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GROWTH MARKETS

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The New Zealand Venture Capital & Private Equity Monitor 2006

NZVCA
NEW ZEALAND PRIVATE EQUITY & VENTURE CAPITAL ASSOCIATION INC

Table 1 Quick Facts	2006	2005
Total Investment Value	1,208,936,106	386,358,007
Total Deals Completed	112	80
Venture Capital Investment Value	75,572,058	63,025,969
Venture Capital Deals Completed	77	51
Mid-Market Private Equity Investment Value	84,834,548	186,452,507
Mid-Market Private Equity Deals Completed	18	25
Top-End Private Equity Investment Value	1,048,529,500	136,879,531
Top-End Private Equity Deals Completed	17	4
Divestment Value	222,587,712	185,608,310
Divestments Completed	11	6
Activity as % of M&A	6.05%	2.15%
Activity as % of GDP	3.91%	1.26%

Source: Ernst & Young/NZVCA Survey 2006

Executive Summary

- Top-end private equity investments were concentrated in the Food & Beverage (49%), Distribution & Services (41%) and Retailing/Etailing sectors (10%). Investment in these sectors included: Pacific Equity Partners and CCMP's joint purchase of Independent Liquor, Nikko Principal Investment's purchase of Hirequip, Next Capital's purchase of Hirepool and Healtheries and the joint acquisition of Kathmandu by Quadrant and New Zealand's Goldman Sachs JBWere;

- Mid-market private equity enjoyed both an increase in deals completed and dollars invested. Activity was spread across Property/Aged Care Facilities (24%), which benefited from Goldman Sachs JBWere's investment in Vision Senior Living, Manufacturing (19%), which was partially attributable to Pencarrow Private Equity's investment in Phil & Ted's Most Excellent Buggy Company, and Media/Communications (10%) which was also partially attributable to another of Pencarrow's investments, this time in the Home Ideas Group;

- Consistent with international trends, top investment sectors for venture capital deals included Information Technology/Software (19), Technology (17) and Media/Communications (12);

- Committed Capital remained steady at $2 billion, with a light year in terms of capital raising, with only $13.2 million raised; and

- Capital notionally available for investment has dropped to $499 million, with $443 million available for private equity transactions and $56 million available for venture capital deals.

Now in its fifth year the New Zealand Venture Capital & Private Equity Monitor has become a useful barometer of investment activity in the New Zealand market. Thank you for your continued support of this initiative.

Jon Hooper
Director
Ernst & Young Ltd

Christopher Twiss
Executive Director,
New Zealand Venture Capital Association

New Zealand id

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Spectacular results evidence of stable economic environment

In 2006 we watched the private equity show roll into town. Much has already been written about the large, high profile deals and the numbers for 2006 certainly make for an interesting read. There has been a significant spike in activity in 2006 and it is hard not be dazzled by this spectacular result. The high profile deals and headline prices have certainly given the sector a boost. Business owners and their advisors are now aware of the opportunities to realise value through a sale of all or part of their business to private equity houses looking at a portfolio approach to return on assets.

However, commenting on the large leveraged buyout transactions (LBO's) only tells part of the story. The shape of our venture capital and private equity market has changed dramatically over the last five years. While LBO's with enterprise values greater than $150 million accounted for a staggering 87% of the total dollars invested in 2006 they only accounted for half of all private equity transactions, indicating there is also a strong mid-market private equity sector, which is made up of New Zealand based funds investing in New Zealand based business. Issues around succession planning currently facing the baby boomer's, combined with the volume of privately owned enterprises, mean that it is critical we get mid-market private equity right to ensure that New Zealand remains economically viable going forward.

"When supply side factors are considered with high demand side levels of liquidity, it should come as no surprise that funds looking at an Asia Pacific play must see New Zealand, comparatively speaking, as more attractive than many other developing markets with less stable economic environments."

Jon Hooper, Ernst & Young Director

Whether the private equity investment levels will continue in the short term not only depends on the ability of companies to service the debt, which in some cases represents 75% of a company's enterprise value, but also the continued supply of quality enterprises with platforms for creating and realising value. While overseas commentators have raised concerns about the long term consequences of high debt levels associated with private equity our Finance Minister Michael Cullen said that he does not see such risks in New Zealand, and has recently spoken in support of the industry noting that "*private equity firms are providing investment that is helping the New Zealand economy.*"

Ernst & Young Director, Jon Hooper, explains current activity levels by commenting that "On the supply side New Zealand has a mature capital market with a stable economy and regulatory environment, there are a number of oligopolies and even a few monopolies still around, both of which have high barriers to entry and enjoy healthy margins. At the same time there are increasing opportunities for New Zealand's mid-market private equity sector resulting from baby boomers who will look to retire on the wealth which predominantly lies within their business. When these supply side factors are considered with high demand side levels of liquidity, it should come as no surprise that funds looking at an Asia Pacific play must see New Zealand, comparatively speaking, as more attractive than many other developing markets with less stable economic environments."

Of no less importance are our seed and early stage ventures which are an important part of the framework for future growth. This particular market sector is showing signs of increased maturity with strong levels of both activity and investment combined with a rise in the number of follow on investments and a fall in the capital notionally available for investment. There is a desire within the industry to see New Zealand and offshore investors continuing with their support in order that we build on the great progress the venture capital market has made in recent years. The hope for 2007 is that we see new venture capital funds emerge, and that current funds look to raise additional capital, which is the next step in the ongoing development of the industry.

