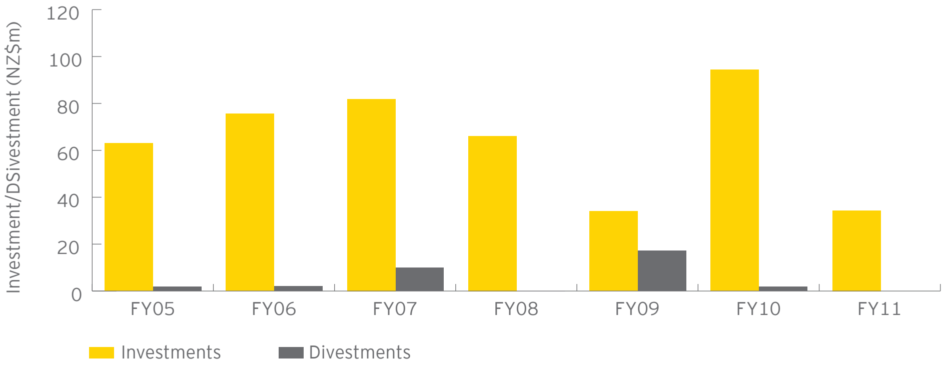
- Mid-market divestment value in 2011 reached its highest level since 2003, with a value of $116.3m across seven deals.
- The average deal value of $16.6m lowered from the 2010 reported average deal value of $26.7m.

Mid-market investments – domicile



Venture and early stage capital

Venture capital investment/divestment summary 2005 to 2011



Overview

Since 2009 our survey results for venture capital activity have been supplemented by deal information from NZVIF's *Young Company Finance* publication. This has led to broader data capture, and the inclusion of early stage investment activity within the venture capital segment. Early stage investment includes activity of fund managers, angel networks and individuals. We have included only activity of fund managers (who employ a General Partner / Limited Partner structure) in our dataset.

Fund managers or General Partners manage capital provided by investors. Fund managers have investment programmes to attract investor's capital prior to deploying the capital. Their activity is distinct from angel networks that help individuals to invest their own capital usually on a deal by deal basis.

The size of early stage funds varies from large venture capital funds (greater than $50m funds under management) to small micro venture capital ($2m-10m funds under management). The stage of investment describes the path from early stage to expansion.

Venture and early stage investment

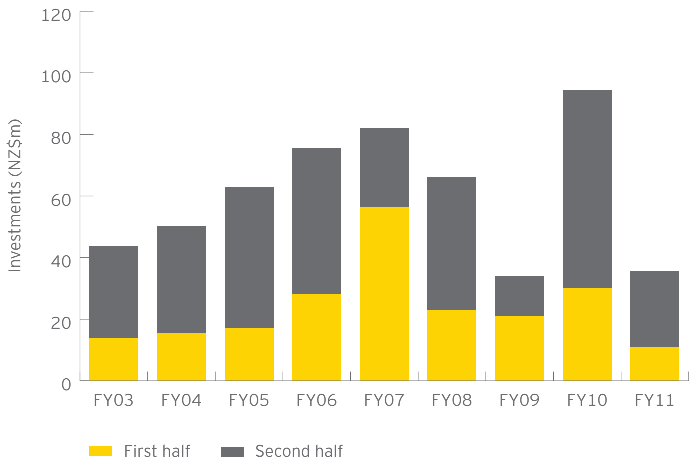
- Total investment activity of New Zealand domiciled funds decreased from 2010 levels to $36.6m. Average deal size was also down at $0.5m on a similar number of deals 70 (2011) and 67 (2010).
- Information Technology (IT) and software sector attracted the highest level of investment activity (2010 highest being health and biosciences) with a significant portion of that being in business targeting the US IT solutions market.
- The number of investment deals reported for amounts of $2.0m or greater was one in 2011 compared with six in 2010. This together with the low average deal size for transactions by New Zealand domiciled funds illustrates the funding gap for early stage growth companies.

