The New Zealand Private Equity and Venture Capital Monitor

First half year results — January to June 2008

NZVCA
NEW ZEALAND PRIVATE EQUITY & VENTURE CAPITAL ASSOCIATION INC

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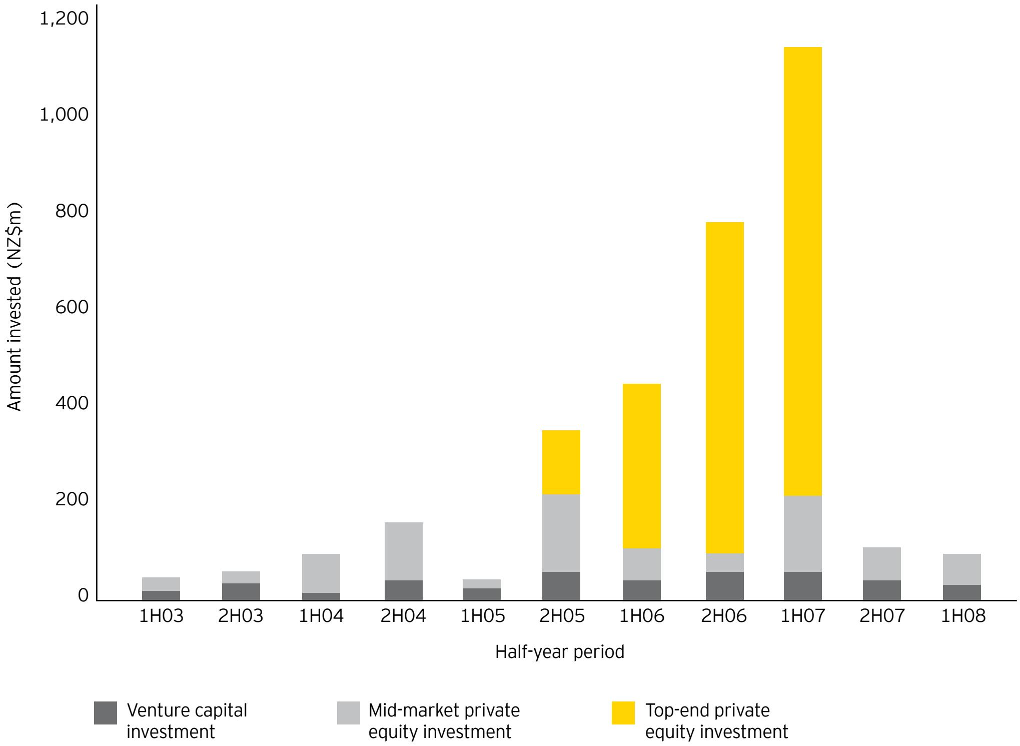
Headlines – at a glance

- Total investments - NZ$88m of equity in 35 deals
- Venture capital - NZ$23m of equity in 28 deals
- Mid-market private equity - NZ$65m of equity in 7 deals
- No LBO / Top-end private equity deals
- Total divestment - NZ$4.7m across 3 deals
- Total funds raised - NZ$252.5m by NZ domiciled funds



> "Current market conditions make for 'great vintage years' for those that recognise the stage of the investment cycle we are in"
>
> Franceska Banga, Chair, NZVCA

Executive summary

- Mid-market private equity and venture capital activity maintains momentum despite tough market conditions, with investments totalling $64.6m and $22.9m respectively in 1H08.
- There has been no top-end private equity activity in 1H08. This is in line with 2H07, likely reflecting that funding for large leveraged transactions is difficult to attain in the current market.
- There appears to be an increasing trend for larger private equity funds to focus on 'follow on' acquisitions, typically through acquisitions of smaller competitors.
- The mid-market segment appears less affected by credit availability issues, though some participants believe that vendor price expectations have yet to fully adjust to the new credit environment, with higher debt costs and lower available debt multiples reducing leverage ratios and hence deal pricing.
- A $250m fund raised by Maui Capital further increases the still significant pool of private equity and venture capital fund equity available for New Zealand market investment (total raised funds including commitments are now approximately $2.6 billion).
- The venture capital market is reaching a significant point where a number of managers seeded by the New Zealand Venture Investment Fund in 2002-03 are close to fully invested and are now moving into the divestment phase. Some will also be looking to raise new funds over the next 12 months. Market conditions make this a challenging time to execute either of these activities, with no venture capital divestments achieved in 1H08, continuing the trend seen in 2H07, and no material new funds raised, though some fund-raising is in progress. At the portfolio company level follow-on investment activity has remained steady.
- Overall, the first half of 2008 is consistent with the outlook we commented on in the 2007 full year monitor, being a return to private equity investment levels more in-line with longer-term historical averages.
- While investment in the venture capital and the mid-market private equity segments was slightly below historical average levels, both deal volumes and average deal size ratios indicate that, while market conditions are challenging, the sector remains fundamentally sound.

