Executive Summary

This report provides an overview of the New Zealand private equity market, with specific focus on the institutional funds management industry. It examines the key features of the market relevant to institutional investors – the size of the market, investment activity, the fund manager landscape and historical returns.

New Zealand presents an attractive private equity investment opportunity for institutional investors, supported by the following features:

1. *Demand/Supply Imbalance Creates Conditions for Attractive Investments* – The demand for risk capital and capital to finance growth from New Zealand companies exceeds supply and this imbalance is likely to persist. This creates an opportunity for private equity and venture capital fund managers to generate attractive returns.

2. *Cohort of Experienced Fund Managers* – The New Zealand private equity and venture capital market has a cohort of experienced fund managers that have managed multiple institutional funds and invested across economic cycles. Fund structures are amenable to local and international investors, and taxation and legal conditions conducive to institutional investment.

3. *Private Equity Returns are Compelling* – New Zealand private equity returns are competitive with private equity returns in other developed private equity markets. A particular attraction of the New Zealand private equity market is its focus on small and mid-sized business operating in industries where New Zealand has international competitive advantages.
About New Zealand

New Zealand is a mixed market economy comprising primary industries (agriculture, forestry and fishing), manufacturing and services. Political and legal institutions are well established, open and transparent. The economy is dominated by small and mid-sized private companies and internationally-focused, with international trade comprising an important part of gross domestic product. While capital markets are relatively small, there is a robust private capital market. New Zealand is ranked well in terms of pre-conditions necessary for private equity investment.

Natural Endowments, Demographics and Political System

New Zealand is located on the Pacific Rim with a temperate climate. Comparable in land mass to the United Kingdom (or the Philippines), the country has 4.5 million people. The workforce is well educated, with over 75% of the population (aged 25-64) having secondary or tertiary education qualifications, above the OECD average.

The political system is a parliamentary democracy and constitutional monarchy, based on a proportional representation electoral system. Legal institutions are English common law, providing a well-defined, open and transparent business environment. In addition, the taxation system is seen as business friendly, with double tax treaties with 35 countries.

Small Open Economy

New Zealand is a small open economy with strong trade relationships across the Asian region. Gross domestic product in 2014 was estimated to be US$ 200 billion (current dollars), with the major contributors being the services sector, manufacturing (in particular, light manufacturing) and the primary sector (agriculture, forestry and fishing). Economic activity is concentrated in Auckland (approximately 35% of gross domestic product), Wellington and Canterbury.

New Zealand Gross Domestic Product by Sector (by value)

New Zealand has international comparative advantages based on its primary production sector. This has led to globally competitive companies in food and beverage, biotechnology (agriculture, food, environmental) and cleantech, as well as specialised manufacturing (marine, food processing, agricultural equipment). Indeed, New
Zealand’s top three exports are located in the primary sector – dairy products (milk powder, butter, cheese), meat, and timber. More recently New Zealand’s information technology and creative industries have attracted investment attention, especially in screen production and digital animation.

International trade is an important component of economic activity. New Zealand’s top five trading partners account for approximately 55% of traded goods (exports and imports).

New Zealand International Trade – Top Five Trading Partners 2013 (by value)

<table>
<thead>
<tr>
<th>Exports</th>
<th>%</th>
<th>Imports</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>23</td>
<td>Australia</td>
<td>20</td>
</tr>
<tr>
<td>China</td>
<td>15</td>
<td>China</td>
<td>13</td>
</tr>
<tr>
<td>U.S.A.</td>
<td>10</td>
<td>U.S.A.</td>
<td>10</td>
</tr>
<tr>
<td>Japan</td>
<td>6</td>
<td>Japan</td>
<td>5</td>
</tr>
<tr>
<td>U.K.</td>
<td>4</td>
<td>Singapore</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>58</td>
<td>Total</td>
<td>53</td>
</tr>
</tbody>
</table>

Source: Statistics New Zealand, New Zealand in Profile 2014

Four of the top five trading partners are located in the Asian region. Approximately 50% percent of exports are primary products (including food and beverage manufacturing), and 70% of imports manufactured goods. New Zealand has free trade agreements with major trading partners including Australia, China and ASEAN.

