

The New Zealand Private Equity Market

An Overview for Institutional Investors

July 2020

Report prepared for the New Zealand Private Capital Association



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, capital available for investment (“dry powder”), 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. The market has deepened over the last ten years, as evidenced by an increase in the number of private equity and venture capital fund managers investing in New Zealand companies and the number and type of limited partners supporting fund raisings. 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 businesses 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 is 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

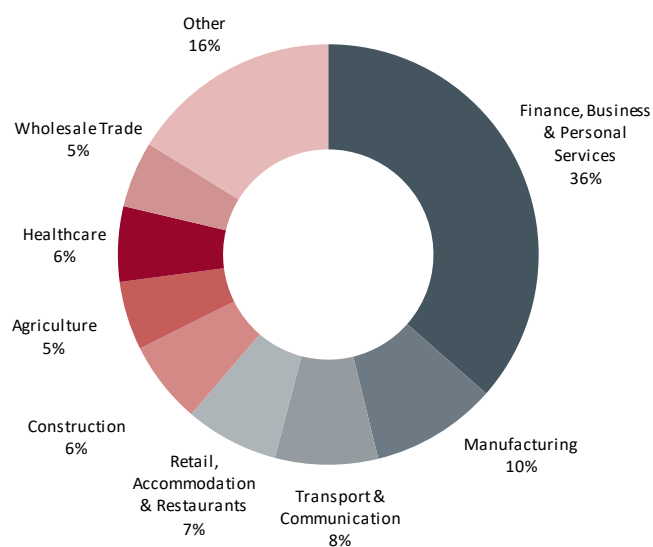
New Zealand is located on the Pacific Rim with a temperate climate. Comparable in land mass to the United Kingdom (or the Philippines), the country has 5.0 million people. The workforce is well educated, with more than 75% of the population (aged 25-64) having secondary or tertiary education qualifications, 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, having double tax treaties with more than 30 countries.

Small Open Economy

New Zealand is a small open economy with strong trade relationships across the Asian region. Gross domestic product in 2019 was estimated to be \$250 billion (current dollars), diversified across the services sector, manufacturing (in particular, light manufacturing), transport and communication, construction, the primary sector (agriculture, forestry and fishing) and healthcare. Economic activity is concentrated in Auckland (approximately 35% of gross domestic product), Hamilton, Wellington and Christchurch.

New Zealand Gross Domestic Product by Sector (by value, constant prices)



Source: Statistics New Zealand, 2019 data

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 dairy products (milk powder, butter, cheese), tourism, and meat. More recently New Zealand’s information technology and creative industries have attracted investment attention, especially in screen production and digital animation. We note, however, that tourism will be significantly impacted in at least the current year by the global COVID-19 pandemic.

International trade is an important component of economic activity. New Zealand’s top five trading partners account for approximately 60% of traded goods (exports and imports).

New Zealand International Trade – Top Five Trading Partners 2019 (by value)

Exports	%	Imports	%
China	23	China	16
Australia	17	Australia	16
U.S.A.	11	U.S.A.	11
Japan	5	Germany	5
U.K.	4	Japan	5
Total	59	Total	53

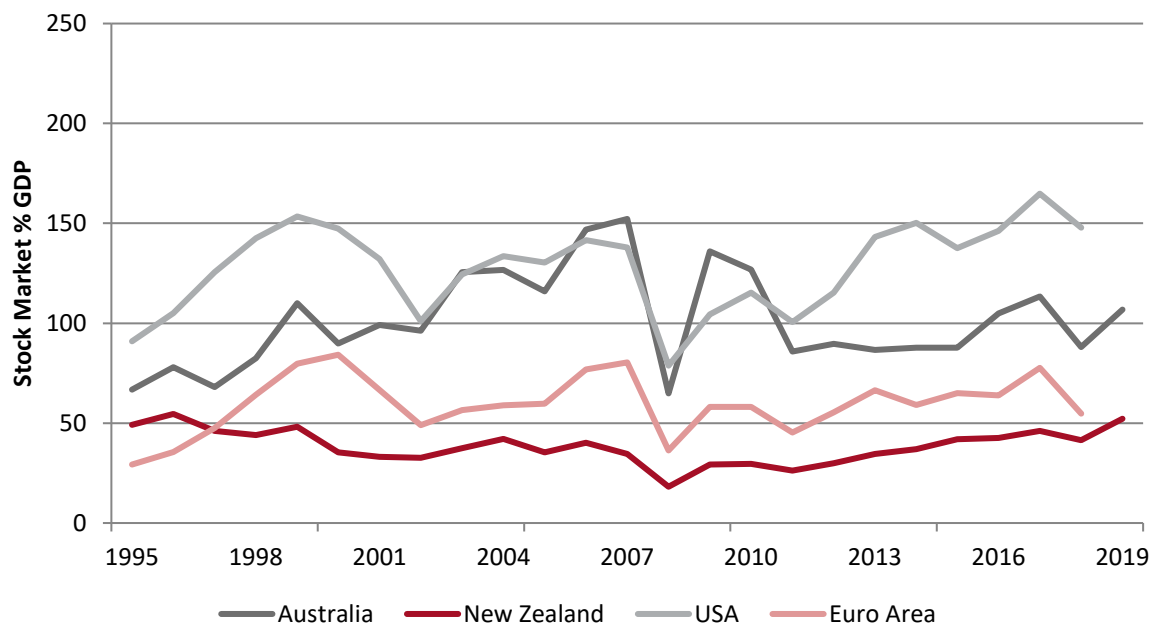
Source: Statistics New Zealand. International trade comprises goods and services

