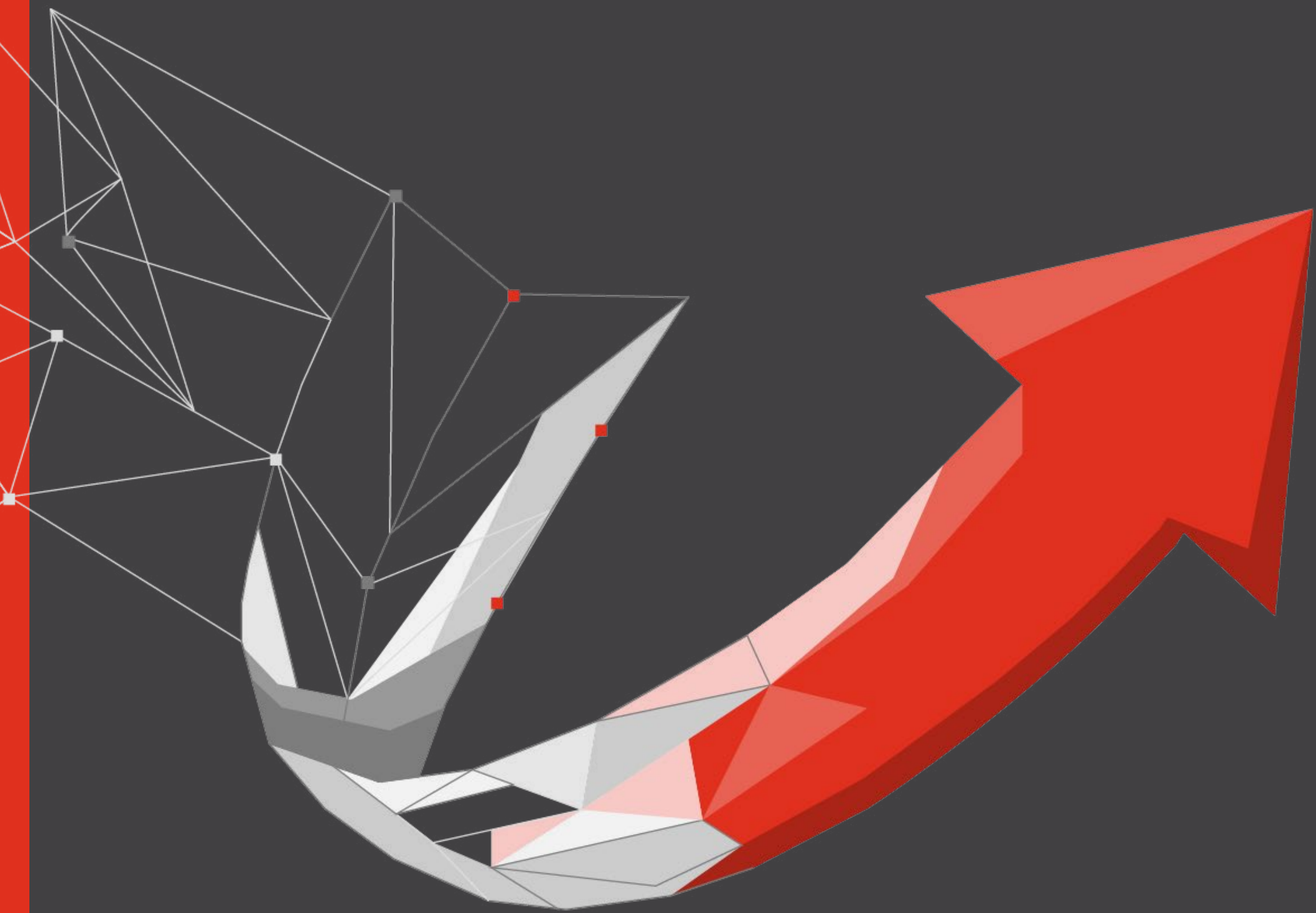

Rebuild New Zealand: private equity

pwc

July 2020

Private equity in New Zealand: an overview

Another
record year
of activity in 2019

$2.2bn
overall Private Capital activity in NZ market in 2019

Record year for mid-market PE investment activity, with
25+ investments made

Including Venture & Early Stage capital,
70+ investments made

Source:
Mergermarket, An Acuris Company
New Zealand Private Capital

In the wake of COVID-19, New Zealand needs businesses that can thrive and grow, create jobs, enhance wealth and contribute to rebuilding the economy.