2006 activity has resulted in New Zealand's profile rise in the Asia Pacific region and early signs for 2007, particularly with the sale of Yellow Pages Group to CCMP Capital and Teachers Private Capital for a reported enterprise value of $2.24 billion, suggest this coming year will deliver an equally impressive result.

Private Equity Dominates Investment Result

The total value of deals undertaken in 2006 has broken all previous records, reaching an incredible $1.2 billion, which represents a 213% increase on 2005. This result includes some large transactions which have been publicly announced but are not due to settle until 2007, including Ironbridge's purchase of Envirowaste, CHAMP's acquisition of Blue Star Print Group and the joint purchase of Independent Liquor by Pacific Equity Partners and CCMP. These deals had a reported enterprise value in excess of $2 billion, and as per our half year monitor we have applied an equity value of 25% for the purpose of normalising these results.

The increasing participation of Australian funds in this survey is indicative of both unprecedented levels of liquidity and an increasingly Australasian marketplace. To provide comparable information we have adjusted the 2005 and 2004 investment values reported to include Australian investment activity for these periods.

To further enhance the analysis of investment activity we have split the activity into three stages – venture capital, mid-market private equity and top end private equity. By splitting the private equity activity into LBO's greater than $150 million enterprise value or "top end" versus deals less than $150 million or "mid-market" private equity it is easier to distinguish between the top end, highly publicised transactions and the mid-market private equity transactions which, while smaller in value, make up the bulk of New Zealand activity.

Table 2	2006 $ Invested	2006 # of Deals	2005 $ Invested	2005 # of Deals
Top-end Private Equity	1,048,529,500	17	136,879,531	4
Mid-Market Private Equity	84,834,548	18	186,452,507	25
Venture Capital	75,572,058	77	63,025,969	51
Total	**1,208,936,106**	**112**	**386,358,007**	**80**

Source: Ernst & Young/NZVCA Survey 2006

Looking at Table 2 reveals not only healthy activity at the top end but also a vibrant mid-market and seed & early stage sector. When split by class we can see that there were 18 mid-market private equity transactions which accounted for $85 million of the total investment in 2006, compared with 17 top-end private equity transactions accounting for $1 billion worth of activity. The remaining $76 million was invested in 77 venture capital deals for the year.

The mid-market private equity transactions represent activity undertaken by the New Zealand private equity houses. Included in these statistics are deals such as Pencarrow Private Equity's investments in Home Ideas Group and Phil & Ted's Most Excellent Buggy Company, and Goldman Sachs JBWere's investment in Vision Senior Living. The reason this market segment is important to understand is that multiples paid here are typically lower than multiples at the top end of town and much of what is being funded by this group is about expansion and growth of successful private enterprises. Enterprises which will, in the medium term, provide a platform for growth and economic sustainability.

For analysis of investment activity the market has been segmented intothree stages - venture capital, mid-market private equity and top end private equity.

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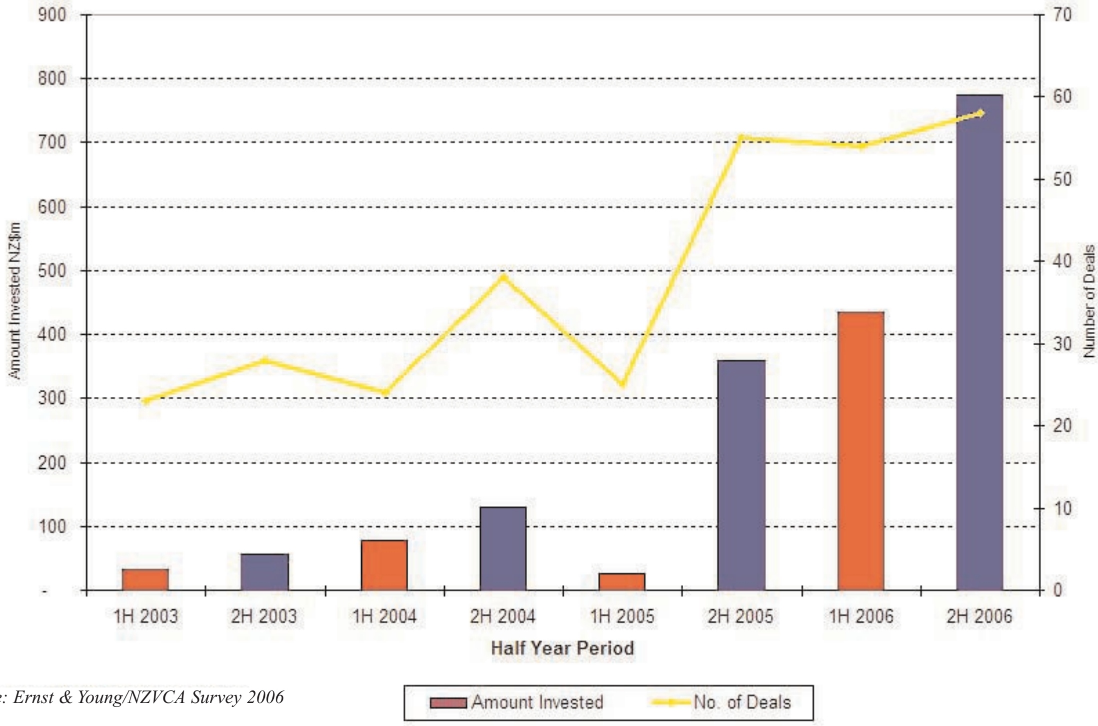
Figure 1 - New Zealand Venture Capital & Private Equity Activity 2003 - 2006