Three of the top five trading partners are located in the Asian region and New Zealand has free trade agreements with all 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 approximately 50% of gross domestic product, below the U.S.A., Australia and the Euro area.

Stock Market Capitalisation (% GDP)



Source: World Bank World Databank, World Development Indicators

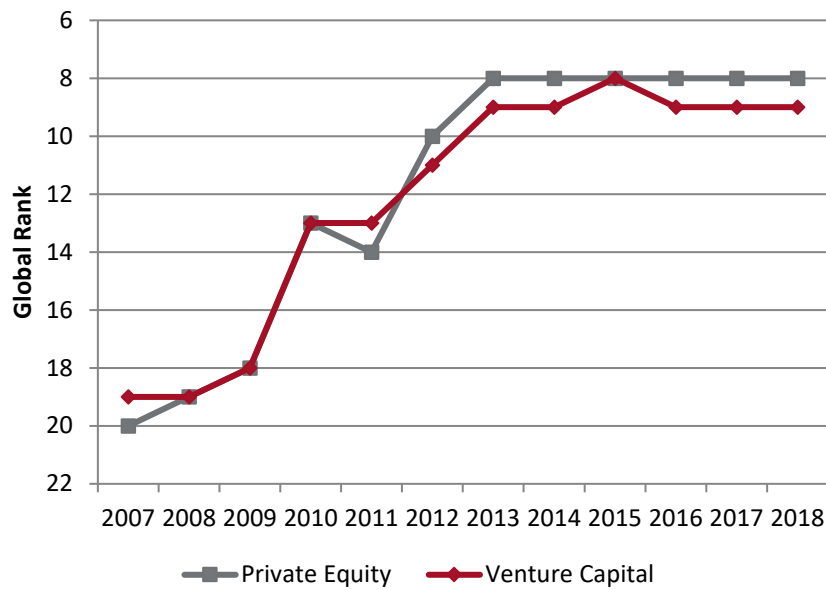
Statistics New Zealand reports that there are over 11,000 small and mid-sized companies in New Zealand with between 20 and 100 employees – a large majority of these companies are private.

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 8th most attractive market for private equity globally (out of 125 countries), comparable to European markets such as Germany, Switzerland, Denmark and Norway.¹ Furthermore, New Zealand's private equity and venture capital markets attractiveness ranking has strengthened over the last fifteen years.

¹ See Groh, A., Liechtenstein, H., Lieser, K. and Biesinger, M. (2018) *The Venture Capital and Private Equity Country Attractiveness Index 2018*, IESE Business School, University of Navarra.

New Zealand Private Equity & Venture Capital Market Attractiveness 2007-2018



Source: Groh, Liechtenstein and Lieser (2018). Inverted scale

Once rankings are adjusted for New Zealand's relatively small capital markets, the country is placed in the top 5% globally in key features such as investor protection and governance, taxation, human and social environment (education, human capital).

