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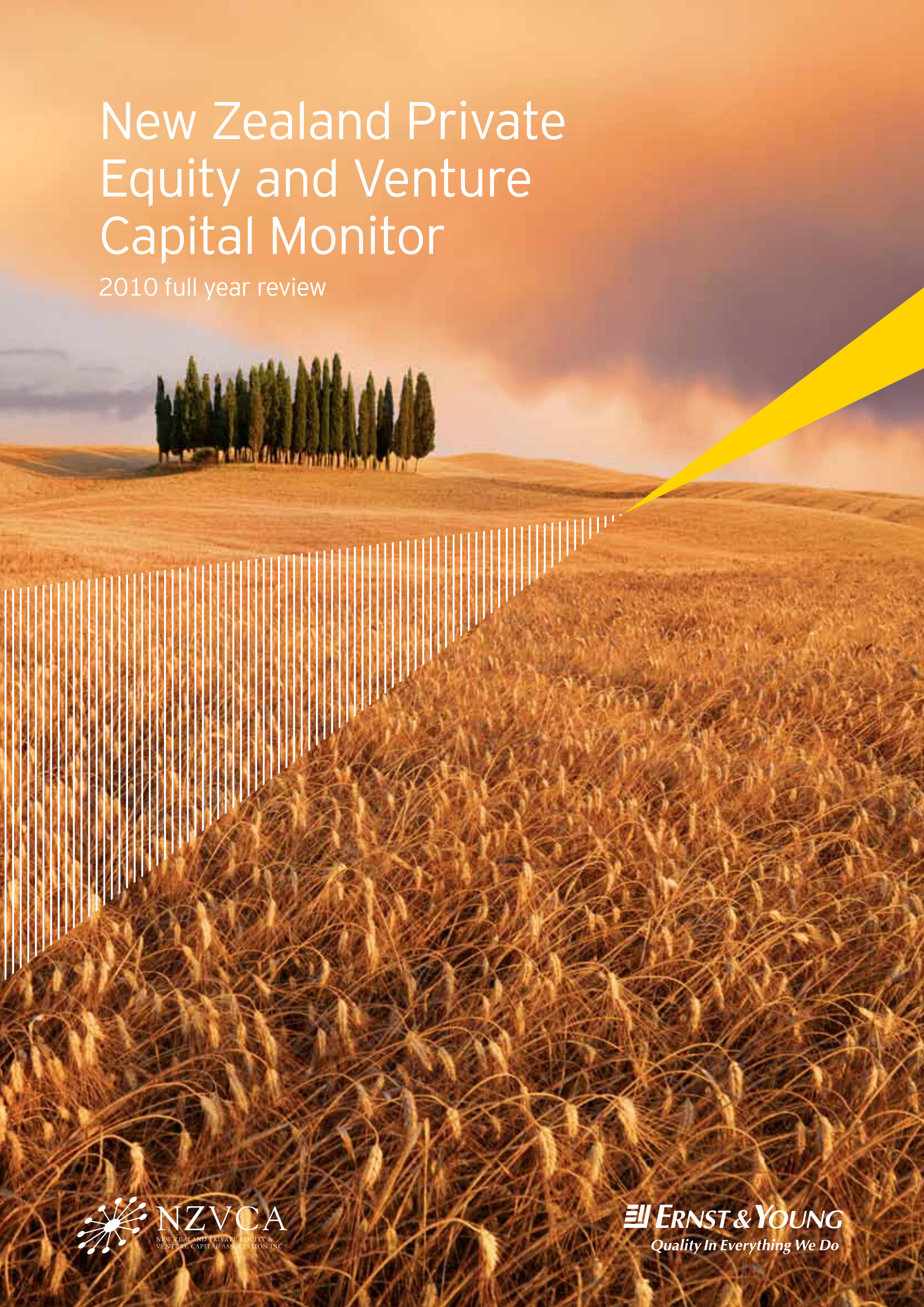
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New Zealand Private Equity and Venture Capital Monitor

2010 full year review



Foreword

We are delighted to bring you the eighth 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 2010 year including commentary on the industry from the New Zealand Private Equity and Venture Capital Association’s (NZVCA) Chair.

The New Zealand Private Equity & Venture Capital Monitor reports an 89% increase in investment value in 2010, from \$155.4m to \$294.4m. Mid-market investment more than doubled in 2010 to \$130m. The New Zealand mid-market has affirmed its stability and capacity to weather recent volatility in financial markets. The industry has a range of fund managers offering investors different fund sizes and investment focus.

Venture and early stage funds investment activity has been consistent in small value transactions less than \$2m. Fund raising in this sector is challenging for New Zealand fund managers. Until some new funds are established the New Zealand market will continue to have limited capacity for early stage deals in the \$2-10m range.

The private equity and venture capital market faces challenges in public awareness. The performance data research (page 9) for the period 1994 to 2010 helps demonstrate attractive investor returns. NZVCA promotes improved understanding of private equity as a provider of capital and resources for growth.