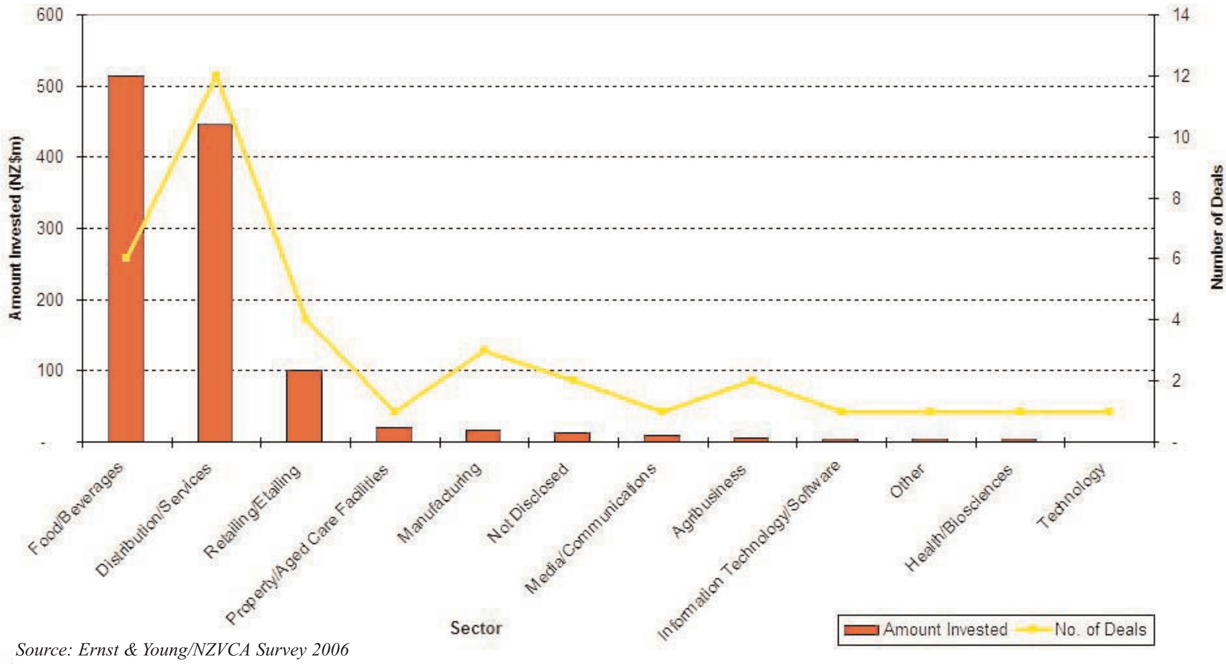
Source: Ernst & Young/NZVCA Survey 2006

As seen in Figure 1, it is not only the value of the transactions but the number of transactions which has been steadily increasing since 2003. There were 112 deals completed in 2006, 32 more than the previous year, representing an increase of 40%.

Also from Figure 1 we can see that during the second half of 2006 there was $774 million invested across 58 deals, compared with $434 million invested in 54 deals for the first half. Large deals for the second half included Next Capital's acquisition of Healtheries, the second New Zealand transaction Australia's relatively young Next Capital has made in 2006, the first being Hirepool, the Japanese acquisition of Hirequip, Australia's DB Capital and Allco Equity Partners joint acquisition of Baycorp, and the follow-on investment by New Zealand's Goldman Sachs JB Were and Australia's Quadrant Private Equity, which picked up the remaining half of Kathmandu.

Mid-market private equity transactions represent activity undertaken by the New Zealand private equity houses. Much of what is funded by this group is about expansion and growth of successful private enterprises. Enterprises which will, in the medium term, provide a platform for growth and economic sustainability.