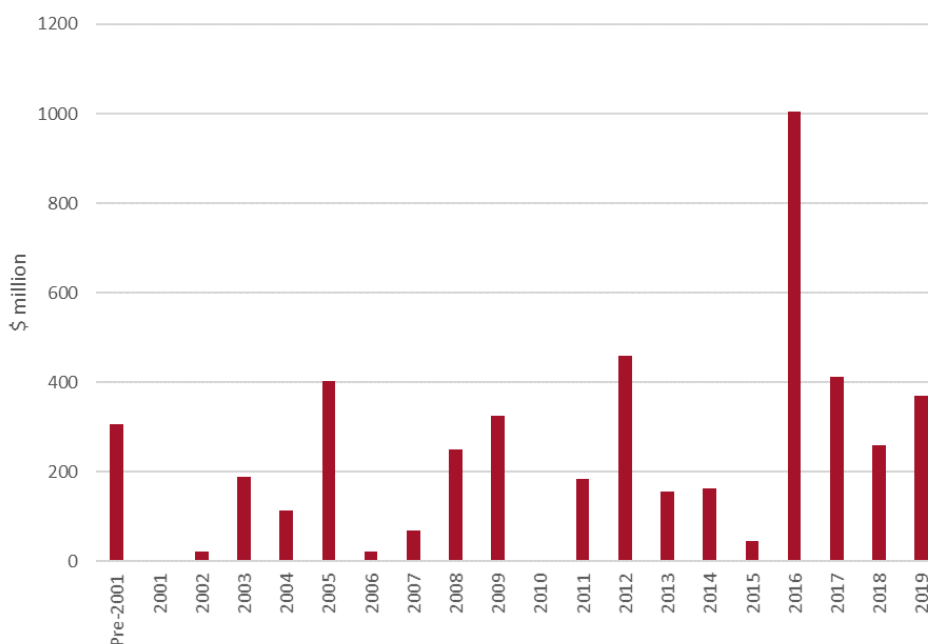
The Private Equity Market

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), types of investors (limited partners), investment activity, the fund manager landscape, capital available for investment (“dry powder”), and historical performance.

Market Size

Institutional investment in New Zealand private equity and venture capital fund managers began in earnest in the early 2000s.² To be sure, private equity investment had flourished in New Zealand prior to this decade, but the institutional market was relatively small.³ The early success of private equity transactions, increasing domestic institutional interest in alternative assets and “stimulus” from the government sponsored New Zealand Venture Investment Fund (now known as New Zealand Growth Capital Partners) coincided in the early 2000s to create conditions for unprecedented growth in assets under management.

Private Equity and Venture Capital Funds Raised 1993-2019



Source: Source: New Zealand Private Capital Association; LECG; firm websites

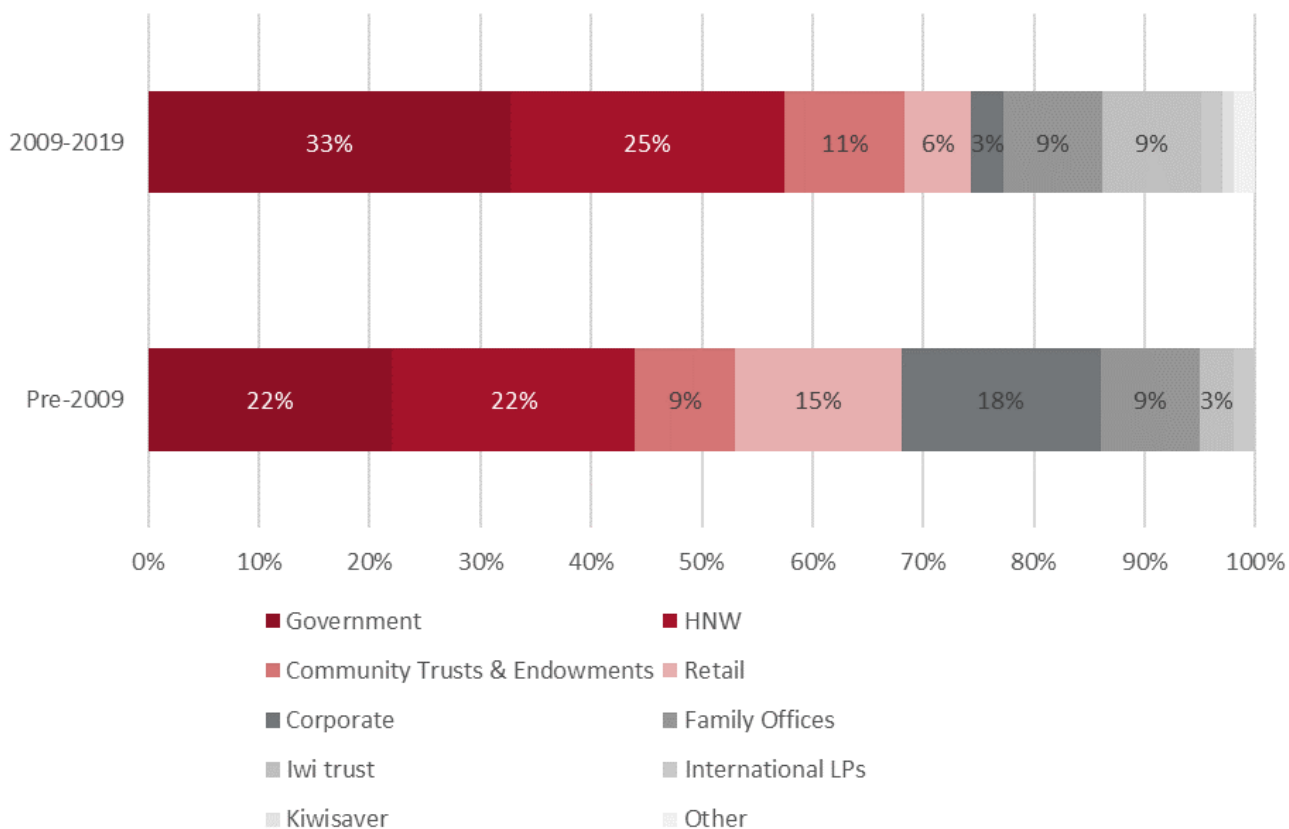
² We adopt the term private equity to denote fund managers specialising in investments in majority (buyout) and minority (expansion or growth) equity positions in established companies. Venture capital fund managers invest in start-up and early stage companies.