NZVCA continues to advocate on behalf of the industry for a healthy regulatory and tax environment. Financial Reporting and Financial Services Providers legislation was a focus in 2010 as well as preliminary discussions on the securities legislation review. The NZVCA has dialogue with Ministers and officials on the issues facing the private capital industry and the opportunities for New Zealand companies to access capital for growth.

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

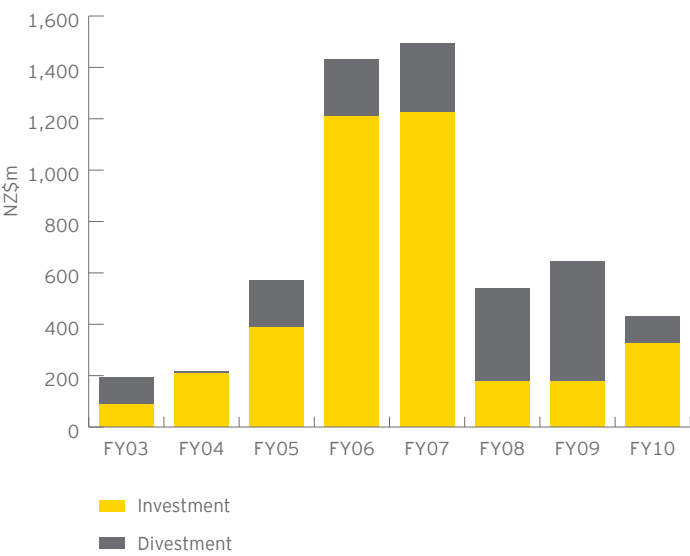
Contents

2	Executive summary
3	Mid-market private equity
5	Venture capital
7	Buy-out private equity
9	New Zealand Private Equity Returns
11	Opinion
13	Outlook
14	Investee plans
15	Activity summary
17	About the survey

Executive summary

2010 saw mid-market investment activity more than double, whilst buy-out investment activity remained steady. International VC investment boosted venture and early stage activity in 2010.

Overall activity summary 2003 to 2010



Investments

- ▶ Total investment value in 2010 was \$294.4m across 82 deals, an increase of 89% on the prior year.
- ▶ This increase in activity was driven by mid-market private equity activity which grew from \$58.7m in 2009 to \$130m in 2010.
- ▶ Venture and early stage investment activity grew from \$34m in 2009 to \$94.4m in 2010.
- ▶ Buy-out activity continued in 2010 at a similar level to 2009, following a hiatus in 2008.
- ▶ A total of 82 investments occurred in 2010, up slightly from 78 in 2009, with average deal value increasing from \$2m to \$3.6m, reflecting the mid-market resurgence in 2010 and two large venture capital deals.

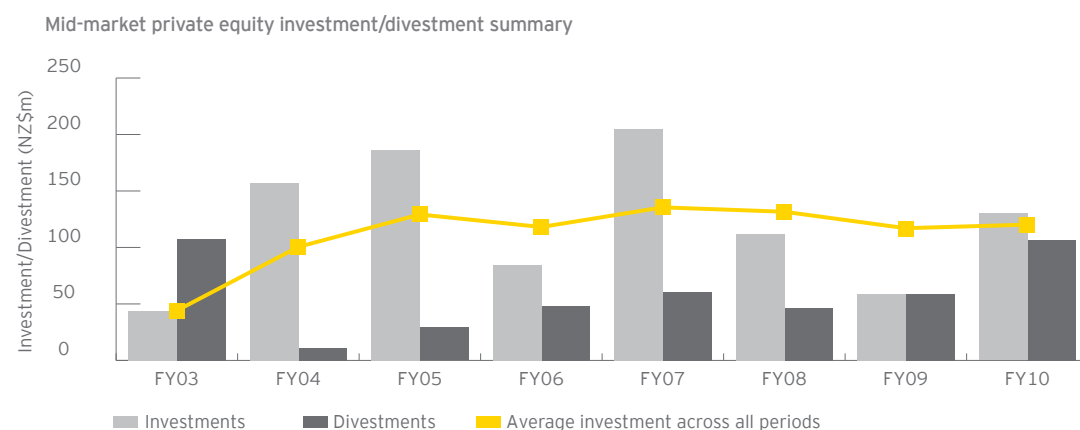
Divestments

- ▶ Total divestment value decreased to \$108.7m in 2010, down from 2009 which included two significant top-end divestments with a combined equity value of \$390m.
- ▶ Mid-market divestment activity was strong, with value increasing by 81% on the prior year. There is one divestment event noted in the venture capital segment.
- ▶ A total of five divestments were recorded in 2010, down from eight in 2009, with average divestment value declining from \$58m to \$22m.