Private Companies

The private company sector plays an important role in the economy. Indeed, the business sector is largely comprised of unlisted companies. The New Zealand domestic stock market capitalisation is below 50% of gross domestic product, while other developed economies have experienced significant growth in public equity markets since the 1990s.

Stock Market Capitalisation (% GDP)

Source: World Bank World Databank, World Development Indicators
Statistics New Zealand reports that there are over 11,000 small and mid-sized companies in New Zealand with between 20 and 100 employees – a large majority of these companies are private.

**Strong Preconditions for Private Equity**

The economic, legal and social environment in New Zealand provides strong preconditions for private equity investment. New Zealand is ranked the 11th most attractive market for private equity globally (out of 118 countries), comparable to European markets such as France, The Netherlands, Norway and Denmark.\(^1\) Furthermore, New Zealand’s private equity and venture capital markets attractiveness ranking has strengthened over the last five years.

**New Zealand Private Equity & Venture Capital Market Attractiveness 2007-2012**

![Chart showing New Zealand's attractiveness ranking in private equity and venture capital markets from 2007 to 2014.]

Source: Groh, Liechtenstein and Lieser (2014)

Once rankings are adjusted for New Zealand’s relatively small capital markets, the country is placed in the top quartile globally in key features such as investor protection and governance, taxation, human and social environment (education, human capital), and entrepreneurial culture and deal opportunities.

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The Private Equity Market

The New Zealand economy provides attractive investment opportunities for private equity. Foremost, as discussed above, the economy is dominated by private companies which raise capital outside established stock markets. Second, small and medium sized enterprises are important players in many sectors of the economy – notably, light manufacturing, agribusiness, consumer retail, services, healthcare, and leisure. Many of these companies were established in the second half of the twentieth century and are now facing succession issues, or are positioned for expansion into adjacent markets in Australia and Asia. The most efficient way (typically) for an institutional investor to invest in these private equity opportunities is through local private equity fund managers. In this section we examine the key features of the New Zealand private equity market relevant to institutional investors – the size of the market (funds raised and number of firms), investment activity, the fund manager landscape, and historical performance.

Market Size

Institutional investment in New Zealand private equity and venture capital fund managers began in earnest in the early 2000s. To be sure, private equity investment had flourished in New Zealand prior to this decade, but the institutional market was relatively small. The early success of private equity transactions, increasing domestic institutional interest in alternative assets and “stimulus” from the government sponsored New Zealand Investment Fund (NZVIF) coincided in the early 2000s to create conditions for unprecedented growth in assets under management.

Private Equity and Venture Capital Funds Raised 1993-2013

Between 2002 and 2013 New Zealand based fund managers raised in excess of $2.0 billion in over two dozen private equity and venture capital funds. In several years, fund raising exceeded $300 million per annum through multiple funds raised, providing adequate scale for an institutional investor seeking to deploy capital. The number of funds raised has been relatively evenly distributed between private equity and venture capital.

Source: NZVCA; LECG; firm websites

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2 We adopt the term private equity to denote fund managers specialising in investments in majority (buyout) and minority (expansion or growth) equity positions in established companies. Venture capital fund managers invest in start-up and early stage companies.
3 The New Zealand institutional private equity market has its genesis in the Greenstone Fund (1993), a government-private sector fund established to invest in private companies. The fund was managed by Pencarrow Private Equity Limited. Direct Capital was established in 1994 and raised its first private equity fund targeting private companies.
firms, although private equity funds have been more successful at raising multiple funds. Indeed, the three most active private equity firms have raised four private equity funds (on average), and have almost 20 years investment experience. Institutional investment in the venture capital market has received strong government-private sector support through the New Zealand Venture Investment Fund program.