New Zealand has always been a net importer of capital to fund growth. Continued access to capital is more important than ever as firms look to restore balance sheets that have been hit hard by the COVID-19-induced recession, focus on how they can grow, and in some cases, take advantage of attractive acquisition opportunities. Some investee companies such as those engaged in tourism may require additional capital while they undergo a period of hibernation before being able to recommence their growth strategy.

Private equity (PE) capital has played an increasingly significant role within New Zealand's capital markets in recent decades. It continues to represent an important source of capital to assist businesses through the rebuild.

While the perception of PE firms can sometimes be controversial (high profile buyouts and takeovers), in challenging economic times PE can help business survival, growth and recovery.

As New Zealand navigates the impact of the pandemic, two important drivers for PE investment firms have emerged:

- 'recovery capital' to restore the balance sheets of companies that have suffered trading losses during the lockdown period and may be facing increased financial pressure during the recovery phase
- 'growth capital' to give businesses and owners the confidence and capability to take advantage of the opportunities provided by the new environment.

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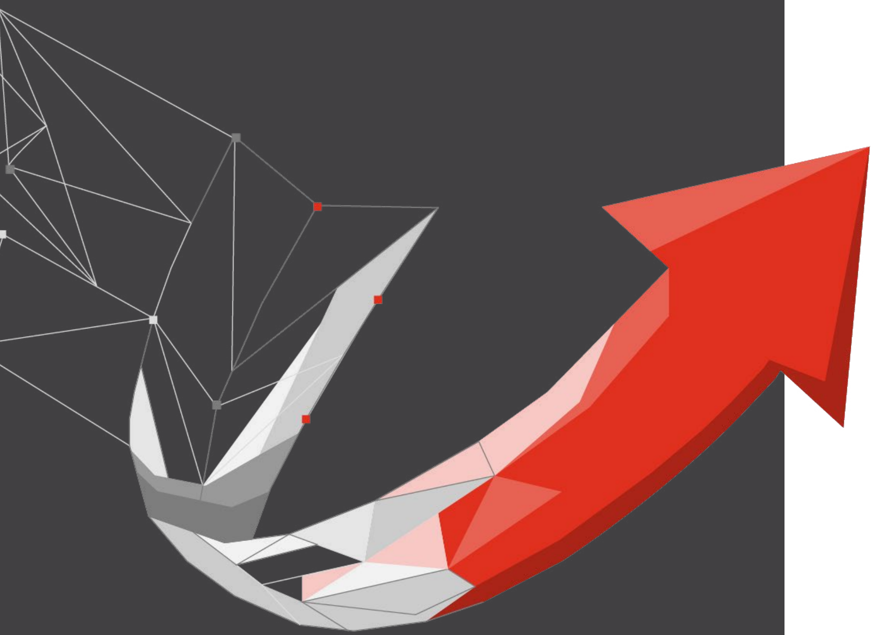

How does private equity work?

Most PE funds are what is known as 'closed-end funds'. This is when investor capital is put into a pooled fund managed by the PE firm, generally with a finite duration. These funds will then be invested in a portfolio of companies (investees) until the fund is exhausted. Sometimes a fund will hold back a portion of its capital 'in reserve' which can be used to support existing investee companies or be used to support 'follow on investments'.

PE firms considering their position in response to COVID-19 will first take account of the status of their funds and the extent to which the funds are partially or fully invested – this will dictate the extent to which PE firms are able to think about fresh opportunities. PE fund managers will also have a focus on the position and performance of their existing portfolio of investee companies, recognising that some of these may have been adversely impacted by COVID-19, and may be in need of additional support. These investee companies will typically have priority when it comes to allocating remaining cash within a particular fund.

There are some PE fund managers who raised funds shortly before the pandemic struck. These funds may have made no investments and will be well positioned to consider opportunities in the recovery period.

Private equity following COVID-19

PE firms are starting to look at new investment opportunities on the basis that this could be a 'vintage' period for them to invest given depressed asset prices and distressed situations. This belief is based on past experience – the investment period following the GFC in 2008-2009 was a particularly good vintage for PE firms who could work through the mire and see the opportunities ahead.