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.

Between 2010 and 2019 New Zealand based fund managers raised in excess of \$3.0 billion in over two dozen private equity and venture capital funds. Since 2016 total fund raising has typically exceeded \$300 million per year 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 firms, and there is an increasing number of fund management firms (private equity and venture capital) that have raised multiple funds. Indeed, the five most active firms have raised three or more funds (on average) and have more than 20 years' investment experience. Institutional investment in the venture capital market has received strong government-private sector support, initially through the New Zealand Venture Investment Fund programs (venture capital fund and seed fund investments) and more recently with the New Zealand Growth Capital Partners Elevate NZ Venture Fund (\$300 million fund of funds program).

The deepening of the New Zealand private equity market over the last ten years is also illustrated by an increase in the number and types of limited partners investing in private equity and venture capital funds. The graphs below show the types of limited partners in New Zealand private equity and venture capital funds for two time periods – pre-2009 and 2009-2019.

Type of Limited Partners in New Zealand Funds



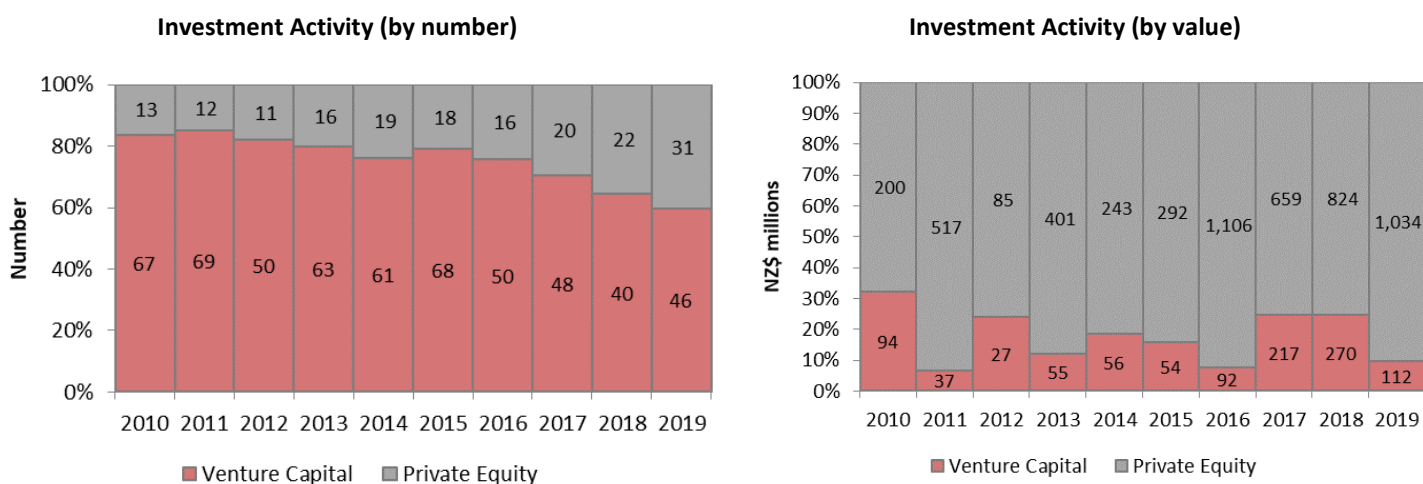
Source: Cambridge Associates (2019)

Government entities (e.g. Accident Compensation Corporation; New Zealand Superannuation Fund; New Zealand Government Superannuation Authority) provide the largest proportion of funds to the domestic industry (22% of all funds raised pre-2009; 33% of all funds raised 2009-2018). High net worth investors are also an important investor group, with commitments to funds usually brokered through wealth management firms. Over time, retail offerings and corporations have decreased in importance as providers of funds while a number of groups such as community trust, endowments, and iwi trusts have increased in importance.

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. 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 in the last ten years has been around 80 transactions per year (by median) with equity investment of approximately \$550 million per year (median). There are typically 50-70 venture capital transactions per year and 20-30 private equity transactions. By value, private equity comprises the largest component of investment activity.

