

# 2009 New Zealand Private Equity and Venture Capital Monitor

# Foreword

We are delighted to bring you the seventh full-year edition of the New Zealand Private Equity and Venture Capital Monitor. This issue consolidates the findings of previous surveys and provides a more detailed review of the 2009 year including commentary on the industry from New Zealand Private Equity & Venture Capital Association's (NZVCA) Chair.

Confidence is returning to capital markets. The survey participants in the 2009 New Zealand Private Equity and Venture Capital Monitor reported growing optimism in their market outlook for the next 18 months.

However, the landscape of capital markets is fundamentally changed as a result of the global events of the last two years. The New Zealand economy has weathered the storm relatively well. But the capital markets landscape for investors and the broader community has changed. The change is ambiguous and uncertain. Legislative reforms aim to restrain the excesses of the past at the same time as governments are promoting business

innovation and productivity as essential for growth recovery.

NZVCA is the voice for the private capital industry. NZVCA has provided submissions on regulatory and taxation reform including the Capital Markets Development Task force, the Statutory Framework for Financial Reporting and the Financial Services Providers Bill. The Securities Act review is up next.

NZVCA continues dialogue with Ministers and officials on the issues facing the venture capital segment of the market and the serious lack of expansion capital impacting the New Zealand innovation system.

Market data is critical to support our representation of the industry. We value the continuing support of Ernst & Young as the NZVCA Research Partner and, in particular, its significant commitment of resource to the New Zealand Private Equity and Venture Capital Monitor.

NZVCA enjoys support from members 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 helps measure our progress and share the success of our endeavours.

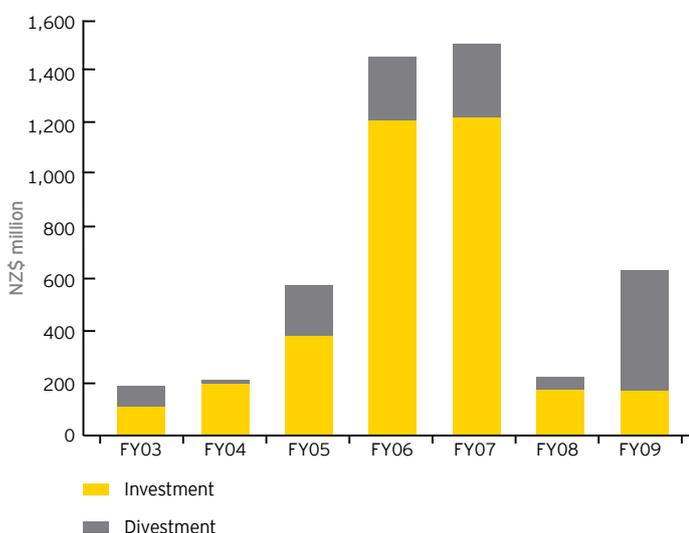
**Colin McKinnon**  
Executive Director, NZVCA

<b>2</b>	Executive summary
<b>3</b>	Mid-market private equity
<b>5</b>	Venture capital
<b>7</b>	Top-end/LBO private equity
<b>9</b>	Opinion – NZVCA's Chair
<b>11</b>	Pipeline
<b>12</b>	Industry plans
<b>13</b>	Activity summary

# Executive summary

There was a significant increase in overall activity both in terms of the number and value of deals. Mid-market activity was resilient, and angel-led venture capital activity increased significantly. Investors are optimistic.

Overall activity summary 2003 to 2009



## Investments

- ▶ Total 2009 investment of \$177.6m was almost identical to that seen in 2008, albeit with a different segment mix
- ▶ In the venture capital segment angel investor activity supported similar investment levels to 2008 while the return of top-end private equity activity, largely in the form of follow-on investment, offset a decline in mid-market investment activity by Australian domiciled funds
- ▶ New Zealand mid-market fund investment levels remained steady at around \$50m, being closely in line with 2008
- ▶ In total, 108 deals occurred in 2009, similar to 2006 and significantly up from 2007 and 2008 levels, with average deal size decreasing from \$2.2m in 2008 to \$1.6m in 2009, reflecting the influence of the angel investment activity