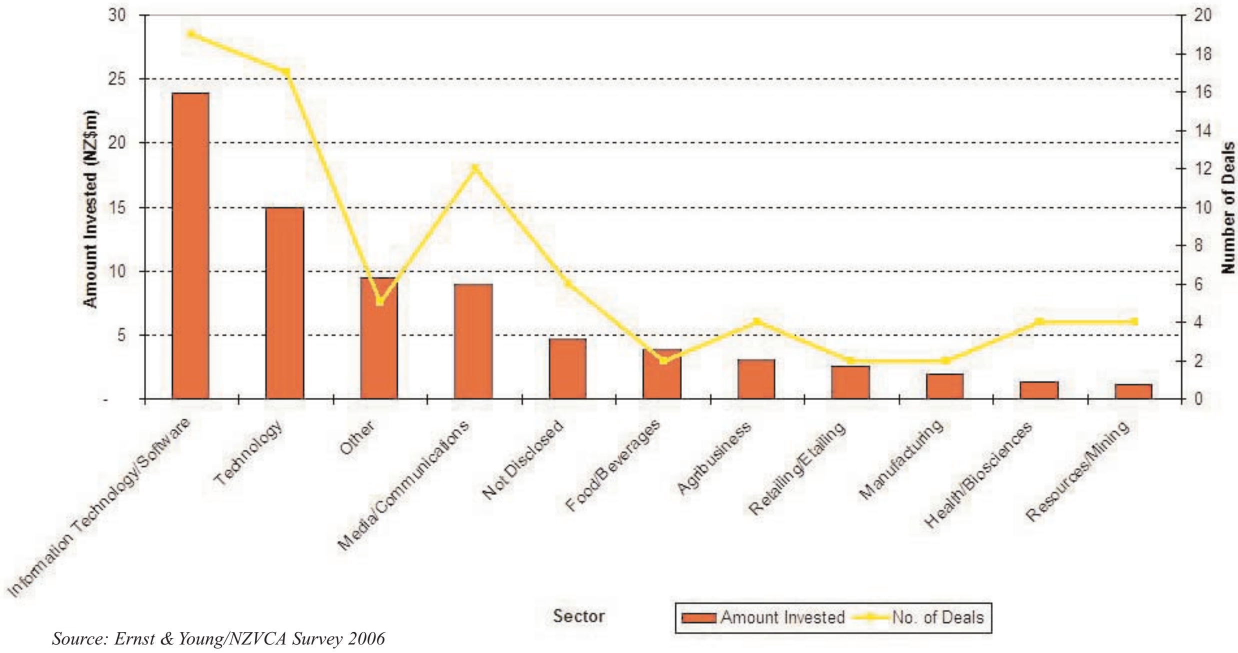
New Zealand id



Source: Ernst & Young/NZVCA Survey 2006

Looking at aggregate investments by sector we can see from Figure 2 above that top-end private equity activity is focused in the sectors of Food/Beverages, Distribution/Services and Retailing/Etailing, which typically include more mature enterprises. Significant deals included in these results were Hirepool, Hirequip, Independent Liquor, Kathmandu, Envirowaste and Healtheries. On the other side mid-market private equity transactions, focussed on a broader range of industries, with particular emphasis on Property/Aged Care Facilities, Manufacturing and Media/Communications. This wider range of investment activity is indicative of the nature of New Zealand businesses, where there are multiple industries and a typical nature of family ownership with succession opportunities. These New Zealand businesses make up the core of the market and provide strong platforms for growth.

Figure 3 - New Zealand Venture Capital Investments by Sector 2006



Source: Ernst & Young/NZVCA Survey 2006

In Figure 3 we see venture capital investment activity was, as expected, focused in Information Technology/Software (19), Technology (17) and Media/Communications (12) sectors where there are a high number of deals but comparatively speaking lower dollars. Although these sectors are broadly in line with activity we have seen globally, New Zealand has somewhat deviated from the global curve when it comes to Health & Biosciences – which was a large benefactor of global venture capital funds in 2006. Later in this Monitor we explore the New Zealand industry within a global context and feature the results of some of the revolutionary biomedical and technological research ouputs which are being commerialised by our universities. With an aging population and the research and development focus in our universities on improving the health & lifestyles of this section of the population we expect Health & Bioscience investments will provide good returns and as a result will attract increasing interest going forward.

Market Segmentation highlights unique characteristics

The average deal size for 2006 was a whopping $10.8 million, up from $4.8 million in 2005, a number which is heavily influenced by the top-end private equity transactions undertaken during the period. Drilling down, the average deal size for top-end private equity was $62 million, mid-market private equity was $4.7 million, and for venture capital the average deal size was $981,000. These numbers highlight the considerable difference in investment between top-end private equity, mid-market private equity and venture capital, with the lower size deals being indicative of the type of activity New Zealand private equity funds are participating in. It is important to understand these differences as top-end deals typically transact at higher multiples and with higher debt levels, while mid-market private equity deals are more in line with New Zealand M&A multiples and debt levels.

From 2004 to 2006 there has been significant growth in the level and dollar of venture capital investment, which is in line with NZVIF Fund Manager mandates and timelines for operating a venture capital fund. Funds typically invest heavily during the first 1-4 years and then seek to manage their portfolio through to eventual exit in years 7-10. In keeping with the stage of development of the market we are also seeing an increased trend towards follow-on investment by funds during this year as opposed to new investments.

A little over half of all investments were in Auckland, a considerable decrease on previous years. As highlighted in the first half of the year, the South Island is making considerable leeway, with a quarter of all deals being completed there, particularly due to increased participation in Canterbury. And while the Australians appear happy to invest in New Zealand, we don't seem to be returning the favour, with only 4% of all deals being completed across the Tasman and 6% of investments being made further a field.

With increasing levels of venture capital activity we are starting to see early signs of success, and we profile in this monitor a company which first received venture capital in 2004, and is starting to gain global recognition.

Case Study – Wise Giant positioned to leverage multiple business opportunities

Some say history never repeats but this is certainly not the viewpoint of a group of investors, and some visionary technology-driven movie makers at Auckland based Huhu studios.

With a $25 million production deal based around a 6-part Epic Stories of the Bible animation series secured, Huhu studios has linked with the Wise Giant Enterprise Group. Wise Giant was established in anticipation of having multiple business lines—particularly in facilitating the eventual sales of media intellectual property.

Although the majority of its shareholders are New Zealand based (and therefore subject to New Zealand tax), Wise Giant is a British Virgin Island registered company. This structure was put in place to facilitate possible merger & acquisition initiatives or when the company or its media assets might be sold.

The first challenge for Wise Giant is the revamp of the Cecil B DeMille classic The Ten Commandments. British born actor Ben Kingsley has been cast as the narrator with movie and television character actor Christian Slater replacing Charlton Heston as the voice of Moses.

As well as time, what differentiates the two versions is clearly the technology involved. Rather than expensive and expansive sets and a literal cast of thousands, cutting-edge 3D animation will be behind the recreation of these Biblical classics.