Andrew Taylor
Andrew Taylor
Partner
Transaction Advisory Services, Ernst & Young

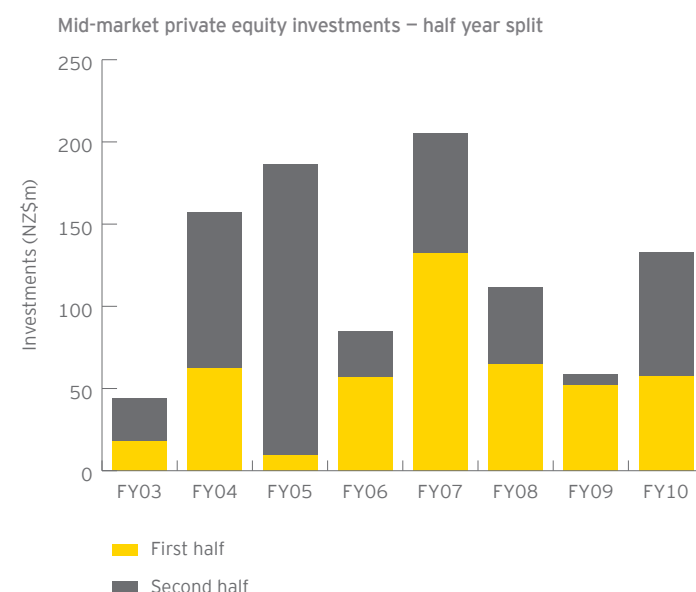
Colin McKinnon
Colin McKinnon
Executive Director
New Zealand Private Equity and Venture Capital Association

Mid-market private equity



Mid-market investment

- ▶ The level of mid-market investment from deals with disclosed values more than doubled from \$58.7m in 2009 to \$130m in 2010.
- ▶ 2010 investment value was the highest since 2007 and exceeded the historical average level across the previous seven years.
- ▶ The number of deals increased from 12 to 14, with average deal value also increasing by 90% year-on-year.
- ▶ This growth reflects investment activity from funds which completed fund raisings in 2009.



“The New Zealand private equity mid-market has developed since the early 1990's and has demonstrated stability through investment cycles.”

Kerry McIntosh, Chair, NZVCA

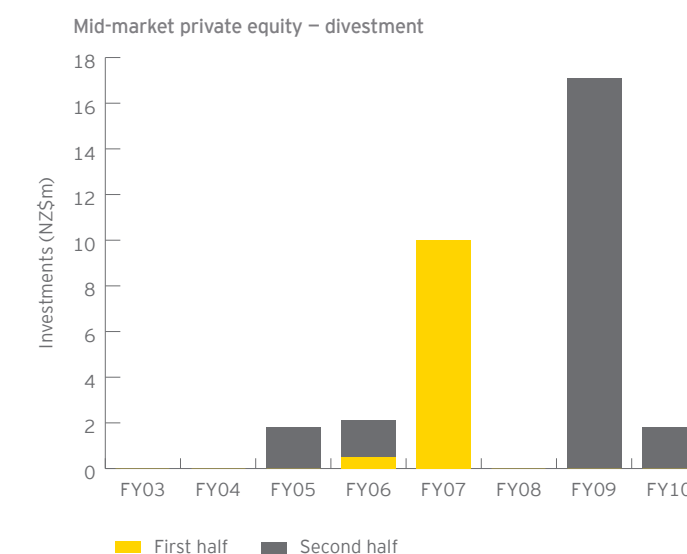
Mid-market domicile

- ▶ Mid-market investment activity has been underpinned by strong New Zealand domiciled fund activity, which grew from \$43.7m in 2009 to \$127.8m in 2010 the second highest level since data was first collected in 2003.

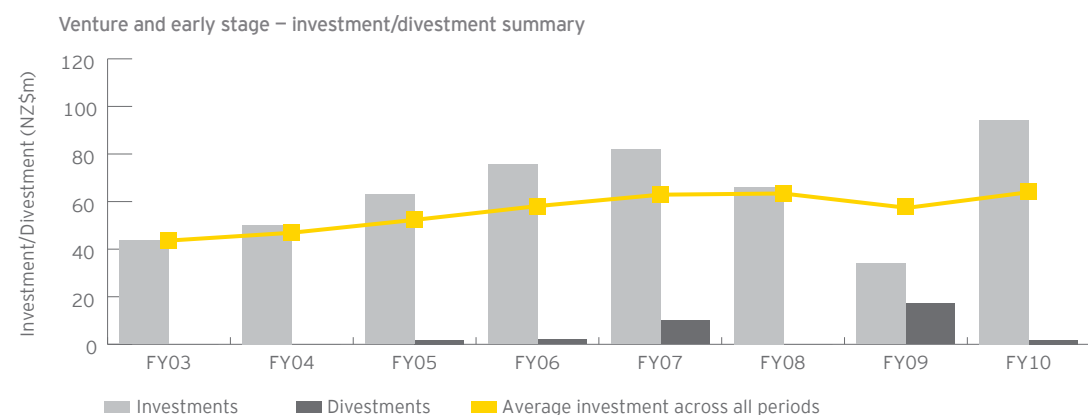


Mid-market divestment

- ▶ Mid-market divestment value in 2010 reached its highest level since 2003, with a value of \$106.9m across four deals.
- ▶ The average deal value of \$26.7m was more than double the prior year average.
- ▶ Post year end activity for the mid-market includes the divestment of M-Com to US financial services firm Fiserv, which will be captured in 1H 11 results.