Andrew Taylor
Director
Transaction Advisory Services
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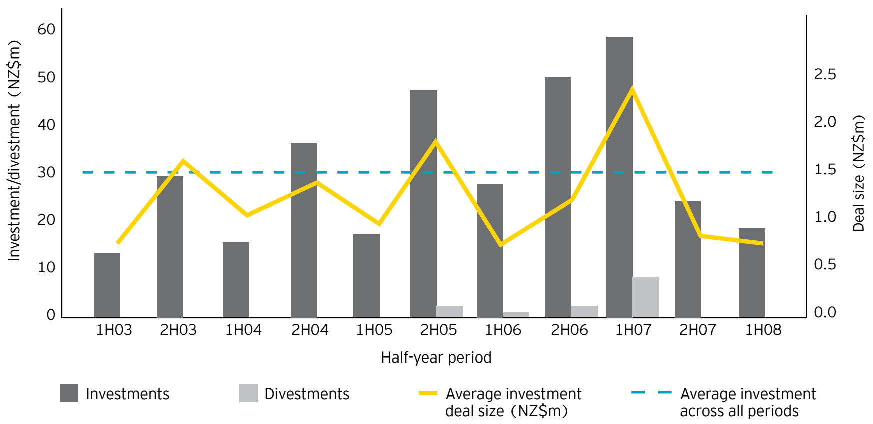
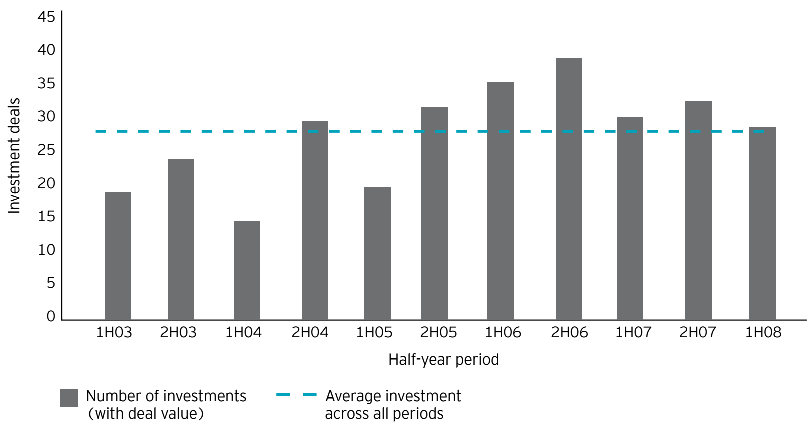
Colin McKinnon
Executive Director
New Zealand Private Equity
and Venture Capital Association

Market segment review

Venture capital investment/divestment



Venture capital deal volume



Outlook: challenges lie ahead but the venture capital industry is in a good position to cope