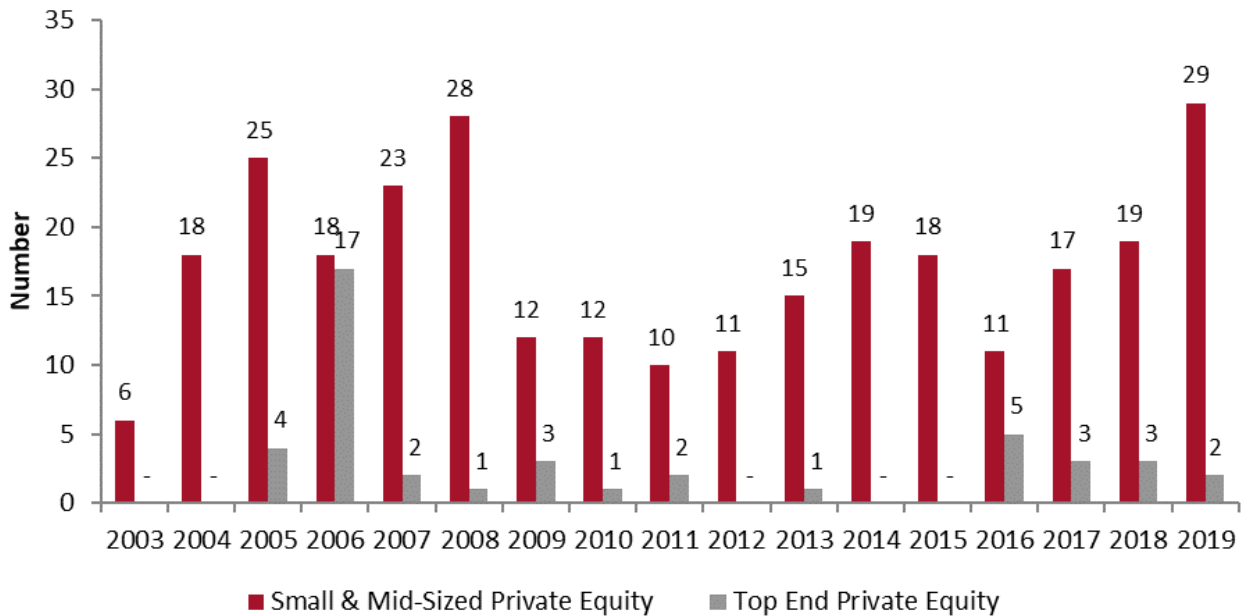


Source: New Zealand Private Capital Monitor

In addition to institutional venture capital investment activity, start-up and early stage companies raise finance from an active angel investor market.

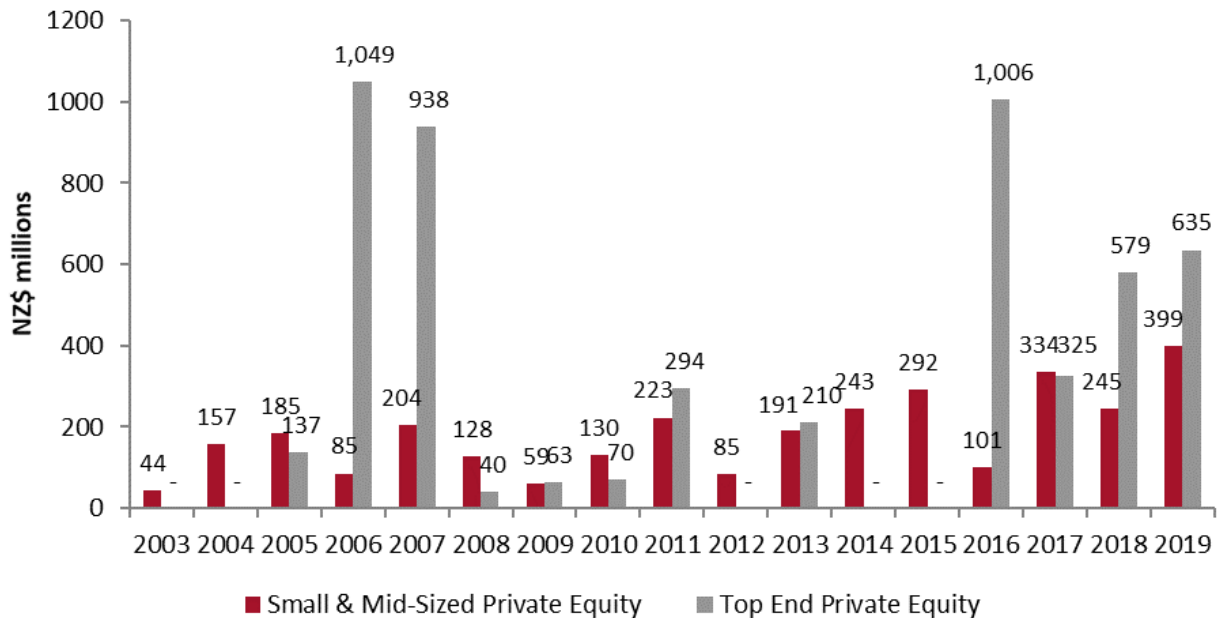
Private equity investment activity is predominantly in small and mid-sized companies with enterprise values less than \$150 million. Analysis of investment activity by enterprise size shows that small and mid-sized transactions are at least 90% of all deals by number each year.