Stage of investment

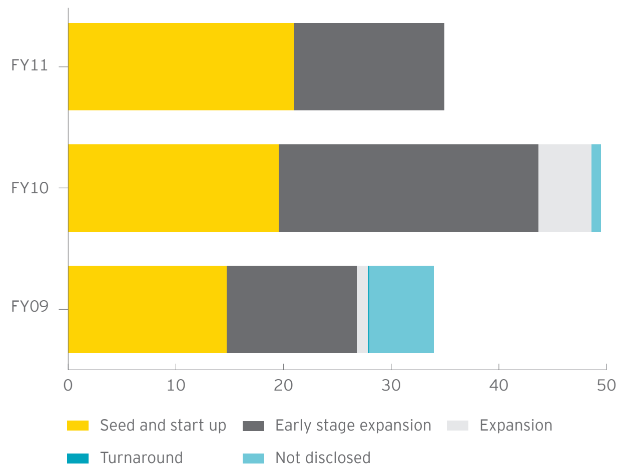
Seed and start up investment continues to grow with 2011 investment at $20.9m up on 2010 investment of $19.5m.

Investment in Expansion and Early stage expansion stages fell from $29.0m in 2010 to $15.7m reflecting a challenging environment for expansion capital in 2011.

Venture and early stage investment summary



Stage of investment – New Zealand domiciled funds



New Zealand venture and early stage sector activity in 2011 has been dominated by IT/software sector investments.

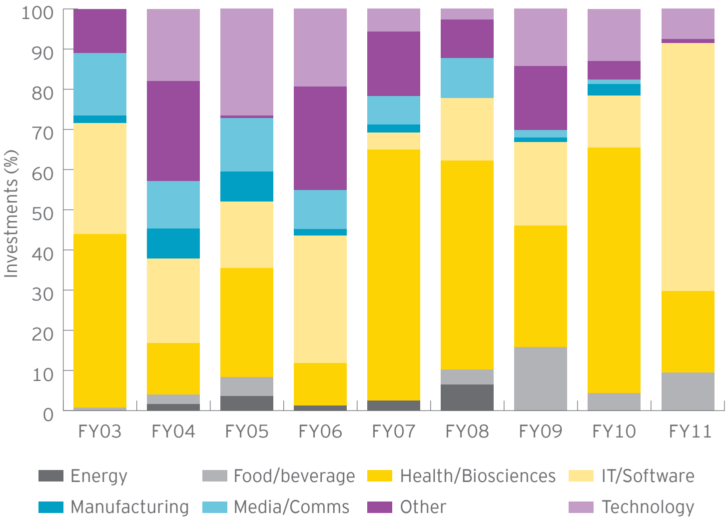
Venture and early stage sector review

- The sector mix in 2011 moved to a greater focus on IT/software businesses while health and biosciences and technology continue to be key sectors attracting venture capital investment.

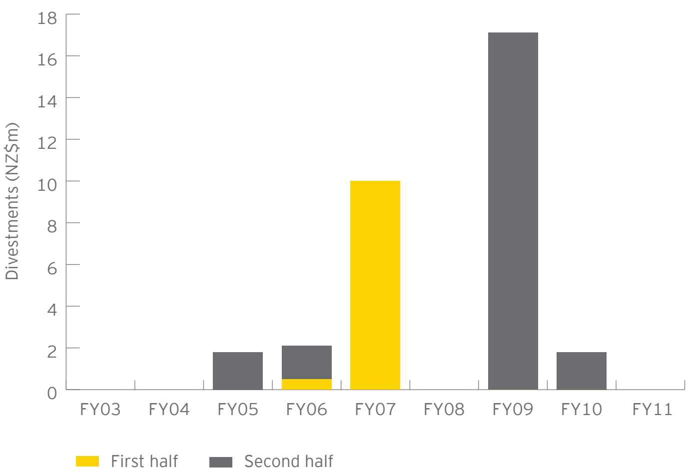
Venture and early stage capital – divestment

- No disclosed deal value divestments were noted following one divestment with disclosed deal value recorded in both 2009 and 2010 years.
- The level of divestment activity reflects the continuing evolution of the industry, but also highlights a key challenge: the need to demonstrate returns for investors.