A story of equally epic dimensions has been the path toward creating the funding, technology and entertainment creation mix.

Wise Giant managing director and Huhu head Trevor Yaxley recalls that "Huhu Studios appeared on iGlobe Treasury's investment radar as early as 2003 (iGlobe Treasury Management is a joint New Zealand and Singapore Government funded investment management group). Initially, it met their fund management criteria of assisting promising technology companies in their seed, start-up and early expansion stages. They also perceived the work that we had done was excellent and we also had a reasonable project pipeline. The communication kept on until August 2005, when this current project required us to raise money to participate. Like us, they saw the potential of a market that was 'screaming' out for family based content."

New, Wide Open, Media Spaces

Trevor Yaxley says the additional opportunities offered in the 3D animation and new media space didn't go unnoticed.

"Initially Huhu had developed some workflow and pipeline management software to better deal with the entire production process. Sophisticated though it was, it didn't have the technological robustness for theatrical grade media projects. Over the course of producing The Ten Commandments we've further extended and 'bedded in' the software. We're now in the great position of having a very robust tool that can be used to position Wise Giant/Huhu for massive outsourcing works from third parties."

As Trevor Yaxley explains 3D animation is unique as the assets, properties and related technology created can be "leveraged" into other adjacent products and projects such as POD-cast, games and edu-tainment. These new platforms have tremendous growth opportunities.

"In the fast paced 3D animation and new media spaces, technology is the key success factor that keeps an animation studio at the cutting edge. There are lots of technologies that have to be applied to be effective, whether in cross border collaboration, workflow tools, version control, animation and special effects, surface textual or superior rendering.

"Nevertheless, we have to recognise we are producing 'entertainment' that will need to be accepted (and purchased) by the public. So we also have to be cognizant of what drives entertainment tastes and trends, be focused on our market niche, be proactive in delivering a superior product and have our eyes firmly on new opportunities as they arise. In the end we are probably best described as a hybrid—being both a technology and entertainment group."

Manna from Above

In terms of initial funding, iGlobe Treasury Management gave impetus to the creation of animation production opportunity.

Further funding for the Bible project came from EKD Media, and Singapore Technologies. As well as the investment benefits, Trevor Yaxley says Singapore Technologies is trying to create an animation team in Singapore. "They hope to learn from us in the process of co-working through a global project."

"There are a lot of small animation studios all over the world. Our skill is the ability to assemble the entire creative pipeline. In producing The Ten Commandments, we've become particularly adept at using third parties animation technology through collaboration with overseas based studios. In our space, there is more collaboration than competition. After all, we are a small company in a small country, trying to create media properties that will be successful in a global market."

Trevor Yaxley admits the learning curve to date has been steep. Nevertheless, having gone through the process once, he is now ready to take on the world.

"This hasn't been an overnight sensation. We've had to overcome several hurdles along the way. Having said that we've had some great support from New Zealand Trade and Enterprise—they clearly recognise the need and benefits of showcasing New Zealand products offshore. They have also been very helpful in setting up meetings with key people overseas. We've also started our own animation school to train talented Kiwis to the level required for international work. While we feel there is still more work ahead of New Zealand in terms of access to investment funds, we acknowledge the support of vehicles like the NZVIF."

Real Deal Driver

Trevor Yaxley says also that the 'hard yards' achieved to date now mean they clearly understand what the American/Western market wants—which he aims to supply.

"The cultural similarities we share are certainly attractive but a real deal 'driver' is the attractiveness of our quality/cost matrix. Our culture is akin to theirs yet our quality/cost matrix is extremely attractive. We can deliver a world class product effectively, efficiently and very competitively."

Despite the size of this opportunity and the stature of his company name, there is no way Wise Giant plans to hog the world stage.

"There is definitely room for more than one New Zealand company to be successful in this space. Afterall, the global market is looking for companies that can create and manage the entire creative pipeline and put good media properties into the marketplace.

"We've found that most overseas people enjoy the innovative atmosphere that exists in New Zealand and the 'can do' attitude that is still prominent in our psyche. We'd like to see a lot more support for private sector initiatives which we feel contribute to the reputation (and ultimately economy) of New Zealand.