## Divestments

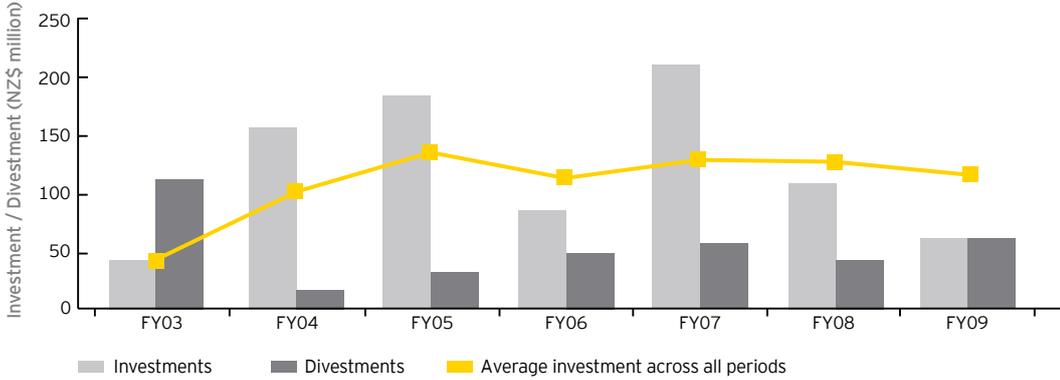
- ▶ Divestment activity in all categories was up substantially on 2008
- ▶ A significant venture capital divestment transaction was completed during 2009
- ▶ Five mid-market divestments with a total value of \$58.9m were reported in 2009 – this represents a significant increase on the total divestment activity of \$46.5m in 2008
- ▶ Two significant divestments were recorded in the top end private equity segment, with a total deal value of approximately \$390m

Andrew Taylor  
Partner  
Transaction Advisory Services, Ernst & Young

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New Zealand Private Equity and Venture Capital Association

# Mid-market private equity

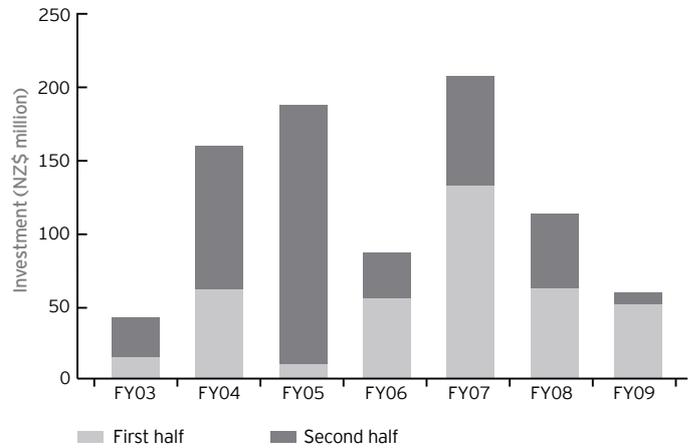
Mid-market private equity investment/divestment summary



## Mid-market private equity – investment

- ▶ The level of mid-market investments from deals with disclosed values decreased in 2009
- ▶ The number of investments decreased from a peak of 30 deals in 2008 to 14 in 2009, whilst average investment size showed a 14% year-on-year increase
- ▶ A sizeable mid-market private equity deal signed in 2H09 is not yet formally completed, this will be included in 1H10 results
- ▶ Burger King New Zealand was acquired by Anchorage Capital Partners in September for an undisclosed price, and is therefore not included in deal value
- ▶ A significant mid-market fund raising was completed during the year with the close of the Direct Capital IV fund at approximately \$325m

Mid-market private equity investments – half year split



“The mid-market is the one to watch. While activity dropped back over 2009 this is part of the market where we can expect to see future growth.”

Franceska Banga, Chair NZVCA

#### Mid-market private equity – domicile

- ▶ New Zealand domiciled fund activity was relatively stable, at just below \$50m
- ▶ Following the trend of 2008, the decrease in mid-market investments in 2009 was driven largely by a further decline in Australian domiciled fund activity

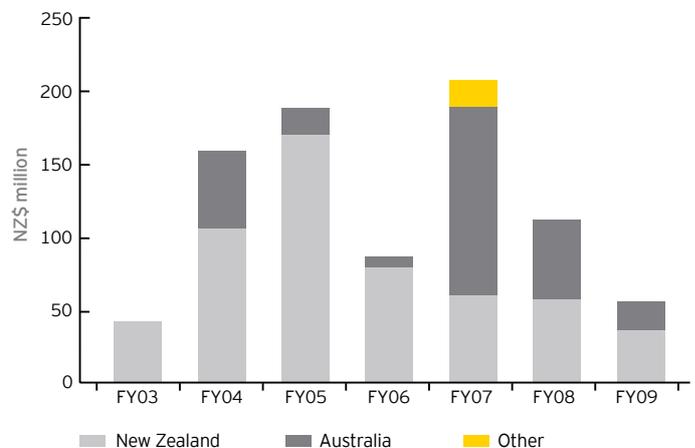
#### Mid-market private equity – divestment