Private Equity Investment Activity (by number)



Private equity investment activity by value (equity invested) is more evenly distributed between small and mid-sized private equity and larger deals (“Top end private equity”) which, by definition, require more equity.

Private Equity Investment Activity (by value)



Source: New Zealand Private Capital Monitor

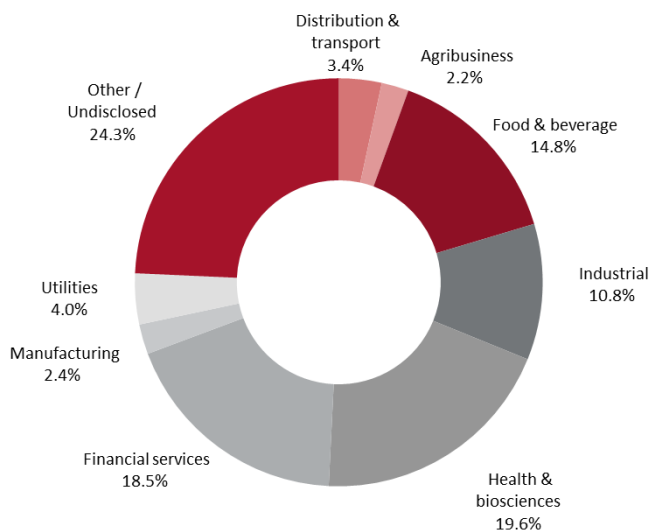
The fact that the number of private equity deals each year is dominated by small and mid-sized business should be noted by institutional investors. Small and mid-sized companies are the largest part of the New Zealand economy and capital raising for these companies is typically less intermediated than for larger companies. Therefore, private equity can provide institutional investors access to parts of the economy less represented on the New Zealand Stock Exchange.

The private equity industry has featured larger buyouts, although the number of deals is typically only one or two per year. 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. Since 2016 there has been a re-emergence of larger private equity deals in New Zealand, again with most transactions completed by offshore private equity firms. Another notable feature in recent years has been several private equity bids for publicly listed companies (“public-to-privates”) including Abano Healthcare Group and Metlifecare.

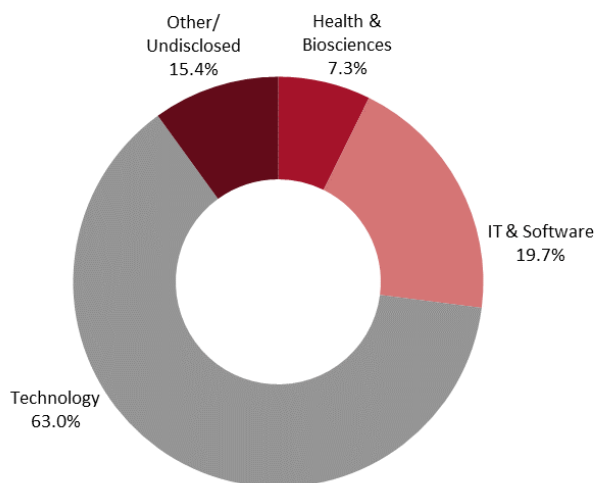
The increase in investment activity has meant that private equity is an important part of the New Zealand M&A and private placement market. Private equity transactions have typically accounted for 5% to 10% of M&A activity by number of deals and value of deals each year.

A sector breakdown of venture capital and private equity investment for the five years 2015-2019 is provided in the graphs below. Private equity delivers investors exposure to core areas of the New Zealand economy including financial services, healthcare, industrials, food and beverages, utilities (including energy), distribution and transportation, manufacturing, and agribusiness sectors.

**Private Equity Investment by Sector
2015-2019**



**Venture Capital Investment by Sector
2015-2019**



Source: New Zealand Private Capital Monitor

Investment in start-up and early stage companies (through venture capital) is concentrated in the technology, information technology and software and health and biosciences sectors.

Fund Manager Landscape

The New Zealand private equity and venture capital market is serviced by approximately 20 local fund managers. In addition, Australian and larger regional/global firms are opportunistic investors with a focus on larger businesses.

The New Zealand fund manager landscape is presented overleaf, categorising fund managers by location and their investment focus (as determined by their investment strategy's target enterprise size).

New Zealand private equity fund managers are concentrated in the small and mid-cap space consistent with the structure of the local business landscape which provides the major source of private equity deals. In addition, there is a robust start-up and early stage growth sector serviced by venture capital firms.

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 more than a dozen firms that have completed at least one transaction in New Zealand in the last five years (many firms have completed several deals).

Large private equity transactions (enterprise values greater than \$150 million) 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 irregular.