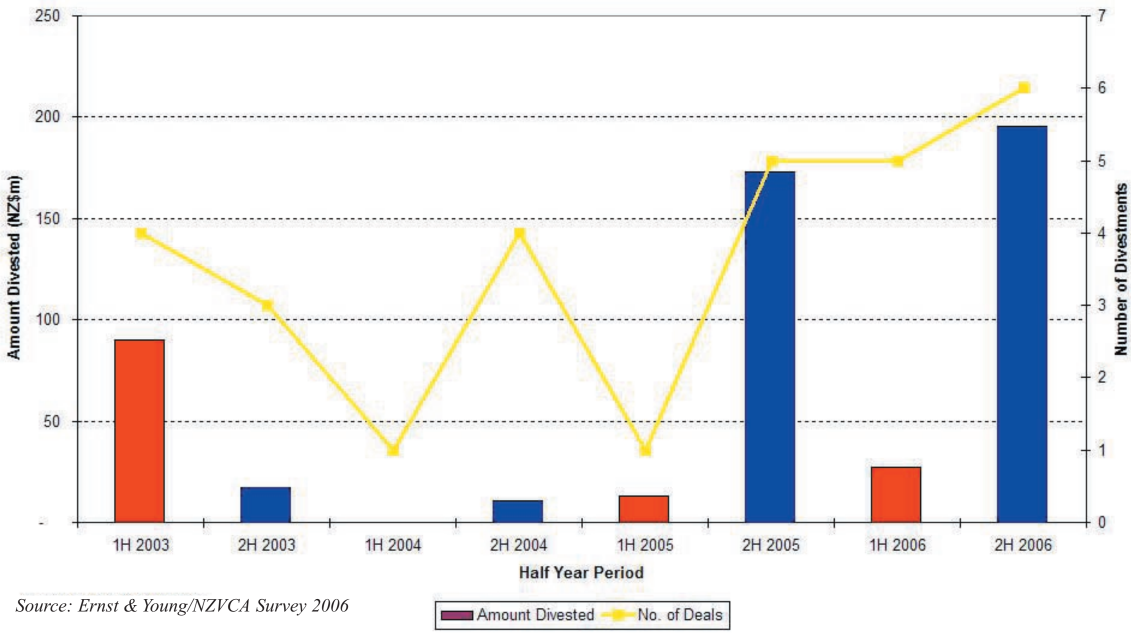
We're excited about the potential that exists in New Zealand and feel there is a huge reservoir of innovation, talent and quality among Kiwi's that is still waiting to be released."

Divestment Activity

There were six divestments reported for the second half of 2006, with a divestment value of $195 million, bringing the year to a close with $223 million of cash realised via 11 exits. This divestment value indicates growth of 20% on total divestments for 2005, an encouraging trend. An average IRR of 76% was calculated from those reported

Despite the relatively small size of the New Zealand market, with five years of divestment information, we are starting to build a meaningful dataset of divestment returns information, which is another indicator of the health of the industry. The average time between initial investment and exit is 3 years, so with the growing level of investment activity we logically expect to see an increasing number of participants successfully exiting New Zealand assets. Through realising investments fund managers will not only be able to demonstrate returns to investors but will also free up capital which will add to the velocity of investment within our economy.

Figure 4 - New Zealand Venture Capital & Private Equity Divestment Activity 2003 - 2006



Source: Ernst & Young/NZVCA Survey 2006

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New Zealand

Committed Capital

Investment and divestment activity is not the only element to consider when building a successful and sustainable venture capital and private equity market in New Zealand. Further elements to consider include the availability of capital. As we can see from Table 3 below, Committed Capital remains steady at $2 billion, despite some portfolio restructuring which occurred during the year resulting in a net decrease in the Committed Capital balance of $44 million. This decrease was partially offset by capital raising for the year which was reported at $13.2 million.

Table 3: Committed Capital (New Zealand Funds only)

Fund Manager	Committed Capital Balance as at 31 December 2006
Direct Capital	156,053,862
No 8 Ventures Management Limited	62,000,000
Endeavour i-cap Limited	60,000,000
iGlobe Treasury	31,125,000
West Coast Development Trust	29,827,741
Other/Not Separately Disclosed	63,000,000
Venture Capital Committed Capital	**402,006,603**
ANZ Capital (A$400 million as at 31 December 2006)	457,142,857
i-cap Partners	334,000,000
Pencarrow Private Equity Limited	250,000,000
Direct Capital	145,973,658
Rangatira Limited	123,500,000
Goldman Sachs JB Were NZ Limited	95,567,000
Invest South Limited	10,000,000
Other/Not Separately Disclosed	193,100,000
Private Equity Committed Capital	**1,609,283,515**
Total Committed Capital as at 31 December 2006	**2,011,290,118**

Source: Ernst & Young/NZVCA Survey 2006

Low levels of new capital raised combined with high investment activity reflects the vintage of a number of local funds, many of which are now into their fourth or fifth year. Against this backdrop it is not surprising that capital notionally available for investment has decreased some 35% from 2005 to $499 million with $443 million being available for private equity and $56 million (or 11% of total capital notionally available) being available for venture capital.

One aspect highlighted by the current year's trends of decreased capital raising, increased levels of follow-on investments and a decrease in capital notionally available for investment in seed and early stage opportunities is the case for government to continue to intervene and provide co-investment to fund managers as a mechanism to encourage institutions and other investors to support this market segment. This, combined with implementing the Limited Partnership regime to allow managers to raise offshore capital in an efficient and simple manner, are the two key platforms which policy makers need to ensure are supported as part of creating the right environment for growth and economic sustainability.

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Industry Opinion - Where To From Here?

Hamish Bell, Chairman, NZVCA shares with us his thoughts on the venture capital & private equity landscape and the ongoing role of NZVCA

The industry lept forward in 2006 – this was 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.

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 New Zealand industry is still in the early stages of its development – with very low levels of M&A as a % of GDP in New Zealand compared to international markets, and with private equity in New Zealand 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 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. Studies by the British & Australian 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. Add to that the growing cost of compliance in public markets and growing awareness of the availability and value of private capital, and it's little surprise that private investment activity is growing strongly.

The New Zealand venture capital story is exciting. A high level of entrepreneurship and innovation has created a breeding ground for internationally viable intellectual property and ventures – offering interesting opportunities for local and international venture capitalists. New Zealand's venture capital market continues to be dominated by local players and will likely remain that way – albeit with local players working closely with their international networks. With continued support from investors, this market will generate some of New Zealand's future success stories.

The private equity story is no less 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 are more aggressive. The top end of town is and remains a finite market – and such businesses will always attract international interest and will commonly attract higher levels of gearing than in the mid market.