Venture and early stage capital – sector review

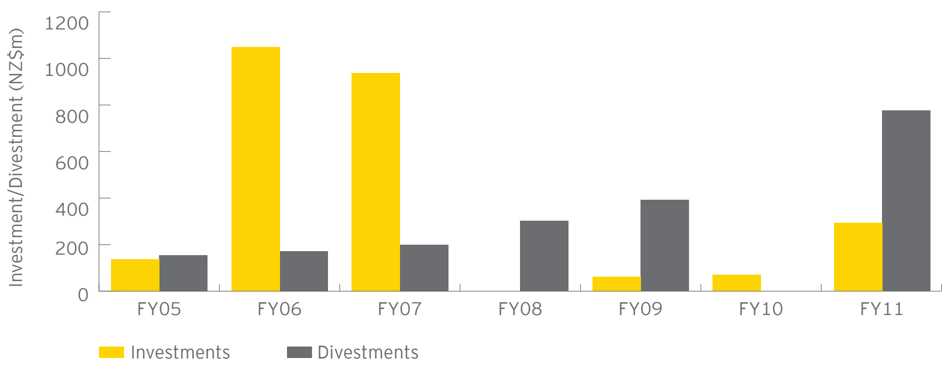


Venture and early stage divestment summary



Buy-out private equity

Buy-out private equity investment/divestment summary 2005 to 2010



Overview

- Buy-out deals are defined as those transactions with an enterprise value over $150m, and observed deal value trends from 2003 to date are a result of a small number of high value transactions in this segment.
- Few buy-out deals have occurred in New Zealand outside of the peak years of 2006 and 2007.
- 2011 buy-out activity was dominated in size by the divestment of Independent Liquor and Tegel Foods, through a trade sale and secondary private equity buy-out respectively.
- We note that the investment in Yellow Pages Group is captured in FY07. However the changes in FY10 and FY11 are not included on account of the absence of disclosable data.

Buy-out investment

- There was a strong showing of top-end investment activity in 2011, albeit still at lower levels than seen in 2006 and 2007.
- The top-end investment value of $294.5m represented two secondary PE deals.

Buy-out divestment

- A significant uplift in buy-out divestments was recorded in 2011 with transactions including exits via IPO and off-shore secondary markets.

Case studies

Direct Capital invests in PF Olsen Group

Direct Capital, through its Direct Capital IV and Pohutukawa II funds holds a 30% shareholding in PF Olsen Group Limited, one of Australasia's largest providers of professional forestry services.

The remaining 70% of the Company's shareholding is held by management, led by Chief Executive, Peter Clark, and employees.

Direct Capital's Bill Kermode said "PF Olsen is well-established in Australia and has significant growth opportunities with increasing harvestable wood volumes and investment in carbon forestry. With the benefit of its long history in the New Zealand forestry sector, PF Olsen is well-placed to service its growing client base in Australia".

Employee ownership is strongly supported by Direct Capital and it is consistent with one of its core beliefs – that where shareholders, management and employees are aligned through their ownership interest, companies outperform their peers.

PF Olsen manages over 170,000 hectares of plantation forests in New Zealand and, harvesting planning for more than 3.6 million tonnes of logs annually. As a part of its service offering, the Company provides forestry management, harvesting planning and engineering, seed and containerised seedling sales from company-owned and leased orchards and nurseries, and advisory services. PF Olsen contracts out the physical harvesting and tending operations to third parties. The Company's forestry clients include timber investment management organizations ('TIMOs'), local forestry investors, government agencies, and corporate forest owners.

Based in Rotorua the Company employs 113 staff operating out of 15 offices across New Zealand and Australia. The Company's trans-Tasman operations and growth opportunities are a key feature that attracted Direct Capital to the investment.

The investment in PF Olsen is the fifth investment from the Direct Capital IV fund which raised $325 million in 2009 for investment into private companies.

Maui opens opportunities for Freshmax

Maui Capital bought the 60% holding in Freshmax in late December from Australian investor Wolseley Private Equity, whose pre-established term of investment in the company was coming to an end. Freshmax's management – which owns the remaining 40% of the company – approached Maui Capital to help with its aim of expanding the business.

The company is now the third or fourth largest in the business on both sides of the Tasman Sea.

Since Wolseley bought into the company in 2006, Freshmax's business has roughly tripled with the acquisition of Australian fresh produce companies John Holman & Co, Panda Ranch, OzTaste, Grewal and De Luca Banana Marketing, and a joint venture with grower-marketer the Crasborn Group in New Zealand. The company's gross annual sales are more than A$365m (US$375m).