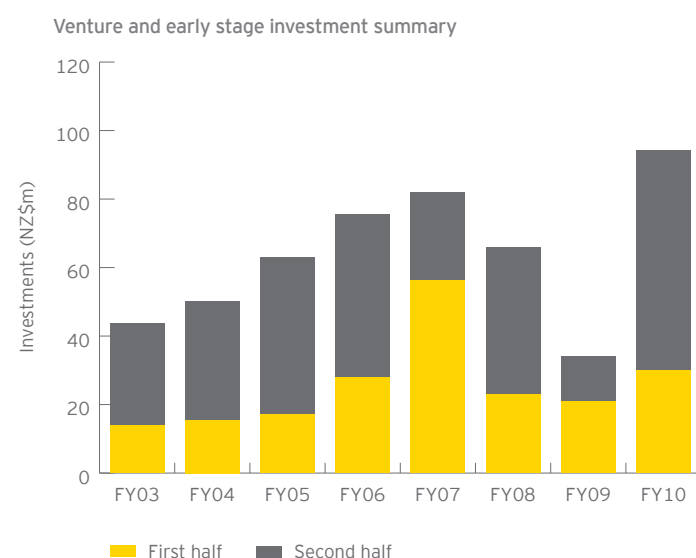
Venture and early stage capital



Venture and early stage investment activity grew from \$34m in 2009 to \$94.4m in 2010, boosted by two international deals totalling \$45m.

Venture and early stage investment¹

- Total investment activity of New Zealand domiciled funds increased from 2009 (\$31m)² to 2010 (\$50m). Average deal size increased (\$0.5m – \$0.8m), over a similar number of deals 62 (2009) and 65 (2010).
- 2010 investment activity included two major deals involving overseas VC investors in New Zealand businesses, totalling \$45m. These were a \$20m investment in Atlantis Healthcare by White Cloud Capital, a UK based fund, and a \$25m investment in Lanzatech NZ Ltd by Chinese funds Qiming Ventures and Softbank China Venture Capital.
- The number of investment deals reported for amounts of \$3m or greater was nil in 2009 and four 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.

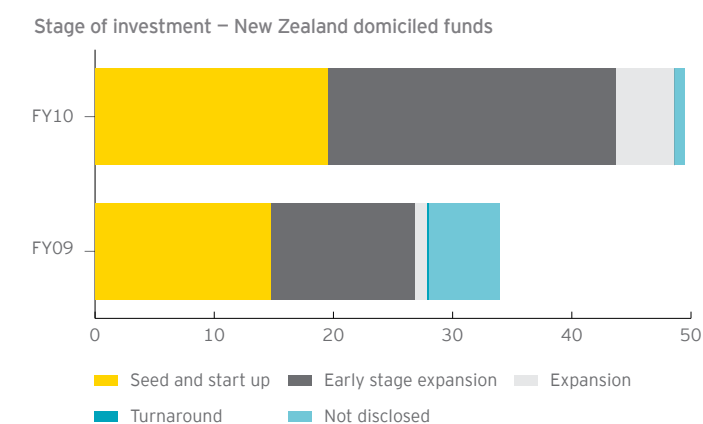


Stage of investment

- Seed and start up investment was up 33% at \$19.5m (2009 – \$14.7m) while early stage and expansion was up to \$29.0m (2009 – \$10.2m). A large deal for which the stage was undisclosed (\$6m) from the 2009 survey could significantly impact comparisons.

Angel investing

Angel investment activity (not included) also remained buoyant at similar levels to 2009 as reported in Young Company Finance. Angel investing provides capital for young companies through the stages of seed, start up and early expansion often co-investing with fund managers.



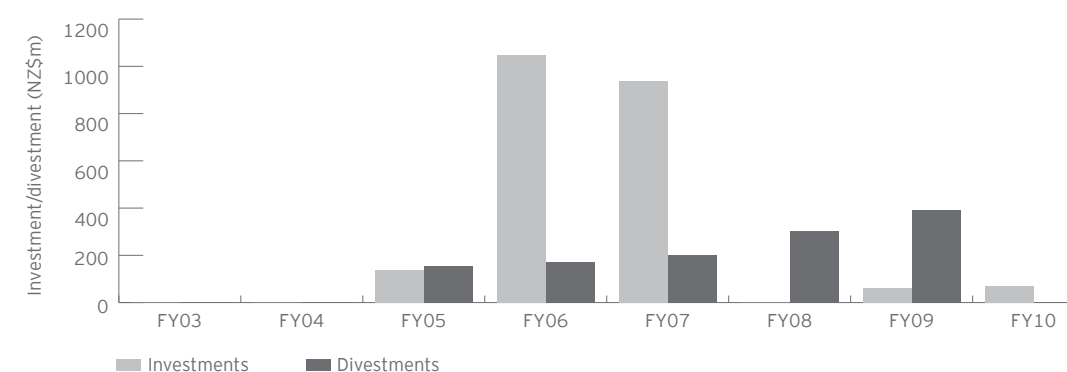
¹ Early stage investment includes investment led by fund managers but excludes deals led by angel networks, brokers and individuals.
² 2009 year data has been adjusted to reflect the 'venture and early stage' definition.