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 Landscape

Target Enterprise Size	<i>New Zealand-Based Firms</i>	<i>Australia-Based Firms*</i>	<i>Regional/Global Firms*</i>
<i>Large cap (EV > \$150 m)</i>	--	CPE Capital Pacific Equity Partners Quadrant Private Equity	Advent International Blackstone Group HgCapital TA Associates
<i>Small & mid-cap (EV < \$150 m)</i>	Direct Capital Genesis Private Equity Maui Capital Milford Private Equity NZ Equity Partners Oriens Capital Pencarrow Private Equity Pioneer Capital Rangatira Investments Waterman Capital	Adamantem Capital Advent Partners Allegro Funds Archer Capital Catalyst Investment Partners Crescent Capital Five V Capital Livingbridge Mercury Capital Navis Capital Partners Pemba Capital Partners Point Nine Capital The Growth Fund	Kestrel Capital Kirkwood Capital Oaktree Capital The Riverside Company Winona Capital
<i>Start-ups/Early stage growth</i>	Cure Kids Ventures Global from Day One Icehouse Ventures Impact Investment Fund Movac Punakaiki Fund Soul Capital WNT Ventures Zino Ventures	AirTree Ventures Blackbird Ventures Brandon Capital OneVentures Partners for Growth	8i Ventures Bessemer Venture Partners Bonfire Ventures Flybridge Capital Partners Horizons Ventures GRC SinoGreen Khosla Ventures Promus Ventures Rincon Venture Partners Tessera Capital

* Fund managers that have completed at least one New Zealand deal in the last 5 years (2015-2019)

Recent Fund Raisings and Dry Powder

The increase in size and depth of the New Zealand private equity market over the last ten years has increased the availability of capital for private companies. There are typically 50-70 venture capital transactions per year and 20-30 private equity transactions completed by more than three dozen local and offshore fund managers. Since 2016 annual fund raising has typically exceeded \$300 million raised by multiple funds and several funds have raised capital in 2020 (pre- and during the COVID-19 pandemic). How much capital is currently available for investment (dry powder) and how does this compare to previous periods?

We have calculated dry powder available in the New Zealand private equity market from publicly available information on recent fund raising and a survey of the leading domestic firms. Our estimates exclude the New Zealand Growth Capital Partners Elevate NZ Venture Fund (\$300 million fund of funds program) but make an allowance for Australia-based firms which invest in New Zealand.

	NZ\$m	Three-Year Investment (per annum) NZ\$m
<i>New Zealand Funds</i>		
Existing Dry Power	575	
New Funds Raised 2019/2020 ⁴	625	
New Zealand based dry powder	1,200	400
<i>Australian Funds</i> ⁵	7,700	
10% invested in New Zealand	770	257
20% invested in New Zealand	1,540	513
<i>Total Dry Powder</i>		
Low	1,200	400
Mid	1,970	657
High	2,740	913

We estimate that there is between \$1.2 billion and \$2.7 billion of dry powder available for New Zealand private equity and venture capital investment over the next few years, assuming no further fundraising. This corresponds to a three-year investment rate of between \$400 million and \$913 million per annum. New Zealand funds have approximately \$1.2 billion available for investment, while Australian funds have the potential to invest between \$770 million and \$1.54 billion into New Zealand deals (10% to 20% of current funds).

The amount of dry powder per annum (\$400 million and \$913 million) is below the average annual investment rate for the previous three years (2016 to 2019), when \$1.04 billion per annum was invested in private equity and venture capital deals.

⁴ We have assumed that 85% of new funds raised is available for investment, with 15% reserved for management fees and expenses.

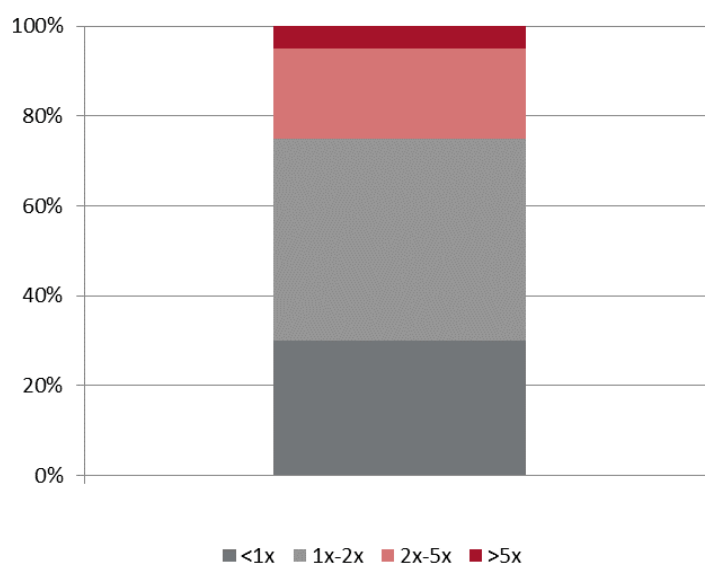
⁵ Total Australian private equity and venture capital fund raising for 2018 and 2019, converted to New Zealand dollars at A\$1.00 = NZ\$1.05.