- ▶ Five divestments with deal values were reported in 2009, with an average deal size of \$11.8m, substantially higher than the average deal size of \$4.7m in 2008

#### Mid-market private equity – IRR

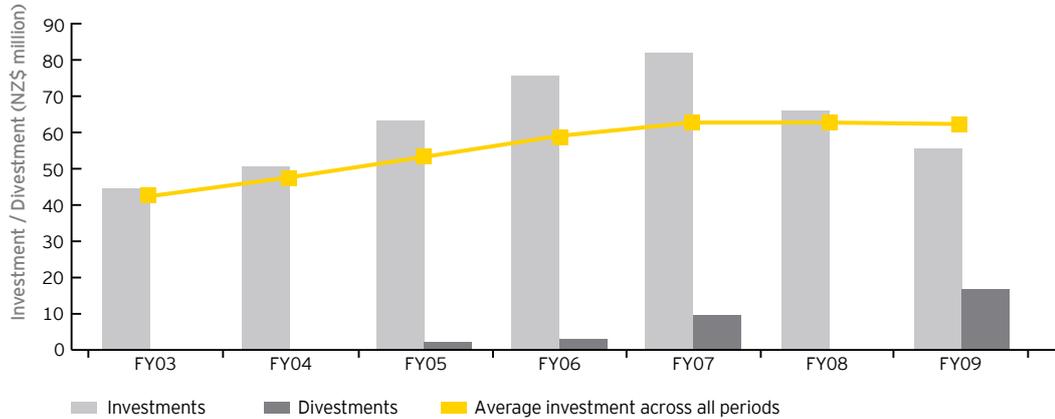
- ▶ Of the five divestments disclosed, two provided IRR information of which the average exit where this metric was disclosed was approximately 40%

Mid-market private equity – domicile



# Venture capital

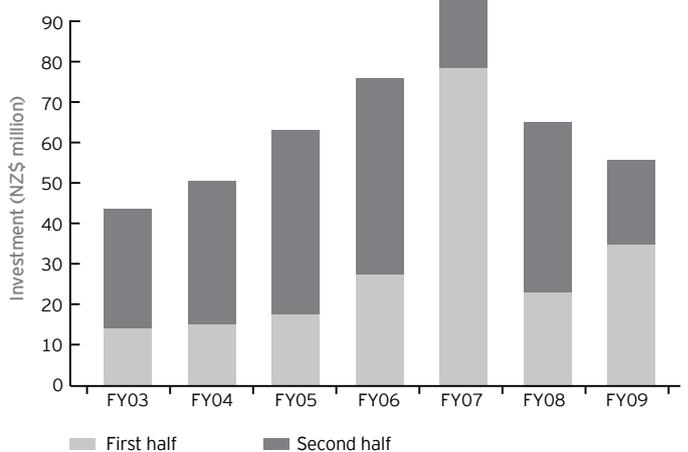
Venture capital – investment/divestment summary



## Venture capital – investment

- ▶ 93 venture capital investments were made in 2009, a substantial increase on 2008, however average investment value declined 52% year-on-year, contributing to a 15% decrease in total investment value compared to 2008
- ▶ The evolution of the angel segment over recent years has seen greater tracking of activity by NZVIF through the Young Company Finance (YCF) publication. The data has provided increased transparency of activity in this segment. Since 2008, YCF information has been captured in the monitor
- ▶ Due to a greater breadth of angel investment data being captured in the Monitor results, there is a higher proportion of angel investments in the 2008 and 2009 data, which contributes to the lower average investment value seen in 2009