“Until some new funds are established the New Zealand market will continue to have limited capacity for early stage deals in the \$2-10m range.”

Colin McKinnon, Executive Director, NZVCA

Buy-out private equity

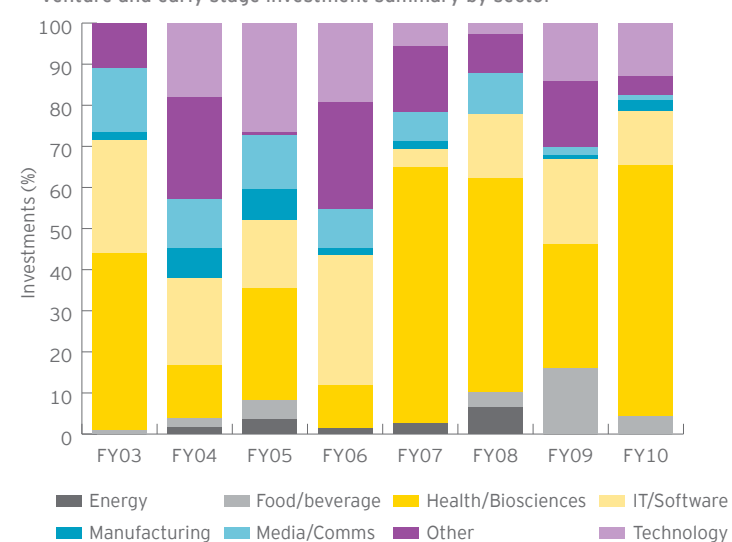
Buy-out private equity investment/divestment summary



Venture and early stage – sector review

- ▶ The sector mix in 2010 was similar to that seen in 2008 and 2009, with a continuation of significant health and biosciences investments.
- ▶ Technology, IT and software also continue to be key sectors attracting venture capital investment.

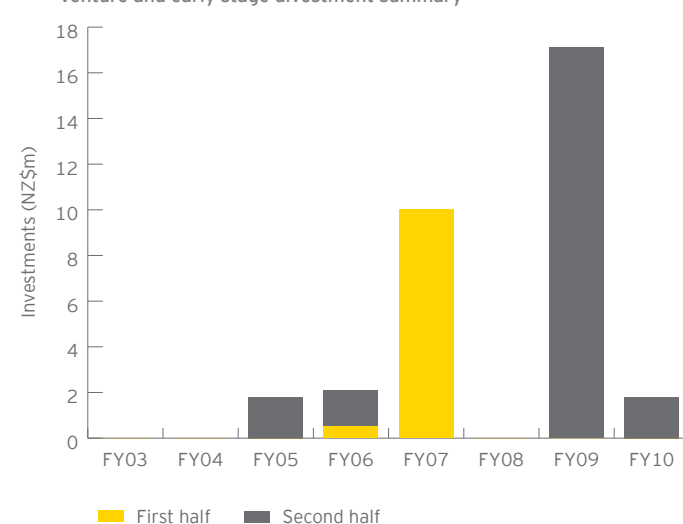
Venture and early stage investment summary by sector



Venture and early stage – divestment

- ▶ One divestment with disclosed deal value was recorded in 2010, following one significant divestment in 2009.
- ▶ The level of divestment activity reflects the early evolution of the industry, but also presents a key challenge for the industry moving forward.

Venture and early stage divestment summary



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 been reported in New Zealand outside of the peak years of 2006 and 2007.

Buy-out investment

- ▶ There was a continuation of buy-out investment activity in 2010, albeit at much lower levels than seen in the pre-Global Financial Crisis (GFC) peak of 2006 and 2007.
- ▶ The buy-out investment value of \$70m in 2010 represented a single follow-on investment.

Buy-out divestment

- ▶ No buy-out divestments were recorded in 2010.
- ▶ The prior year saw two major divestments with a total deal value of \$391.5m.
- ▶ Post year end activity includes the divestment of Tegel by Pacific Equity to Affinity, a regional private equity fund. This will be reported in 1H 2011.

New Zealand Private Equity Returns

There has historically been limited data availability in relation to private equity returns in New Zealand, which has constrained full analysis of the industry’s performance. Research undertaken by NZVIF¹ seeks to address this information gap by analysing returns over the period from 1994 to 2010. The full report is available to download from www.nzvif.com.

Survey approach

The survey involved investments into New Zealand companies by professional private equity fund managers from New Zealand and Australia. Data has been collected for investments made into 74 companies over the past 16 years across a wide range of sectors and deal sizes. The total amount invested into these companies was \$675m, with an average of \$9m.

The survey does not include unrealised returns and does not look at the performance of individual funds, but provides an evaluation of the aggregated company level returns over the period. These are gross returns from realised investments – or “cash on cash” returns. Given the focus on companies where a divestment has occurred, there is an inherent positive bias in the data set.

The returns are before management fees and costs are accounted for. The analysis does not include venture capital investments as there is insufficient information available on returns.