New Zealand Private Equity Returns

There is strong empirical evidence that realised private equity returns to New Zealand transactions are attractive from an internal rate of return and multiple on cost perspective.

Cambridge Associates provides company level data for 176 private equity investments in New Zealand since 1998. The distribution of realised private equity returns (64 investments) in the Cambridge Associates sample shows that approximately 70% of transactions have delivered returns above investment cost, with approximately 25% returning greater than 2 times cost (gross).

New Zealand Private Equity Returns – Multiple on Cost Invested

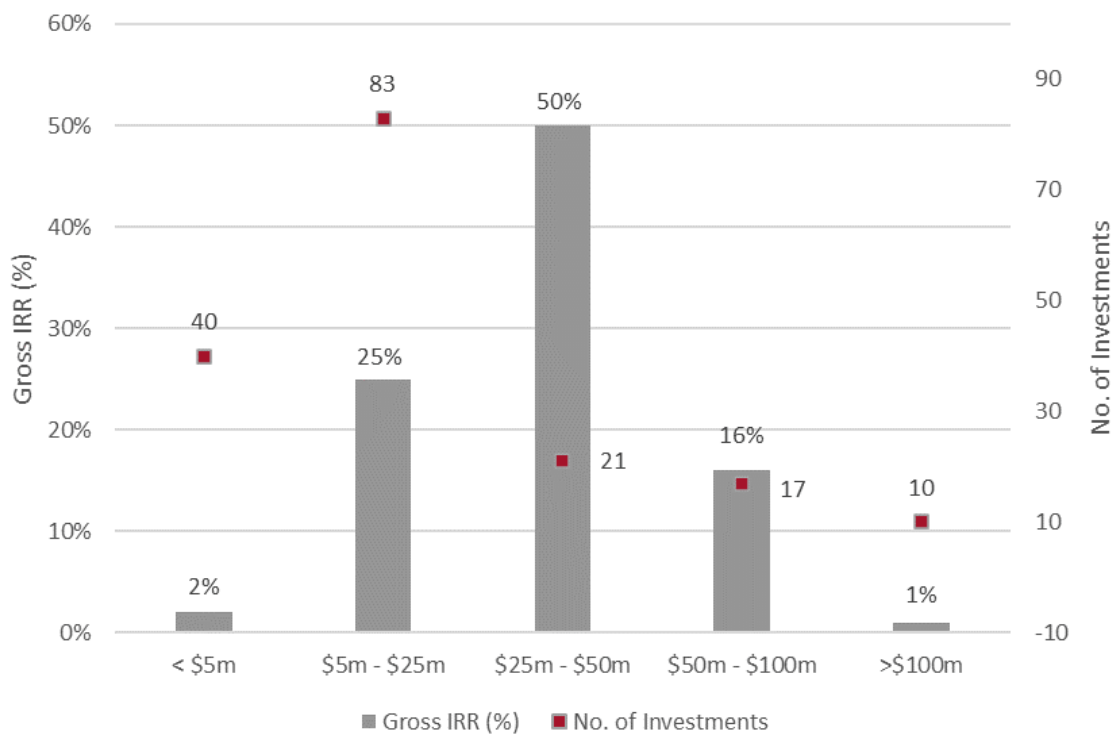


Source: Cambridge Associates (2019)

The percentage of investments which did not deliver a full return of investment cost (30%) is not unusual for private equity and venture capital, and in line with other developed markets.

Cambridge Associates have also analysed New Zealand private equity returns by size of investment. The largest cohort of private equity investments were investments between \$5 million and \$25 million (83 investments), which delivered an aggregate gross IRR of 25% (see graph overleaf). Private equity investments between \$25 million and \$50 million in invested capital have delivered the highest returns, with an aggregate gross IRR of 50% per annum (21 investments).

New Zealand Private Equity Returns by Size (Invested Capital)



Source: Cambridge Associates (2019)

Investments with \$50 million to \$100 million in invested capital (17 investments) delivered an aggregate gross IRR of 16% per annum. The Cambridge Associates study suggests that investors should be cognizant of investment size (and by implication, enterprise size) and private equity fund size when seeking superior returns from New Zealand private equity.

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

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. The market has deepened over the last ten years, as evidenced by an increase in the number of private equity and venture capital fund managers investing in New Zealand companies and the number and type of limited partners supporting fund raisings. Fund structures are amenable to local and international investors, and taxation and legal conditions conducive to institutional investment.

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 businesses 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 Capital Association

www.nzprivatecapital.co.nz

Investment in New Zealand

www.nzte.govt.nz/en/invest

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 Capital Association. 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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