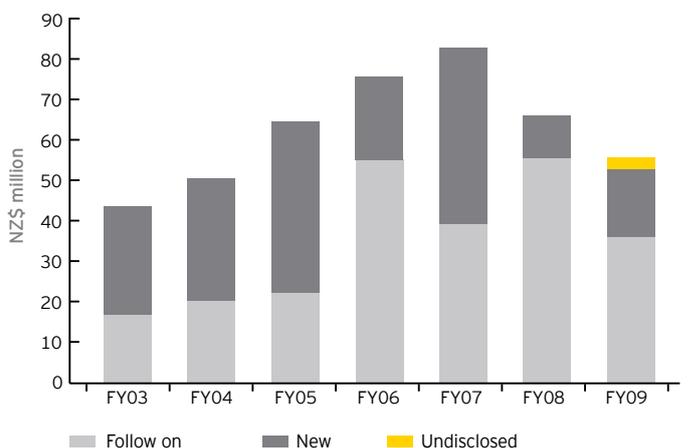
Venture capital investment summary



## Venture capital investment – new vs follow-on

This chart shows the mix of new versus follow-on investment by year, and illustrates a continuation of the trend first observed in 2006 of follow-on investments being the greater proportion of total venture capital investment

Venture capital investment – new vs follow-on



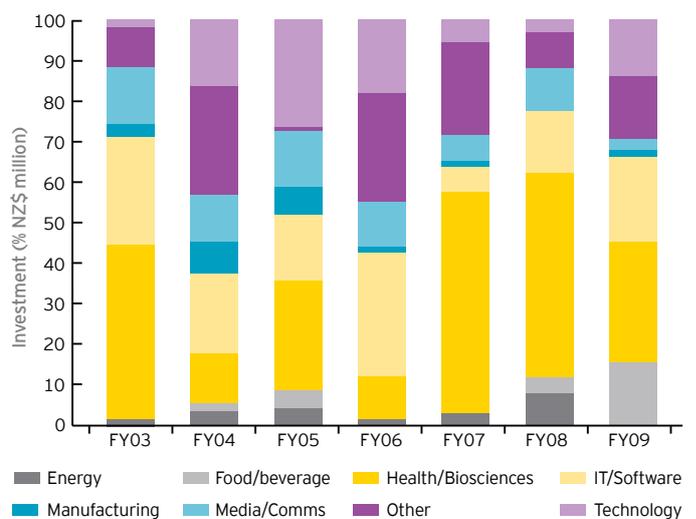
“Ninety-three venture capital investments were made in 2009, including a substantial increase in reported angel investment.”

Colin McKinnon, Executive Director NZVCA

### Venture capital – sector review

The sector mix in 2009 was similar to that seen in 2007 and 2008, with a continuation of significant health/biosciences investments, and increases in food/beverage and technology investments.

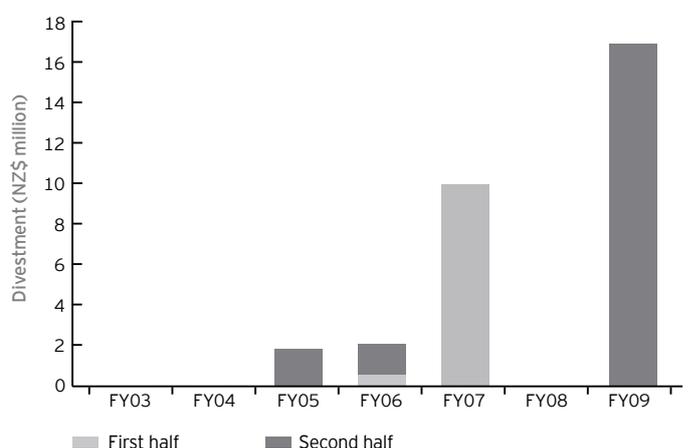
Venture capital investment summary by sector



### Venture capital – divestment

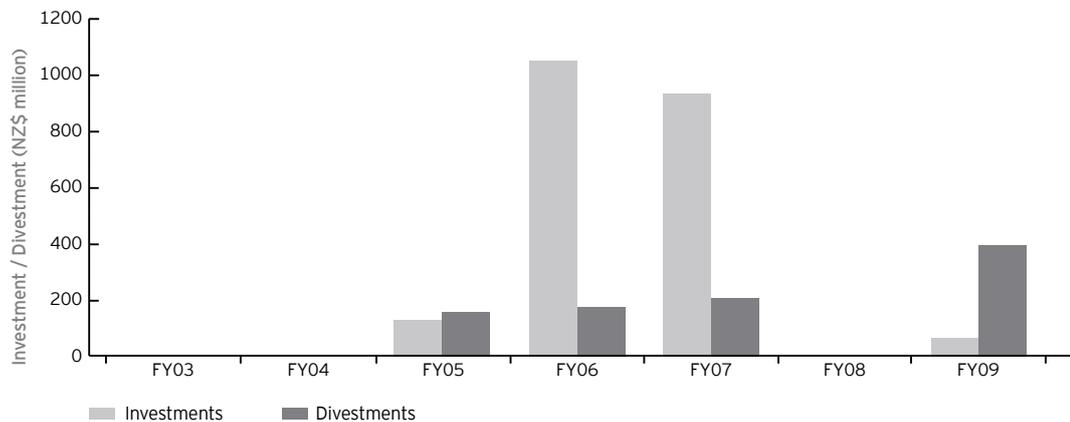
A significant venture capital divestment occurred during 2009 with a sale by TMT Ventures; NZVIF was a co-investor with TMT Ventures in this business.