Survey results

The \$675m of investment into New Zealand companies has returned \$1.7b for investors. This represents a “cash on cash” multiple of 2.54 times. The average holding period across the data set was 4 years. Table 1 provides a summary of the return metrics:

Returns on divestments in period

Period	Pooled average	Median	Cash-on-cash multiple
1994-2010	33.6%	22.0%	2.54x

The difference between the pooled average (which is a dollar weighted return) and the median indicates that there is a positive skew in the returns data. This is not unexpected for private equity investment because good performing companies often generate spectacular returns. If the two largest deals are taken out of the data, then the returns are as follows:

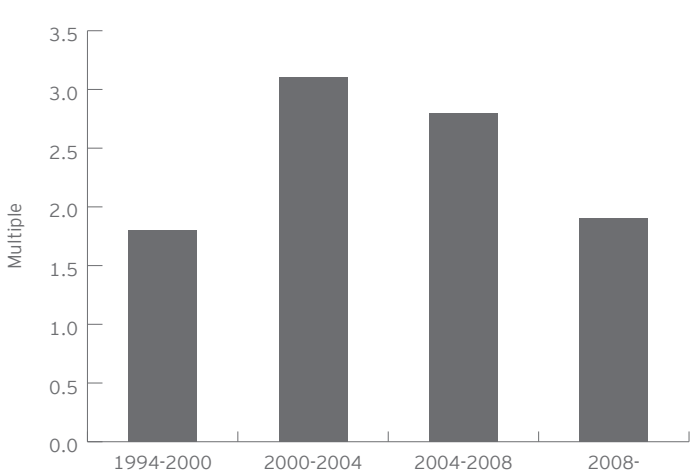
Returns on divestments in period (excluding two largest divestments)

Period	Pooled average	Median	Cash-on-cash multiple
1994-2010	26.8%	21.7%	2.13x

Time period analysis

When looking at the returns achieved by the date they were divested indicates that private equity fund managers have been able to achieve strong returns consistently across time and economic cycles. Not unexpectedly returns were stronger in the 2000-2004 and 2004-2008 periods as this was a time of high liquidity and low interest rates which resulted in strong divestments.

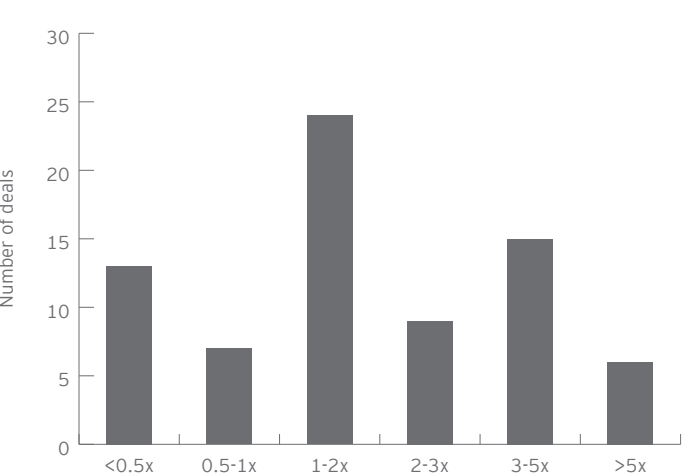
Returns by time period



Range of returns

The range of individual multiples reaffirms the need to take a portfolio approach. The data set includes a full range of outcomes with six investments earning over five times the original investment, through to 20 investments earning less than invested.

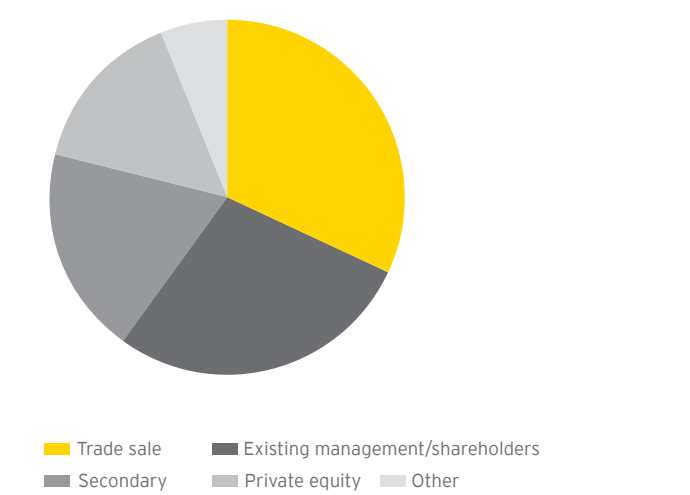
Range of multiples achieved



Divestment Types

Looking at how the private equity fund managers divested their investments, the data is consistent with what has been observed offshore. The sale of companies to a competitor or trade buyers accounts for almost a third of all liquidity events, with sale back to existing management and/or other shareholders in the company not far behind. Secondary sales, where the fund manager sells the company to another private equity firm or financial investor, also remains a common form of divestment.

Divestments by type



¹ Research undertaken by Aaron Tregaskis, Investment Director with New Zealand Venture Investment Fund (NZVIF), November 2010.