Freshmax's future projects are substantial, according to the Maui Capital Managing Director Paul Chrystall. "Our current Indigo fund is a NZ$250m fund, with capital left to invest in follow-ons for existing investments. We are currently raising a new fund, so capital resources will be adequate to drive future growth."

Tony Mahoney Freshmax Group CEO said "the biggest advantage of Maui's involvement is the financial ability to take advantage of future opportunities as they arise, feeding into the long-term scale of Freshmax's plans."

New partners

NZVCA and Cambridge Associates partner to deliver performance data

NZVCA and Cambridge Associates have embarked on a strategic partnership to provide comprehensive, independent New Zealand private equity and venture capital data to industry participants.

Under the agreement, NZVCA will give its members access to aggregate New Zealand private equity and venture capital benchmark data and statistics. Cambridge Associates, a global provider of independent research and investment advice, has been advising institutional and private clients on alternative assets since the 1970s.

Kerry McIntosh, NZVCA Chair, said, "The NZVCA acknowledges that credible fund-level industry performance data is important to institutional investors. We urge all GPs to participate in this initiative through the provision of quarterly performance data to Cambridge Associates."

Cambridge Associates and NZVCA will aim to issue quarterly performance data which will include New Zealand private equity and venture capital industry returns compared to other market indices, as well as vintage year returns and aggregate portfolio company returns by industry.

Commentary from the Chair

Kerry McIntosh,
Chair, NZVCA

2011 was an active year for private equity in New Zealand with levels of activity similar to pre GFC levels. The two primary drivers were firstly the continued realisation of investments made by buy-out funds in the record 2006 and 2007 years and secondly increased levels of mid market investment from the increasing numbers of New Zealand domiciled General Partners (GP's or Managers) with funds to invest. Of continuing concern are the low levels of venture investment which declined from $94.4m in 2010 to only $36.6m in 2011.

Mid Market

In the 2010 commentary we noted that New Zealand mid market private equity had matured as an asset class with a good cross section of managers who had funds to invest. The confidence in these managers was proved up in 2011 with the highest level of investment ever recorded at $223.0m. This can be attributed to the desire to invest commitments secured in 2009 and 2010 fund raisings combined with improving deal flow as vendors expectations adjusted to the new post GFC realities and economic conditions, whilst not improving, at least stabilised.

In addition to the active New Zealand funds we have seen the return of off-shore funds to this market.

Divestments totalling $52.7m, sourced mainly from the Australian controlled funds, were consistent with prior years.

Buy-out

The buy-out market was largely a story of divestments with the continuing realisation of investments made during the peak 2006 and 2007 years.

There were three divestments totalling a record $791.6m which represents a significant return of funds to investors. The divestments included two significant realisations by Pacific Equity Partners of Tegel Foods to Affinity Partners and Flavoured Beverages Group Holdings (Independent Liquor) to Asahi Breweries.

Pacific Equity Partners won the inaugural "Investment of the Year" award from the NZVCA for returning investors 3.9 times the money from its investment in Tegel. To deliver these returns they transformed Tegel from a solely domestic business to a leading Trans Tasman player. EBITDA increased 324% from FY2006 to FY2011 with 17% increase in employees. Exports now contribute around 10% of revenue.

Blackstone Group, one of the largest global alternative asset managers and a listed Fortune 500 company made its first foray into the New Zealand market, buying Antares Restaurant Group, the operator of 75 local Burger King restaurants. Antares, operators of the Burger King franchise in New Zealand was previously owned by Australasian private equity fund, Anchorage Capital Partners.

One of the notable global trends throughout 2011 has been the realisation of investments to other private equity firms (secondaries). It has been no different in New Zealand with the Tegel, Antares and Freshmax transactions all secondaries.

> **"The confidence in New Zealand mid market managers was proved up in 2011 with the highest level of investment ever recorded at $223m."**
>
> Kerry McIntosh, Chair, NZVCA

While there has historically been debate amongst investors as to the desirability of secondaries, this has faded as investors have recognised that with such a broad range of skills and investment strategies across GP's there is an ability to add value at different stages in a business life cycle. Affinity Partners acquires businesses capable of growing into the broader Asia region and will be focused on growing Tegel beyond Australasia while Antares will benefit from Blackstone's global Quick Service Restaurant expertise.