Venture capital divestment summary



# Top-end/LBO private equity

Top-end/LBO private equity investment/divestment summary



## Overview

- ▶ Consistent with previous monitor reports, top-end/LBO private equity is defined to be deals with an enterprise value of greater than \$150m
- ▶ Following a lack of top-end private equity activity from 2H07 to 1H09, 2H09 saw a return to activity in this segment, with three top-end investments made in this period, two with disclosed deal values totalling \$62.7m, and two divestments with a total value of \$391.5m

## Top-end/LBO private equity – investment

- ▶ Top-end investments included two recapitalisation related follow-on investments, and one new investment
- ▶ The new investment transaction represented Quadrant Private Equity's (Quadrant) investment in Summerset. This deal represented a "secondary" private equity deal with the concurrent AMP exit. No transaction values have been disclosed
- ▶ We note that in early 2010, Quadrant has subsequently undertaken a further investment in Summerset, acquiring the remaining AMP stake

## Top-end/LBO private equity – divestment

- ▶ Two top-end divestments occurred in 2009
- ▶ The Kathmandu dual IPO, jointly listed on the New Zealand and Australian securities exchanges by Goldman Sachs JB Were and Quadrant Private Equity
- ▶ Australian Private Equity fund Archer Capital also divested its holding in Onesource Group
- ▶ Note the inclusion of transactions is based on publicly listed information and further interpolated based on historically utilised debt/equity assumptions where required

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**“The observable 2009 activity  
in the top-end/LBO market is  
encouraging given the absence  
of activity post 2007.”**

Andrew Taylor, Partner Ernst & Young

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# Mid-market resilience anchors private capital investment

Franceska Banga, NZVCA Chair

**The market remains steady. The 2009 year saw New Zealand mid-market resilience and growing angel venture activity with the re-emergence of some activity at the top-end/leveraged buyout level.**

Overall, 2009 saw \$177.6m of private equity investment across 108 deals – broadly the same level of investment as in 2008 but across a larger number of deals. Of this, \$58.7 comprised twelve mid-market investment deals. The mid-market also generated five divestment transactions totalling \$58.9m.

The mid-market remains the one to watch. While activity dropped over 2009 – \$59.7m across 14 deals compared to \$112m invested across 30 deals in 2008, this is the part of the market where we can expect to see future growth. The recent successful capital raisings by Direct Capital (2009) and Maui Capital (2008), amounting to about \$575m, suggest strong institutional investor appetite for New Zealand's private equity industry where there is a proven track record. We can expect to see heightened activity over the next year.

It is good to see the New Zealand Superannuation Fund continuing its participation, with recent new commitments to private equity. The future growth of private equity in New Zealand – particularly at the venture capital and mid-market levels – is dependent on more of New Zealand's institutional investors becoming familiar with the asset class and backing good quality managers.

The venture capital sector saw \$56.2m of investment activity, in line with the annual average level of venture capital investment. Much of this activity was driven by angel investor led deals which has been consistent with experience in places like the United States and Europe. With most of the venture capital managed funds close to or fully committed, angel investors have stepped up activity in the early stage market. The low level of venture capital fund activity and the earlier stage focus angels is reflected in the 52% reduction in average

deal size. Last year's investment activity was across 93 deals at an average deal size of \$604,300, compared to 2008's average of \$1.27m. The challenge is to make sure the best of these companies can get funded in the future.