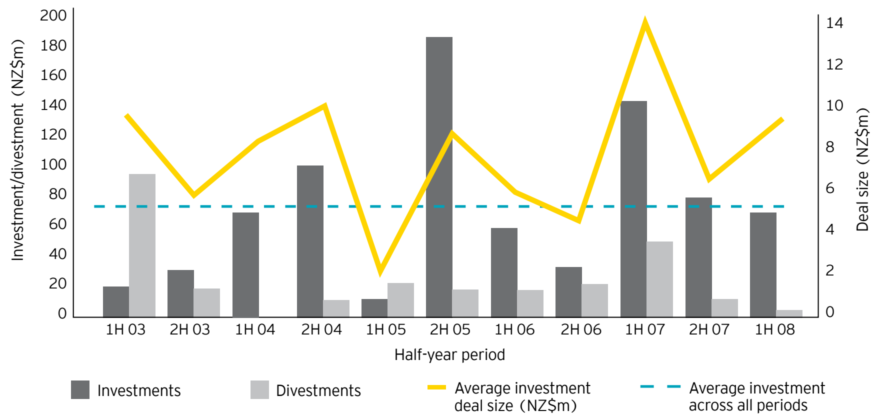
Venture capital

- Total investment of $22.9m was below the average for the historical period shown of $30m, driven primarily by a decline in deal size relative to the historical period.
- Significant deals announced during the period include an investment by Bancorp in Smartfoods Limited, an investment in Mobile Mentor Limited by a consortium (ICE Angels, private investors and K1W1) and selected investments by Endeavour Capital in start-up companies created by university commercialisation company WaikatoLink.
- Overall, the venture capital segment has flattened off over the last eighteen months but is still performing relatively strongly with the number of deals in line with average historical levels.
- There were no venture capital divestments in 1H08, in line with 2H07. This reflects the market conditions currently facing the venture capital segment that is making exiting investments difficult. However, several companies attracted third party follow-on capital, some of these at improved valuation, which offers some promise for future performance.
- A number of funds seeded by the New Zealand Venture Investment Fund from 2002-03 are now reaching an inflection point where they are looking to both divest initial investments and raise funds for the next stage of their investment cycle.
- Current market conditions are making it increasingly challenging for these funds to exit their investments, with the average time to divestment now around seven years. These extended times to achieve an exit, even where companies are in good health, will undoubtedly impact on the ability of the manager to convince investors to invest again in new funds.

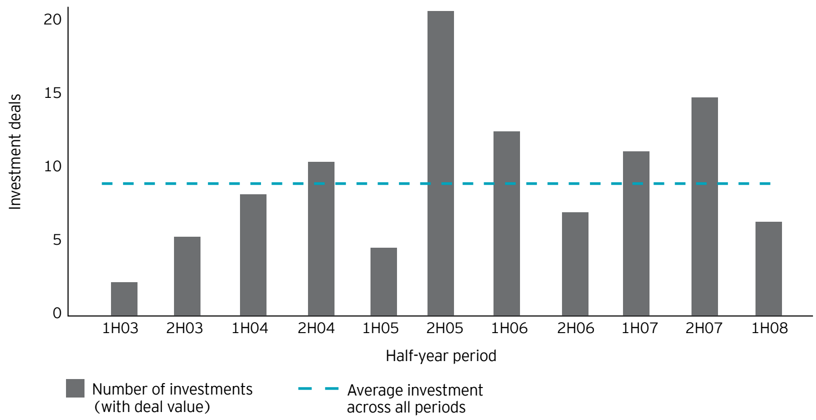
Mid-market private equity

- Total investment of $64.6m for 1H08 represents a decline of 11% from 2H07 and is slightly below the average for the historical period of approximately $70m.
- Significant deals announced during the period include the acquisition of Borders by Pacific Equity Partners investee A&R Whitcoulls, the divestment of BBQ Factory by Hellaby Holding to Capital Group, investments in Camm 4 Limited and Shears & Mak by Direct Capital and the acquisition of Pacific Brands NZ assets by Rangatira investee company Vita.
- Given the relatively adverse market conditions this suggests that the New Zealand mid-market private equity segment continues to be relatively buoyant. This is consistent with anecdotal views expressed by many market participants.
- While 1H08 deal volume has dropped to 7 from the 13 achieved in 2H07 this has been largely offset from an investment value perspective by significant growth in average deal size from $5.6m to $9.2m.
- Mid-market deals have long been the strength of the New Zealand private equity market and there is still strong underlying demand from private equity buyers for quality assets in this segment which has been buoyed by significant new fund raising in the period. Demand is in turn being driven by factors such as owner succession planning.
- The mid-market segment appears less affected by credit availability issues, though some participants believe that vendor price expectations have yet to fully adjust to the new credit environment with higher debt costs and lower available debt multiples reducing leverage ratios and hence deal pricing.

