

27 April 2007

The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600
AUSTRALIA

Dear Sir/Madam

We refer to your letter of 4 April regarding the Senate enquiry into private equity investment in Australia.

Set out below is our submission in relation to this enquiry which we have divided into three parts:

- A brief history of private equity funds and investment in New Zealand;
- A summary of the New Zealand's venture capital and private equity industry data from 2006; and
- An overview of the key current dynamics and characteristics of New Zealand's private equity market.

Brief history of private equity funds and investment in New Zealand

New Zealand's first professional private equity fund (the Greenstone Fund) was established in 1993. This government backed initiative was then followed by the gradual arrival and growth of a relatively small number of other New Zealand based private equity funds. Over the last four years in particular Australian based private equity funds have also become significant investors in the New Zealand private equity market. The amount of committed capital available to spend by New Zealand based private equity managers has grown from approximately NZD\$900 million in 2003 to NZD\$1.6 billion in 2006. This is a very modest amount by international standards and is indicative, we believe, of a market that is still in its early stages of development and of one where there is a huge amount of scope for growth.

Summary of the New Zealand's 2006 venture capital and private equity industry survey

Attached to this submission is a copy of the 2006 NZ Venture Capital & Private Equity Monitor survey. This survey is a joint initiative between the NZVCA and Ernst & Young and covers professional private equity and venture capital funds – including all New Zealand based private equity and venture capital funds and most of the Australian based private equity funds that actively invest in New Zealand companies.

These results 2006 show that the industry leapt forward in 2006 – as evidenced by strong growth in investment, a growing level of exits, an increasing number of managers in the market, growing international interest from investors and institutions; and growing awareness by companies and managers of the value that private capital can bring to the table.

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Selected highlights of the 2006 survey

Investment

- NZD\$1.2bn invested across 112 deals, up 213% on 2005
- Private Equity investment grew 250% to \$1.1bn / 35 deals (29 deals in 2005)
- Venture Capital investment grew by 20% to \$76m / 77 deals (51 deals in 2005)

Divestment

- 11 divestments worth \$223m (+20% on 2005 \$186m, 6 deals)

The New Zealand venture capital and private equity market in context

- Total investment represents approximately 6% of New Zealand's total merger and acquisition (M&A) activity, up from 2.2% in 2005 – a very low level compared to international private equity markets
- Total investment represents 3.9% of New Zealand's GDP, up from 1.3% in 2005 – again, relatively low by international standards.

The survey results show that most of the growth in the private equity market in New Zealand in 2006 was driven by 17 "top-end" (i.e. companies with enterprise values >NZD\$150 million) private equity transactions accounting for NZD\$1.0 billion worth of activity. The majority of these top-end transactions were carried out by Australian based private equity funds and we expect that these funds will continue to dominate this top-end part of the market in New Zealand for the foreseeable future.

Key current dynamics and characteristics of New Zealand's private equity market

- Our market is following a similar path to other international markets where private equity and venture capital have become mainstream in recent years (in particular to Singapore, Australia and the United Kingdom). In fact, when compared to those markets, it appears that the NZ industry is still in the early stages of its development– with very low levels of M&A as a percentage of GDP in NZ compared to international markets, and with private equity in NZ accounting for a fraction of all M&A deals completed – particularly when compared with the UK – where more than half of all M&A deals are now estimated to involve private equity investors.
- Importantly, the international rise of private equity has proved a key driver of corporate success and has made a material contribution to economic growth. We note that studies by the British & Australian Private Equity and Venture Capital Associations suggest that private equity-backed companies generate stronger than average employment growth; are more innovative than their peers, have better access to management advice – helping them become more productive and competitive; have stronger corporate governance; feel that private equity makes a real difference to their prospects and generally contribute more strongly to the country's economic growth than their peers. The NZVCA is currently commissioning its own economic impact report for the New Zealand private equity market and this should be completed by the end of 2007.
- The private equity story in New Zealand is compelling – but it is important to differentiate between two very different segments of the market: the corporate mid market - where deals are generally smaller, the pool of prospects is large and where local investors dominate; and the leveraged buyout market – where values generally run in to hundreds of millions, prospects are finite, where international investors dominate and where

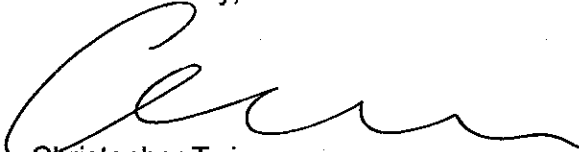
leverage ratios can be more aggressive. The large private equity transaction market has been, and remains, a finite one in New Zealand – and such businesses will always attract international interest and will commonly attract higher levels of gearing than in the mid market.

- It is in this mid-market area though that we expect to see the bulk of New Zealand's future private equity transactions occurring. New Zealand has a high rate of private business ownership compared with other countries – including the vast majority of New Zealand's mid market companies. But this market has experienced little M&A activity and now presents a myriad of consolidation and other growth opportunities – particularly as the baby-boomer generation ages and many of these owners look towards change of ownership over the next 5 years or so. This will bring many opportunities for those businesses and their managers and investors alike.
- The private equity market is very much a trans-Tasman one. Aside from the high levels of investing in New Zealand by Australian based funds, there are also New Zealand based funds investing in Australian companies and in 2006 we also saw the first direct investments by Australian based institutional investors into New Zealand based private equity funds.
- The New Zealand government is very supportive of the development of our venture capital and private equity markets. The NZVCA has worked closely with government over the last 5 years with the joint objective of establishing a tax and regulatory framework that supports the development of world-class venture capital and private equity markets in New Zealand. Perhaps our most significant initiative in this area has been working towards the introduction of a new Limited Partnership regime which is on track to come into effect in early 2008. New Zealand's Finance Minister, Dr Michael Cullen, has also recently spoken in support of the private equity industry noting that *"private equity firms are providing investment that is helping the New Zealand economy"*.

Our priority in making this submission has been to focus on setting out a succinct overview of the current scale, and key dynamics, of New Zealand's private equity market. While still very small by international standards, we believe that this market will follow a similar path to other international markets and become mainstream and a key driver of corporate success and economic growth in New Zealand.

We would, of course, be happy to discuss our submission in more detail or provide further relevant information if you would find this useful.

Yours sincerely,



Christopher Twiss
Executive Director