**Investment Activity**

The private equity and venture capital industry has posted robust investment activity since the early 2000s, as a result of increases in the number of private equity fund managers and the “demonstration effect” of successful private equity transactions on investor appetite for excess returns. Private owners have been increasingly willing to engage with private equity as a viable provider of capital.

Private equity and venture capital investment activity in New Zealand is around 80 transactions per year (by median) with equity investment of approximately $300 million per year (median). There are typically 50-70 venture capital transactions per year and 15-25 private equity transactions. By value, private equity comprises the largest component of investment activity.

Source: NZVCA

In addition to institutional venture capital investment activity, start-up and early stage companies raise finance from an active angel investor market comprising around $40 million in 2012-2013.4

Private equity investment activity is predominantly in small and mid-sized companies with enterprises values less than $150 million. Analysis of investment activity by enterprise size (by number and value) shows that small and mid-sized transactions are 90% of all deals by number and at least 70% by value (excluding the two years 2006 and 2007).

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4 The New Zealand Angel Association and the New Zealand Venture Investment Fund’s Seed Co-Investment Fund program are important players in this part of the venture capital market. For further details, see NZ Young Company Finance (various issues).
This feature of the market is important for institutional investors. Small and mid-sized companies are the largest part of the New Zealand economy and capital raising for these companies is typically less intermediated than for larger companies. The industry has not been immune to larger buyouts where the use of financial leverage was important in securing the transaction and generating returns. The global boom in buyout activity in 2006 and 2007 found its way to New Zealand in the guise of several high profile transactions – for example, New Zealand Yellow Pages, MediaWorks, and Independent Liquor Group. Investment activity increased markedly between 2005 and 2006 – the participants in these transactions were global buyout firms or larger regional/Australian players (rather than local managers) purchasing large capitalisation businesses.

A sector breakdown of venture capital and private equity investment for the five years 2009-2013 shows that investors gain exposure to core areas of the New Zealand economy including distribution and transportation, agribusiness, food and beverages, healthcare, utilities (including energy) and the industrials and manufacturing sectors. Investment in start-up and early stage companies (through venture capital) is concentrated in the health and biosciences, information technology, services and technology sectors.

Source: NZVCA
Private equity has developed over the last 15 years to be an important player in the New Zealand M&A and private placement market.

**Private Equity as a Percentage of M&A Activity**

![Chart showing Private Equity as a Percentage of M&A Activity from 2006 to 2013.](chart)

Source: Capital IQ/AVCAL

Private equity transactions have typically accounted for 5% to 10% of M&A activity by number and value (median 8% by number and 8% by value).

**Fund Manager Landscape**

The New Zealand private equity and venture capital market is serviced by approximately 15 local fund managers. In addition, Australian and larger regional/global firms are opportunistic investors with a focus on larger market capitalisation businesses.

A fund manager map for the New Zealand market, categorised by the location of the fund manager and their investment focus (as determined by their investment strategy's target enterprise size), is presented below.

New Zealand private equity fund managers are concentrated in the small and mid-cap space consistent with the structure of the economy. In addition, there is a robust start-up and early stage growth sector serviced by venture capital firms. New Zealand based fund managers are the main participants in these sectors of the market, and have demonstrated consistent transaction capabilities.

Some Australian, regional (Pan-Asian) and global private equity fund managers have also canvassed private equity investment opportunities in New Zealand. Our market map lists firms which have completed at least one transaction in New Zealand in the last ten years. Large cap private equity transactions are more likely to be completed by non-New Zealand private equity fund managers – typically from Australia. However, as we noted previously such transactions are relatively uncommon.