Mid-market private equity investment/divestment

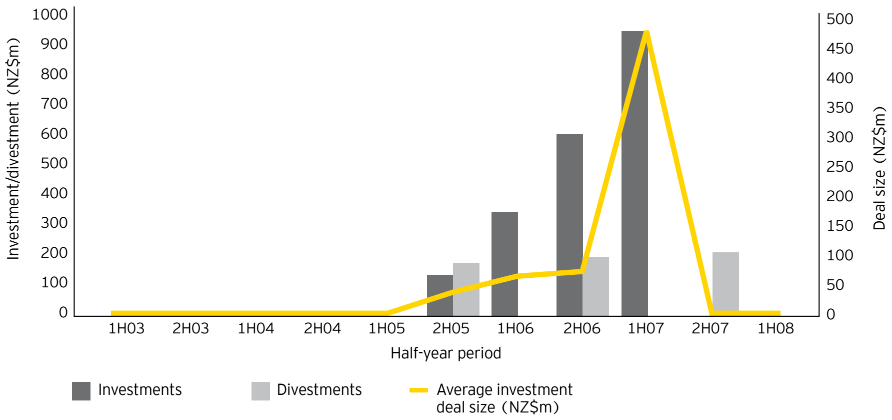


Mid-market private equity deal volume



Outlook: mid-market activity will continue to underpin the New Zealand private equity market

Top-end private equity investment/divestment



Top-end private equity

- There has been no top-end private equity or LBO activity in 1H08, consistent with 2H07 and in line with expectations.
- It was announced during the period that a number of significant deals that had been in progress had been aborted. This was largely reflective of increasing debt costs and lower lending multiples preventing the type of debt syndication seen in 2006 and 1H07. We note that had one or more of these transactions closed, top-end private equity investment levels for the period would likely have matched or exceeded those seen in 1H07.
- Large private equity funds appear to be increasingly driving growth through the targeting of smaller bolt-on acquisitions in their investee companies and through investments in operational efficiencies.
- PEP announced the sell down of a minority stake in Tegal Foods to ANZ Capital in November 2007. While this deal was not captured in the FY07 full year monitor, no deal value was disclosed and no adjustment has therefore been made to previously published results.

Outlook: it is unlikely top-end private equity or LBO market activity will significantly increase during the balance of this year

Industry outlook

All survey participants were asked what they felt the outlook was for both the next 6 months and next 18 months. Fifty percent of the respondents said that their outlook for the next 6 months was pessimistic with an even split of 25% for neutral and optimistic respectively. Interestingly, the respondents' outlook for the next 18 months seems to be more positive with 59% being optimistic, 33% being neutral and only 8% being pessimistic.

Issues identified by participants for private equity over the next 12 months include the cost of credit; availability of capital from credit crunch wary institutional funds; the ability to achieve returns on recent investments made when multiples paid were high and the cost of debt low – leading to longer investment horizons; and macro-economic factors affecting New Zealand.

However the survey respondents still see opportunities for the private equity sector through the increasing number of business owners looking to exit. Assisting with succession planning and building an awareness of private equity as a good method to exit will be key to realising these opportunities.

While the top-end LBO market is likely to watch and wait until credit conditions improve, the fundamentals of the New Zealand mid-market remain solid. The venture capital market continues on a steady track but the availability of capital to fund further growth is likely to remain challenging until news of successful exits starts to filter through.

Franceska Banga, Chair of NZVCA comments "Current market conditions make for 'great vintage years' for those that recognise the stage of the investment cycle we are in. As business owners adjust their valuation expectations, the opportunities to invest will become apparent."

About the survey

The survey

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 at Ernst & Young or Colin McKinnon at the NZVCA. Contact details are provided below.

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Our Transaction Advisory Services team works with some of the world's largest organisations, fastest growing companies and private equity firms on some of the biggest and most complex cross-border deals in the global market. We can help you achieve the growth, performance improvement and returns your stakeholders expect.

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About the New Zealand Private Equity & 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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