New Zealand private equity activity lifts strongly in 2010

Kerry McIntosh, Chair NZVCA

Private equity investment grew strongly throughout 2010 driven by increasing activity from the local mid-market funds. Investment in venture and early stage has been boosted by international funds investing in New Zealand companies while domestic activity continued at the subdued levels experienced in 2009.

Conditions for private equity gradually improved throughout 2010 resulting in the highest level of new investment since 2007. Investment activity across all segments in 2010 increased 89% in total activity to \$294.4m across 82 deals.

This comprised \$94.4m in early stage and venture capital, \$130m in mid-market and a single follow-on investment of \$70.0m in buy-out. Divestments fell to \$108.7m down from \$467.5m in 2009, which included two significant buy out divestments.

In last year's Monitor we identified mid-market private equity as a space to watch following a number of successful fund raisings in 2009. This optimism was borne out with the number of investments increasing from 12 to 14 while average deal size increased to \$9.3m. This activity was driven by New Zealand domiciled funds that had their most active year since 2005.

Mid-market private equity in New Zealand now has a 15 year track record and is maturing as an asset class. The number of General Partners ("managers" or "GPs") has grown to 8-9 investing primarily expansion capital across a range of industry segments. These GPs are supported by a small number of institutional investors, the New Zealand Superannuation Fund and high net worth individuals. The growing acceptance of the asset class is demonstrated by GPs' increasingly active international fund raising programmes.

The absence of credible performance data for the industry has hampered the participation of a broader range of institutional investors. NZVIF has undertaken research that analyses returns

over the period from 1994 to 2010. There were 74 investments totalling \$675m over the 16 year period which returned \$1.7b for investors, cash on cash return of 2.54x or an average Internal Rate of Return (IRR) of 33.6%. While this data is at an investment rather than fund level it does demonstrate to investors a proven track record of attractive returns over a period long enough to capture a range of economic conditions.

Venture & early stage capital sector investment activity was skewed upwards by two major deals funded by international VC funds. The New Zealand domiciled fund activity has increased from 2009 at around \$49m invested in 65 deals for an average deal size of \$760,000. As in 2009 much of the activity was driven by smaller early stage fund investment. There were few investments in the critical \$3m-\$20m range where companies are generally looking to venture capital to bridge the gap between proven idea or product and commercial revenues. This structural weakness in the market has arisen as all existing New Zealand domiciled venture capital funds are now fully invested.

The fund raising environment for venture remains extremely difficult both internationally and in New Zealand. No new venture funds were raised in 2010 with the last successful fund raising having occurred in 2007. The NZVCA believes that a vibrant, healthy and active venture market is a key ingredient in harnessing innovation as a source of economic growth. We believe that the NZVIF programme has helped catalyse a venture capital industry with a pool of skilled managers and advisors. This valuable infrastructure will wither away if the

"An average IRR of 33.6% over 16 years demonstrates to investors a proven track record of attractive returns over a period long enough to capture a range of economic conditions."

Kerry McIntosh, Chair NZVCA

current fund raising issues are not addressed. We are working with a range of government agencies including New Zealand Trade and Enterprise (NZTE) and NZVIF to identify industry wide solutions.

The quiet buy-out market reflected the absence of larger opportunities as many of the Australian and regional funds considering investments in New Zealand have plenty of "dry powder" – committed but undrawn funds. Internationally and regionally there has been a resurgence in LBO markets as leverage credit markets have reopened and vendors of assets have regained the confidence to take their businesses to market. In Australia Carlyle Group and TPG Capital acquired Healthscope for A\$2.7b in the largest buy out since 2002.

Those LBO managers with New Zealand assets in their portfolios have been managing these through an extended downturn with continued difficult operating conditions throughout 2010 and on into 2011. Investments in consumer facing businesses where demand has been adversely impacted by consumer deleveraging have proven especially difficult. Yellow Pages and Red Group were notable challenges for international PE owners and their banking syndicates during 2010.

On a more positive note, we have also seen the first successful liquidity event for a major Leveraged Buy-out (LBO) investment made during the boom 2005-2007 period. Pacific Equity Partners and ANZ Capital sold Tegel in March 2011 via a secondary to Affinity Capital Partners.

The outlook for the New Zealand private equity and venture capital market is bifurcated. The future prospects for the increasingly mature and well established mid-market and LBO funds looks good as economic conditions improve along with access to funding. For those managers operating in the venture space their inability to raise new funds is a dilemma which must be resolved if we are to retain an active and vibrant domestic market in which to fund our successful innovators.

Outlook

Industry outlook

Survey respondents were asked for their view on the industry outlook over a six month and 18 month horizon. Responses indicate a slightly less optimistic outlook than the prior year, possibly driven by the slow pace of economic recovery.