Institutional investors need to be aware of nuances in the New Zealand private equity fund manager landscape. The small and mid-cap market represents the overwhelming majority of private equity transactions each year. This market is serviced predominantly by local private equity fund managers. Institutional investors will only achieve meaningful exposure to New Zealand private companies by investing with New Zealand based fund managers.
### New Zealand Private Equity and Venture Capital Manager Map

**Enterprise Size**

<table>
<thead>
<tr>
<th>New Zealand-Based Firms</th>
<th>Australia-Based Firms*</th>
<th>Regional/Global Firms*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Large cap</strong> (EV &gt; $150 m)</td>
<td>Archer Capital CHAMP Ironbridge Capital Quadrant Private Equity Pacific Equity Partners</td>
<td>Affinity Equity Partners Blackstone Unitas Capital</td>
</tr>
<tr>
<td><strong>Small &amp; mid-cap</strong> (EV &lt; $150 m)</td>
<td>Direct Capital Knox Investment Partners Maui Capital Pencarrow Private Equity Pioneer Capital Waterman Capital</td>
<td>Anchorage Capital Catalyst Investment Managers CHAMP Ventures Crescent Capital Equity Partners Mercury Capital Next Capital Propel Investments Wolseley Private Equity</td>
</tr>
<tr>
<td><strong>Start-ups/Early stage growth</strong> (EV &lt; $15 m)</td>
<td>BioPacific Ventures Endeavour Capital Movac No.8 Ventures Pan-Pacific Capital TMT Ventures</td>
<td>CM Capital GBS Bioventures</td>
</tr>
</tbody>
</table>

* Fund managers that have completed at least one New Zealand deal in the last 10 years
New Zealand Private Equity Returns

Institutional investors can draw upon several recent studies on realised private equity transactions to assess the performance characteristics of New Zealand private equity. These studies show that realised private equity returns to New Zealand transactions are attractive. A NZVIF study of 92 realised private equity investments in New Zealand between 1994 and 2012 found that median (average) returns to New Zealand private equity deals were 22.0% per annum (33.7% per annum), with aggregate return on investment of 2.1 times cost.5

The distribution of realised private equity returns in the NZVIF sample shows that over 70% of transactions have delivered returns above investment cost, with approximately 40% returning greater than 2 times cost. The percentage of investments which did not deliver investment cost (29%) is not unusual for private equity, and in line with other developed private equity markets.

The NZVIF sample shows that private equity investments have been realised by trade sale to corporations (35% of all exits), sale to existing management (29%) and to financial buyers (typically secondary transactions to private equity firms; 25%).

Source: New Zealand Venture Investment Fund (2012)

The Investment Opportunity

Private equity provides institutional investors the opportunity to generate attractive risk-adjusted returns by investing in less efficient parts of capital markets.

New Zealand presents an attractive private equity investment opportunity for institutional investors, supported by the following features:

Demand/Supply Imbalance Creates Conditions for Attractive Investments
The demand for risk capital and capital to finance growth from New Zealand companies exceeds supply and this imbalance is likely to persist. This creates an opportunity for private equity and venture capital fund managers to generate attractive returns.

Cohort of Experienced Fund Managers
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Private Equity Returns are Compelling
New Zealand private equity returns are competitive with private equity returns in other developed private equity markets. A particular attraction of the New Zealand private equity market is its focus on small and mid-sized business operating in industries where New Zealand has international competitive advantages.
More Information

For more information on the New Zealand venture capital and private equity market:

New Zealand Private Equity and Venture Capital Association
www.nzvca.co.nz

New Zealand Venture Investment Fund Limited
www.nzvif.co.nz

Investment in New Zealand

Continuity Capital Partners Pty Limited
www.continuitycp.com

This work is based on market research and analysis of information provided to Continuity Capital Partners Pty Limited (Continuity Capital) by the New Zealand Private Equity and Venture Capital Association Incorporated (NZVCA) and New Zealand Venture Investment Fund Limited (NZVIF). Continuity Capital has referenced all publicly available information and ensured that this work is complete and accurate in all material respects to the extent the necessary information is within the reasonable control of, or reasonably capable of verification by, Continuity Capital.

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