The existing venture capital funds are, largely, fully invested, and moving into the 'harvesting' phase of their cycles. There was one strong exit during the year and, we hope, more to come. Venture funds are supporting some exciting companies among their portfolios – companies like Orion Health, Phitek, Biovittoria, Open Cloud, Lypanosis, Zephyr, CODA to name just a handful, are all making headway internationally. While this is all good news, the industry faces a major challenge raising new funds in a market where institutional investors have retreated internationally from venture capital as an asset class. In the ordinary course raising second funds is a significant challenge for fund managers. While institutional investor appetite for venture funds may return – it may be too late for some of the current New Zealand VC managers.

The top-end/LBO market returned in 2009 with \$62.7m comprising three top-end investments. It is encouraging to observe activity re-emerging whilst acknowledging that the nature of reported activity includes follow-on investments. It is worthy of mention that the exclusion of the Quadrant transaction from the data does materially reduce reported investment and divestment activity in this segment in the current year.

The overall activity is back at the levels of around 2003 and 2004. The billion dollar years of 2006 and 2007 stand out as abnormal aberrations. Clearly the global financial crisis (GFC) continues to affect our industry, as it is in most developed

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“The track record of New Zealand domiciled private equity funds is impressive. This coupled with the continual demands for capital by many New Zealand-owned businesses provides real opportunity and impetus for this sector and the New Zealand industry more broadly.”

Franceska Banga, Chair NZVCA

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economies. The value of European private equity deals, for example, fell by three-quarters last year to a 15-year low of €17.3bn, according to recently published data. At the peak of Europe's cycle in 2007, €170bn of deals were completed.

The good news is that even in the current “wait and see” approach of most investors, private markets - the largest part of New Zealand's capital markets – remain attractive to experienced institutional investors, as the recent capital raisings have shown. With the government committed to removing or reducing incentives which favour unproductive asset classes, like property, more productive asset classes – such as investing into high growth companies – should benefit from any ensuing greater availability of capital.

The recovering Australian economy will also assist the sector. The GFC has seen Australian pension funds retreat from offshore investments, leading to the absence of the large deals in the New Zealand market which were driven by the activity of those pension funds. When normal service resumes, we would expect to see renewed Australian interest in our private markets given the attractive opportunities which exist, with over 70% of New Zealand's largest 200 companies being unlisted. The ‘institutional’ end of the market - private equity and venture

capital funds – has developed rapidly over the past decade, as the recent Capital Markets Development Taskforce (CMD) report noted. Over the medium to long-term, attracting greater levels of capital into these funds will, inter alia, require an increase in the size of capital pools and the existence of sufficient institutional high-quality investment products at both the fund-of-funds and fund level. The CMD taskforce and the Victoria University of Wellington Tax group heightened focus on how New Zealand deepens and grows its wider capital markets. This remains an important focus of NZVCA on behalf of its members which we will continue to pursue moving forward.

The track record of New Zealand domiciled private equity funds is impressive. This coupled with the continual demands for capital by many New Zealand-owned businesses provides real opportunity and impetus for this sector and the New Zealand industry more broadly. This coupled with institutional support bodes well for this industry as it continues to stake its claim as an important component of our capital markets.

Overall the New Zealand industry is doing remarkably well all things considered. The early indications suggest we may have confidence looking forward to how 2010 shapes up after what can only be described as a challenging economic period.

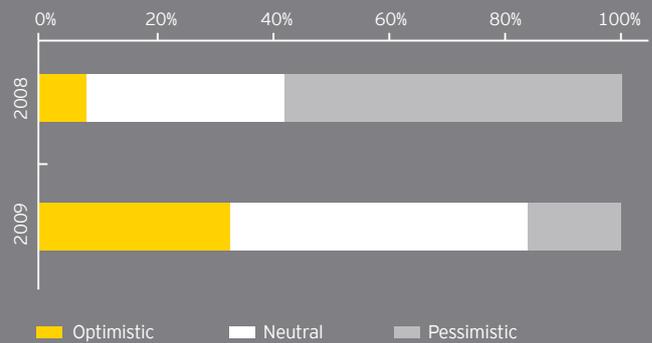
# Pipeline

## Industry outlook

All survey respondents were asked what they felt the outlook was for both the next six months and next 18 months. The outlook for the six and 18 month horizons at the end of 2009 represented a positive transformation from prior year responses.