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 next 12 months:

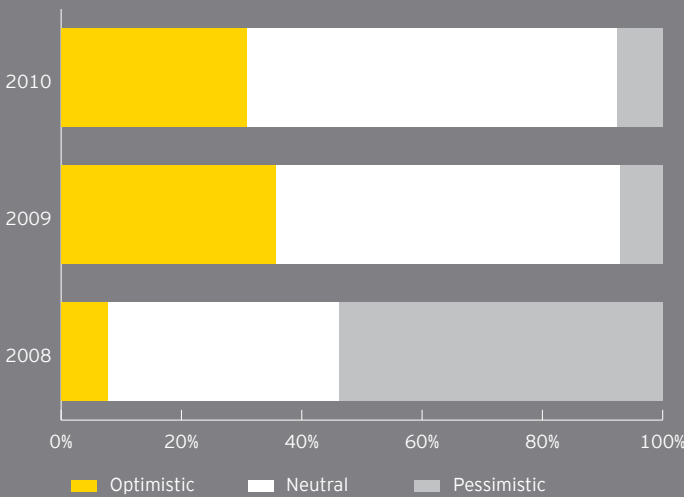
- ▶ Limited track record of VC and PE liquidity events restricting the availability of capital.
- ▶ The availability of bank funding.
- ▶ Cyclical low point in entry valuations providing continued opportunities for good value investments.

Respondents were also asked to comment on key factors expected to affect their investee companies over the next two to three years. Issues identified included:

- ▶ General local and global economic conditions.
- ▶ Ability to deliver productivity and margin growth.
- ▶ The accessibility of IPO markets.
- ▶ Interest rate movements.
- ▶ The impact of the recent Christchurch earthquakes.

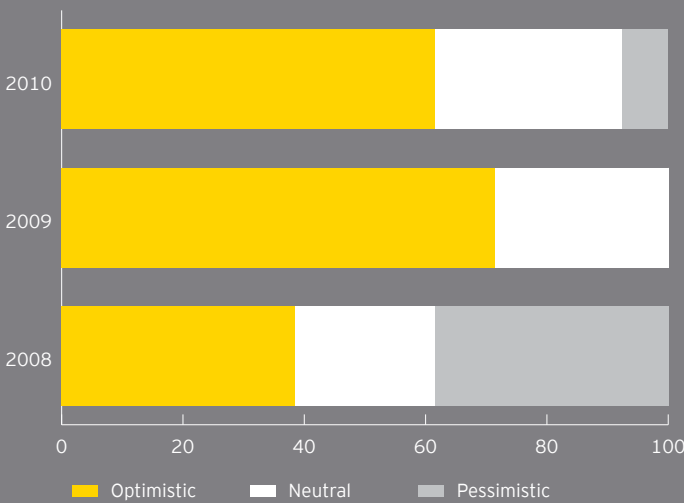
Next six months

- ▶ Respondents' short term outlook is similar to the prior year, with 92% either optimistic or neutral in outlook.



Next 18 months

- ▶ Outlook for the next 18 months has worsened slightly compared to the prior year, though 62% of respondents remain optimistic about the medium term outlook.



Investee plans

As part of our survey, participants were asked to outline their plans for new investee companies over the next 12 months.

Respondents' plans included a strong focus on organic growth, fuelled by new product launches and expansion into new markets, as well as export growth.

To a lesser extent, inorganic growth through acquisitions is seen as an element of growth plans.

	1H10	2H10
Increase R&D	50%	40%
Recruit	75%	20%
Launch products	50%	60%
Make acquisitions	25%	20%
Marketing spend	25%	20%
Capex	50%	20%
New markets	78%	80%
Grow exports	25%	60%

Activity summary

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10
Investment (NZ\$m)								
Venture capital	43.6	50.2	63.0	75.6	81.9	66.1	34.0	94.4
Mid-market PE	44.1	157.0	186.5	84.8	205.0	112.0	58.7	130.0
Buy-out PE	0.0	0.0	136.9	1,048.5	937.7	0.0	62.7	70.0
Total	87.7	207.2	386.4	1,208.9	1,224.7	178.1	155.4	294.4
Investment (no. of deals)								
Venture capital	42	44	50	77	60	52	63	67
Mid-market PE	7	18	25	18	23	30	12	14
Buy-out PE	0	0	4	17	2	0	3	1
Total	49	62	79	112	85	82	78	82
Divestment (NZ\$m)								
Venture capital	0.0	0.0	1.8	2.1	10.0	0.0	17.1	1.8
Mid-market PE	107.4	10.7	29.2	48.5	60.2	46.5	58.9	106.9
Buy-out PE	0.0	0.0	154.6	172.0	200.0	301.5	391.5	0.0
Total	107.4	10.7	185.6	222.6	270.2	348.0	467.5	108.7
Divestment (no. of deals)								
Venture capital	0	0	1	4	3	1	1	1
Mid-market PE	7	2	4	6	4	10	5	4
Buy-out PE	0	0	1	1	1	1	2	0
Total	7	2	6	11	8	12	8	5

Respondents continue to look to new market and export growth as key elements of plans for new investees in 2010

About the survey

The survey

The New Zealand Private Equity and Venture Capital survey is based on 17 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 publically announced information, in addition to venture capital activity as reported in NZVIF's Young Company Finance publication. All data and charts represent information obtained through the survey and 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, optimizing, 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 (NZVCA)

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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