Venture capital

The venture GP activity was mainly supporting follow-on investment. This was reflected in a low level of investment value at $36.3m which was similar to 2009 levels but well down on 2010 levels of $94.4m.

Once again early stage activity was driven by numerous small transactions with only one investment exceeding $2m. This reflects the structural weakness in the market with few sources of investment between $2m to $20m where companies are looking for funds to assist them to bridge the gap between a proven idea or product and commercial revenues.

The NZVCA believes that a healthy and vibrant venture market is a key ingredient in harnessing innovation as a source of economic growth. The focus of the NZVCA during my Chairmanship has been venture managers' inability to raise new capital in what has been an extremely difficult fundraising environment in both New Zealand and internationally. In order to assist these GP's the NZVCA has released a report entitled *Ensuring Venture Capital Plays Its Part in Growing the NZ Economy*.

The purpose of this report was to alert the Government to the currently unsustainable state of the New Zealand venture market and to recommend changes to Government policy to ensure this market's survival and growth. This report, available on the NZVCA website, recommends: greater flexibility in the VIF programme; a more favourable environment for investors; and continued support for the venture capital market infrastructure.

Since the release of this report the outlook for venture capital has improved with the announcement of NZVIF support for two new funds.

Sparkbox Ventures formed a co-investment partnership with NZVIF to invest around $10m in start-up companies over the next five years. ValarVentures and NZVIF announced a $40m fund for capital to early-stage New Zealand technology companies for the development of technology and expansion into overseas markets.

While this is a positive step it is unlikely to fully address the structural weakness in the market identified above.

The NZVCA will continue to work with government and industry leaders to implement policy and operational change in the areas identified in the report such as the Wealthy Migrant programme, KiwiSaver and the Venture Investment Fund. We are encouraged by good working relationships with a range of government agencies including the Ministry of Economic Development, New Zealand Trade and Enterprise and New Zealand Venture Investment Fund.

Measuring performance

Measuring industry activity and performance is a principal role of NZVCA. In order to facilitate this objective NZVCA has formed a partnership with Cambridge Associates to assist it to establish an index of New Zealand fund performance. Cambridge performs this role in many other global markets. Access to robust fund level performance data is an important consideration for many investors and the creation of this index will, in time, meet this requirement. We encourage all New Zealand fund managers to participate in this process and submit the necessary data to Cambridge.

Outlook

Industry outlook

The outlook for the New Zealand private equity and venture capital market is optimistic. Mid-market funds anticipate slowly improving economic conditions and an increasing appetite for shareholders of private held businesses to consider private equity options as part of a succession strategy.

The prospect of new listings on the NZX and some major assets coming to the market in 2012 will engender a vibrancy that will flow into the broader market including private capital transactions.

New capital raised by venture and early stage funds is improving access to capital options for entrepreneurs and providing family offices and individual investors with more choice. There is an increasing interest in New Zealand early stage assets from international investors and the government Venture Investment Fund (VIF) programme is providing a flexible catalyst to market development.

We note respondents' plans in relation to investee companies included a focus towards acquisition activity and increases in capital expenditure.

Survey respondents were asked for their view on industry outlook over a six month and 18 month horizon. Responses indicate a bubbling optimism, tempered with a business as usual neutrality.