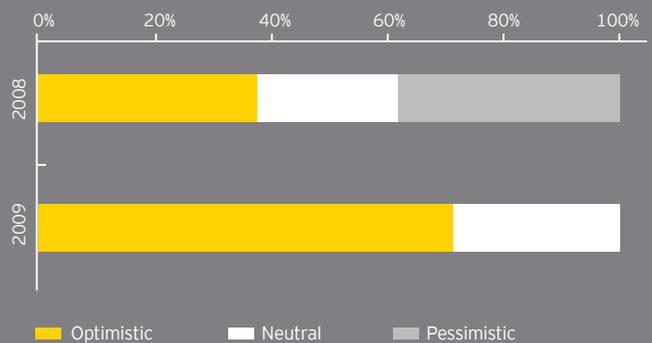
## Next six months

- ▶ 93% of respondents were optimistic or neutral on the short-term outlook at the end of 2009, compared to 46% a year earlier.
- ▶ Expectations for the next six months from fund managers in New Zealand and Australia are very similar.



## Next 18 months

- ▶ Medium-term outlook is also greatly improved from a year earlier, with no respondents pessimistic in outlook for the next 18 months.
- ▶ Expectations for the next 18 months held by Australian fund managers are optimistic, whereas New Zealand fund managers have more cautious expectations.



# Investee plans

Once again, as part of the survey for 2009, we asked survey participants about their investee plans for the next 12 months. It should be noted that these are the plans for new investments made during the respective half years.

There is a strong focus on increasing R&D, recruitment and marketing. The significant increase in the portion of participants focused on recruitment is a notable sign of recovery – during 2008 and 1H09 recruitment was planned by only approximately one third of participants, increasing to 78% by 2H09.

Whilst no respondents indicated plans for new investments in 2H09 to make acquisitions, we note that there is an ongoing desire to grow existing portfolio companies by acquisition.

	1H09	2H09
Increase R&D	56%	78%
Recruit	33%	78%
Launch products	67%	56%
Make acquisitions	11%	0%
Marketing spend	56%	67%
Capex	56%	44%
New markets	33%	44%
Grow exports	33%	44%

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**“Confidence is returning to capital markets. The survey participants reported growing optimism in their market outlook for the next 18 months.”**

Colin McKinnon, Executive Director NZVCA

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# Activity summary

	FY03	FY04	FY05	FY06	FY07	FY08	FY09
<b>Investment (NZ\$ millions)</b>							
Mid-market PE	44.1	157.0	186.5	84.8	205.0	112.0	58.7
Venture capital	43.6	50.2	63.0	75.6	81.9	66.1	56.2
Top-end/LBO PE	0.0	0.0	136.9	1,048.5	937.7	0.0	62.7
<b>Total</b>	<b>87.7</b>	<b>207.2</b>	<b>386.4</b>	<b>1,208.9</b>	<b>1,224.7</b>	<b>178.1</b>	<b>177.6</b>
<b>Investment (no. of deals)</b>							
Mid-market PE	7	18	25	18	23	30	12
Venture capital	42	44	50	77	60	52	93
Top-end/LBO PE	0	0	4	17	2	0	3
<b>Total</b>	<b>49</b>	<b>62</b>	<b>79</b>	<b>112</b>	<b>85</b>	<b>82</b>	<b>108</b>
<b>Divestment (NZ\$ millions)</b>							
Mid-market PE	107.4	10.7	29.2	48.5	60.2	46.5	58.9
Venture capital	0.0	0.0	1.8	2.1	10.0	0.0	17.1
Top-end/LBO PE	0.0	0.0	154.6	172.0	200.0	0.0	391.5
<b>Total</b>	<b>107.4</b>	<b>10.7</b>	<b>185.6</b>	<b>222.6</b>	<b>270.2</b>	<b>46.5</b>	<b>467.5</b>
<b>Divestment (no. of deals)</b>							
Mid-market PE	7	2	4	6	4	10	5
Venture capital	0	0	1	4	3	1	1
Top-end/LBO PE	0	0	1	1	1	0	2
<b>Total</b>	<b>7</b>	<b>2</b>	<b>6</b>	<b>11</b>	<b>8</b>	<b>11</b>	<b>8</b>

# About the survey

## The survey

The New Zealand Private Equity & Venture Capital survey is based on 19 responses received from venture capital and private equity participants in the New Zealand market, including firms from both New Zealand and Australia. We have also included in our analysis any publically announced information. 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 & 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. Contact details are provided below.

## About Ernst & Young Transaction Advisory Services (TAS)

How organizations 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 & 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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