It's the mid-market where the lion's share of New Zealand's future private equity transactions will occur. The vast majority of New Zealand's mid-market companies are in private ownership but have experienced little M&A activity and present a myriad of consolidation 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.

On the funding side of the industry, institutional and private interest in investing in this asset class continues to grow. While funding has slowed in the venture capital space, this is explained largely by a huge jump in funding for private equity and also reflects the fact that this is still a relatively young industry in New Zealand. Continued Government support in the early stage segment of the market via VIF and SCIF is vital as the venture capital industry continues to develop. Institutional support for the industry as a whole is crucial to its long term success – in particular the role of the New Zealand Super fund in cheerleading the New Zealand story and investment opportunity cannot be underemphasised.

The New Zealand Private Equity & Venture Capital Association continues to play its part. We've just completed a strategic review of the industry and the role we can play, and are building on our activities in the year ahead. Our main focus this year is on education – broadening understanding and awareness in the market by developing high quality educational modules, starting with angel investment and venture capital and then moving on to private equity; and a new publication – "The Guide to Private Equity & Venture Capital in New Zealand". We are also in the process of commissioning new research into the impact of private equity in New Zealand. In addition to these initiatives, our five key areas of focus remain as follows: Investor Relations / Research; Advocacy / Lobbying & Industry Representation; Education & Marketing; Member Communication & Events; and Professional Development. www.nzvca.co.nz

Pipeline

delivering information and insights

Another way to gauge the growth of the New Zealand industry is to compare it to other countries with a well established venture capital and private equity industry. New Zealand 2006 activity as a percentage of M&A reached 6.05%. When compared to Australia and the United States, whose activity as a percentage of M&A is estimated to be around 20%, we can see the New Zealand industry is still underdeveloped by global standards.

Further indication of the development stage of New Zealand's industry is our current difficulty in looking to raise capital for our second vintage of funds, which is the same issue other countries have faced in the past, when trying to encourage a second round of investment when the jury is still out on the first vintage. However in other areas our growth has been encouraging. For instance as seen in Table 4, when compared with the Australian Venture Capital & Private Equity Association (AVCAL) statistics, which are collected for a June 30 year end, New Zealand is doing relatively well on the investment side, which again is reflecting an increasingly trans-tasman marketplace

Table 4	New Zealand	Australia
Total Investment ($)	$1.2 billion	$2.3 billion
Total Investment (#)	112	174
Total Funds Raised	$13.2 million	$4.1 billion

Source: Ernst & Young/NZVCA Survey 2006

Australia raised $4.1 billion in new capital and introduced six new funds during the year, as compared with New Zealand's $13.2 million new capital raised in existing funds only. As seen above, relative to size, New Zealand is on par with Australia, which invested $2.3 billion in 174 transactions during 2006, reflecting an increase of 20% over the previous period. Consumer-related industry received 51% of the total amount invested for the period, which is in line with New Zealand, and Communications/Media investments grew significantly on the previous year, a trend which was reflected in New Zealand also.

It is the increasingly trans-tasman marketplace that is resulting in a greater awareness and increasing interest in New Zealand private equity. When transactions of household names such as Kathmandu and Tegel hit the media it is no wonder that venture capital and private equity have entered the vocabulary of the regular punter.

As previously mentioned, the oligopolistic and monopolistic nature of a number of New Zealand's industries, combined with the proximity and similarity to the Australian market, is another reason behind New Zealand's attractiveness abroad.

An important feeder for future private equity transactions is investment at the seed and early stage. As we have previously noted it is important that both mid-market and top-end private equity transactions are supported by a strong seed and early stage market. In part, the New Zealand Government's growth framework has already recognised the importance of supporting this segment of the market through not only providing an environment which is conducive to growth but also ensuring a strong supply of investee companies through various related initiatives such as the Venture Investment Fund (NZVIF) and more recently the New Zealand Seed Co-Investment Fund (SCIF).

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The SCIF programme was announced by Government in mid-2006 and is a fund to be managed by the NZVIF with $40 million of matched seed funding to support the further development of early-stage investment markets through co-investing. The first four seed funding partnerships were appointed this year, Chrysalis Ventures, ICE Angels, Powerhouse Ventures Ltd and Sparkbox Limited. Sparkbox focuses on ICT, Chrysalis Ventures intends to focus on life sciences and medical/veterinary investments; and ICE Angels focuses on ICT, media and life sciences

Coupled with this NZVIF has announced a change to their scheme. Where the funding ratio was previously $1 for every $2 invested by funds, it will now change depending on the perceived level of risk in each investment, ranging from dollar for dollar up to $1 for every $4 for more mature companies. NZVIF backed funds have welcomed the change, considering it to be more in line with similar schemes overseas.

Globally, New Zealand matches popular investment sector trends, such as increasing interest in 'lifestyle' investments, which includes sectors such as Green Technology and Health & Wellbeing.

It is commonly felt that the New Zealand Government should continue its support of venture capital through these incubators and NZVIF. It is also imperative that the The Limited Partnerships Bill is approved as soon as possible in order to make the New Zealand regulatory environment more efficient and transparent.

New Zealand does not currently have the compulsory superannuation scheme which has been credited with seeding the Australian industry, and there have been suggestions of New Zealand implementing a similar scheme to encourage local ownership and participation in the industry.