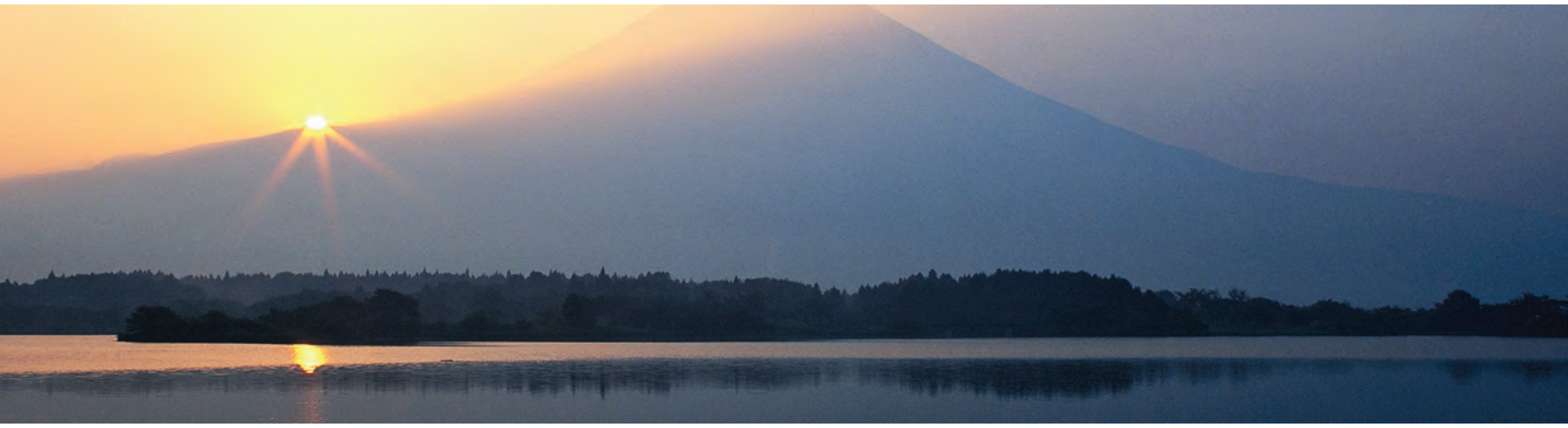
Challenges and opportunities

Respondents noted the following key factors which they consider will impact venture capital and private equity activity in New Zealand in the short term:

- Limited track record of venture capital and private equity liquidity events restricting the availability of capital
- The continuing constraints on availability of bank funding
- Cyclical low point in entry valuations providing continued opportunities for good value investments or taking advantage of demographic changes

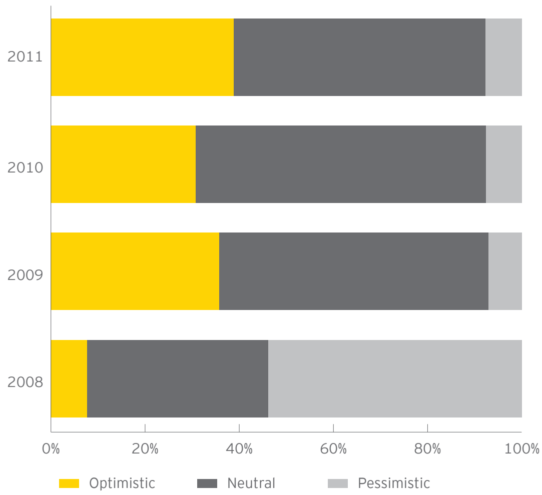
Respondents were also asked to comment on key factors expected to affect their investee companies over the next two to three years. Issues identified continued to be similar to those from 2010, being:

- General local and global economic conditions
- Ability to deliver productivity and margin growth
- The accessibility of IPO markets
- Currency and Interest rate levels
- The ongoing Christchurch rebuild



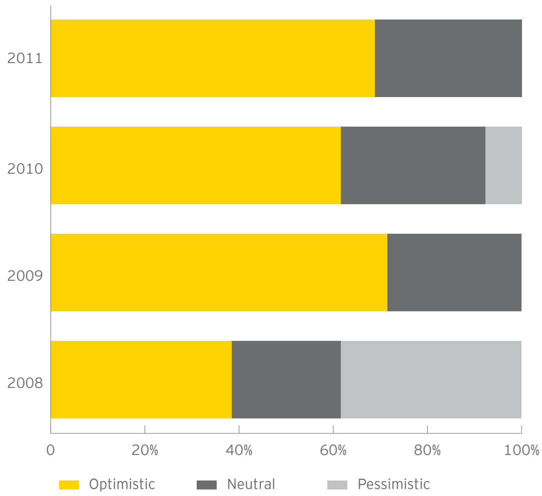
Next six months

Respondents' short term outlook is similar to 2009 and 2010, with 92% either optimistic or neutral in outlook.



Next 18 months

Outlook for the next 18 months has improved slightly compared to the prior year, with optimism creeping back to 2009 levels.



Activity summary

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Investment (NZ$m)									
Venture Capital	43.6	50.2	63.0	75.6	81.9	66.1	34.0	94.4	36.6
Mid-market PE	44.1	157.0	186.5	84.8	205.0	112.0	58.7	130.0	223.0
Buy-out PE	0.0	0.0	136.9	1,048.5	937.7	0.0	62.7	70.0	294.5
Total	**87.7**	**207.2**	**386.4**	**1,208.9**	**1,224.6**	**178.1**	**155.4**	**294.4**	**554.0**
Investment (no. of deals)									
Venture Capital	42	44	50	77	60	52	63	67	70
Mid-market PE	7	18	25	18	23	30	12	14	12
Buy-out PE	0	0	4	17	2	0	3	1	2
Total	**49**	**62**	**79**	**112**	**85**	**82**	**78**	**82**	**84**
Divestment (NZ$m)									
Venture Capital	0.0	0.0	1.8	2.1	10.0	0.0	17.1	1.8	0.0
Mid-market PE	107.4	10.7	29.2	48.5	60.2	46.5	58.9	106.9	116.3
Buy-out PE	0.0	0.0	154.6	172.0	200.0	301.5	391.5	0.0	791.6
Total	**107.4**	**10.7**	**185.6**	**222.6**	**270.2**	**348.0**	**467.5**	**108.7**	**907.9**
Divestment (no. of deals)									
Venture Capital	0	0	1	4	3	1	1	1	0
Mid-market PE	7	2	4	6	4	10	5	4	7
Buy-out PE	0	0	1	1	1	0	2	0	3
Total	**7**	**2**	**6**	**11**	**8**	**11**	**8**	**5**	**10**
Total activity – investments and divestments (NZ$m)									
Venture Capital	43.6	50.2	64.8	77.6	91.9	66.1	51.1	96.2	36.6
Mid-market PE	151.5	167.7	215.7	113.0	265.2	158.5	117.6	236.9	339.2
Buyout PE	0.0	0.0	291.5	1,220.5	1,137.7	301.5	454.2	70.0	1,086.1
Total	**195.1**	**217.9**	**572.0**	**1,411.2**	**1,494.8**	**526.1**	**622.9**	**403.1**	**1,461.9**

About the survey

The survey

The New Zealand Private Equity & Venture Capital survey is based on 21 responses received from venture capital and private equity participants in the New Zealand market, including firms from both New Zealand and Australia. The values reported represent the equity component of transactions only. We have also included in our analysis any publicly announced information, acknowledging Capital IQ as a source of data, in addition to venture capital activity as reported in NZVIF's *Young Company Finance* publication. We do note that there are a small number of industry participants that elect not to participate.

Data integrity/privacy policy

All data received through The New Zealand Private Equity and Venture Capital survey process is the property of the NZVCA and Ernst & Young. Other than for use in the monitor document, all data is subject to the principles of Ernst & Young's Privacy Policy and will not be sold or released to any other parties.

If you are aware of a colleague that did not receive a copy of the New Zealand Venture Capital and Private Equity Monitor or if you would like to participate in future surveys, please contact either Andrew Taylor or Gareth Galloway at Ernst & Young or Colin McKinnon at the NZVCA.

About Ernst & Young Transaction Advisory Services (TAS)

How organisations manage their capital agenda today will define their competitive position tomorrow. We work with our clients to help them make better and more informed decisions about how they strategically manage capital and transactions in a changing world. Whether you're preserving, optimising, raising or investing capital, Ernst & Young's Transaction Advisory Services bring together a unique combination of skills, insight and experience to deliver tailored advice attuned to your needs – helping you drive competitive advantage and increased shareholder returns through improved decision making across all aspects of your capital agenda.

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About the New Zealand Private Equity and Venture Capital Association

The NZVCA is a not-for-profit industry body committed to developing the venture capital and private equity industry in New Zealand. Its core objectives include the promotion of the industry and the asset class on both a domestic and international basis and working to create a world-class venture capital and private equity environment.

Members include venture capital and private equity investors, financial organisations, professional advisors, academic organisations and government or quasi-government agencies.

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