Globally, New Zealand matches popular investment sector trends, such as increasing interest in 'lifestyle' investments, which includes sectors such as Green Technology and Health & Wellbeing.

Although the similarities between New Zealand and the United States are less than those with Australia, New Zealand can still learn a lot from this well established market. United States private equity firms smashed the previous fund-raising record in 2006, reaping $215.4 billion, while venture-capital funds raised $25.1 billion, a 2% decline from 2005.

Footnote: The global statistics reproduced in this section are taken from research published by VentureOne and the Australian Venture Capital Association Yearbook for the period.

As in New Zealand, United States venture capital investment continued its ascent in 2006, with the most annual deal flow and capital investment since 2001. Deal count reached 2,454, slightly ahead of 2005's level, and capital investment reached $25.75 billion, an 8% increase over the preceding year.

Significant interest in some key growing industries, such as the Web-heavy Information Services industry, the Medical Devices and Equipment industry and the Alternative Energy industry, contributed greatly to boost United States investment in 2006. Reflecting trends in the United States and other markets New Zealand venture capital activity is also focused on Information Technology and an increasing interest in all things 'Green', however as discussed below New Zealand is just starting to truly realise potential in the Health and Biosciences field, which is seen as a strong area for growth.

New Zealand's maturing of its first vintage of venture capital funds, combined with private equity houses looking for an exit, is expected to increase the number of venture-backed and private equity listings (IPO's) and Trade Sales, which is consistent with trends we have seen in the United States and other markets. For example, in 2006 there were 56 IPOs completed, raising $3.72 billion, the most IPO activity and largest total raised since 2004. Venture backed exits via mergers & acquisitions totalled 404 with $31.18 billion paid. The median time between initial equity financing and IPO was approximately 6 years, indicating New Zealand is really still to achieve the boost that comes with a number of successful exits.

Further enhancing New Zealand's global competitiveness is New Zealand's undoubtedly high quality biomedical and technology base, which is now being more actively developed by commercialisation groups within the Universities. Despite low levels of government investment in funding the commercialisation initiatives in our tertiary education sector, a recently formed body represented by the various Chief Executive Officer's of the tertiary commercialisation arms, UCONZ, published some interesting results in 2006.

The SCIF programme was announced by Government in mid-2006 and is a fund to be managed by the NZVIF with $40 million of matched seed funding to support the further development of early-stage investment markets through co-investing.

Data collected from UCONZ members and compiled by Ernst & Young shows that:

- Between 2003 and 2005 the market capitalisation of companies founded using intellectual property developed by New Zealand universities grew from $76 million to over $430 million;
- The universities' commercialisation organisations raised over $100 million in capital for spinout companies;
- The number of people directly employed by these new companies grew almost 80% from 198 to 356; and
- Per dollar invested, New Zealand universities produced more than twice the number of new companies than the United States average, and over 50% more than Canada.

Ernst & Young Director, Jon Hooper, comments that while the results are an impressive start, he expects the numbers will continue to grow significantly as many of the companies are still at an early stage. *"In three years the university commercialisation offices have produced 23 start-up companies, with a combined market capitalisation of $430 million. Many of these companies have global potential and have already attracted significant interest from local and overseas investors."* These results are very encouraging and demonstrate that we can produce world class research and convert this into commercial success. While current measurements of commercial endeavour focus on surrogates for commercial outcome such as a percentage of Research and Development funding, as these companies mature we should have more ability to measure a range of commercial outcomes. The results also highlight the case for increased funding to speed up the path to commercialisation and continue to feed the hopper for venture capitalists.

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 Jon Hooper at Ernst & Young or Christopher Twiss at the NZVCA. Contact details are provided below.

Ernst & Young Entrepreneurial Growth Markets

The Ernst & Young Entrepreneurial Growth Markets group provides advisory services to businesses in high growth markets. Globally, Ernst & Young is involved in the analysis of the venture capital industry in association with VentureOne. Our New Zealand team has over 15 years experience in the local entrepreneurial marketplace and a dedicated team of over 20 partners and 200 staff committed to providing specialist services and integrated business solutions.

For further information about the New Zealand Venture Capital and Private Equity Monitor or to find out more about Ernst & Young, please contact one of the specialists noted below.

Auckland			
Jon Hooper	+64 9 375 2670	+64 274 899 952	jon.hooper@nz.ey.com
Darren White	+64 9 300 8140	+64 274 899 102	darren.white@nz.ey.com
Wellington			
Robert Cross	+64 4 495 7367	+64 274 458 236	robert.cross@nz.ey.com
Christchurch			
Tim Howe	+64 3 353 8077	+64 274 337 193	tim.howe@nz.ey.com

Website: http://www.ey.com/nz

About the 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.

For further information about the NZVCA please contact:

Christopher Twiss	+64 9 302 5218	+64 272 969 188	c.twiss@nzvca.co.nz
Executive Chairman NZVCA			
Hamish Bell	+ 64 9 374 4188	+64 21 588 882	bellh@anz.com
Chairman NZVCA, Director Capital Solutions, ANZ National Bank			

Website: http://www.nzvca.co.nz

41 Shortland Street
PO Box 2146
Auckland
Tel: 09-377 4790
Fax: 09-309 8137

Majestic Centre
100 Willis Street
PO Box 490
Wellington
Tel: 04-499 4888
Fax: 04-495 7400

Ernst & Young House
227 Cambridge Terrace
PO Box 2091
Christchurch
Tel: 03-379 1870
Fax: 03-379 8288

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