Although PE firms have expressed interest in new investments, we expect to see these firms continuing to adopt a cautious approach, given the prevailing economic uncertainty. While PE managers prefer to invest at the bottom of the cycle, the cautious approach means sophisticated investors may prefer to adopt a 'wait and see' viewpoint and time their entry into new investment at a point when they are confident the economy has commenced its recovery phase.

It's likely that PE firms will be selective and generally look to invest in only the top quartile of quality businesses. Unlike Venture firms, who are more willing to invest in businesses that are pre-profit or pre-revenue, PE targets are likely to show strong market share, ideally in a market that itself exhibits strong fundamentals (growth and competitive advantage). They will also have a well-thought-out strategy, a quality management team with proven ability to execute and deliver results and a scalable business model that will enable growth.

In the larger enterprise space, sizable international institutions have significant funds to deploy globally and New Zealand is considered an attractive investment destination. An example is the sale of Trade Me to British PE firm Apax Partners.

Looking to the future, it is possible that the recently announced changes to New Zealand's Overseas Investment Act approval process may serve to deter interest from some larger offshore PE funds. Although locally based PE funds may see this as an opportunity.

PE firms will also be considering the significance of international travel restrictions. This will be important for the flow of both capital and people – there is only so much confidence that prospective international investors can take from virtual meetings and online videos. International borders will need to open before capital can truly flow as there is simply not enough domestic capital to support the level of investment required across the whole economy.

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How does private equity help New Zealand's recovery?

PE is a critical element of New Zealand's capital markets. Firms are well placed to assist the country's recovery by providing much needed capital as well as associated financial and industry expertise.

Reasons for encouraging PE investment include:

- **Proven track record** – PE firms in this part of the world have an enviable track record of investing in productive and growing businesses and creating value. Examples include:

Waterman Capital's investment in My Food Bag

Direct Capital's investment in Scales Corp*

**IPO in July 2018*

Pacific Equity Partners' investment Manuka Health*

**Subsequently divested in 2019*

Mercury Capital's investment in Tamaki Health

Pioneer Capital and Oriens Capital's investment in Rockit Apples

Pencarrow's investment in Icebreaker*

**Subsequently divested in 2018*

Maui Capital, Rangatira, Blackstone Capital, Waterman Capital's investment in Partners Life

- **Plenty of 'dry powder'** – PE firms have a significant amount of money to invest. Nearly all the New Zealand firms have new funds to deploy or significant 'dry powder' within existing funds, as do the Australian and international firms that focus on this country. Combined with bank funding, we estimate there is ~NZ$3-4bn of deployable capital from domestic and international PE funds focused on New Zealand.
- **Relevant and broad-based expertise** – PE firms should not be viewed as merely a source of capital. Most are managed by senior executives with a wealth of experience in financial structuring. Firms also possess valuable sector expertise, often because they already have investments in a particular area, or in the case of larger firms, through the specialisation they have across their portfolio managers.
- **Longer term support** – While the Government has rolled out a series of broad-based support measures to assist businesses and maintain employment, many of these initiatives have a short-term focus. PE can provide longer term support to businesses with the right criteria and track record.
- **Bespoke financial solutions** – The Government is unable to deliver tailored solutions for individual companies due to cost and resource constraints (for example the ability to ensure appropriate due diligence is performed). PE firms have the expertise and capability and are able to right-size it for the relevant market.
- **Maintain ownership and share future benefits** – Selling a minority or majority stake in a business to a PE fund provides the business owners with cash today while allowing diversification of their personal asset base. Some, or all, of those same owners may then retain a meaningful ownership stake, allowing them to enjoy an even bigger 'second bite'.
- **Mitigate personal risk** – PE firms are well placed to provide the capital needed across many businesses without business owners needing to take on more personal debt or provide guarantees to external financiers such as banks. PE firms only provide security to lenders over the assets and operations of the business they are investing in. This often means that founders and shareholders are released from their personal covenants as a by-product of the PE investment.
- **Positive mindset** – In the current environment when many business owners are concerned about putting more capital, and years of hard work, at risk to take on new projects, PE firms bring a partner focused on growing and being bold.
- **Create value** – PE funds often bring a heightened degree of rigour and focus on key value levers for the businesses they invest in, by using their combined experience from other industries and portfolio companies to help management set, prioritise and successfully execute on key initiatives within their companies.
- **Benefits for all New Zealanders** – The benefits stemming from successful PE investment accrue not only to the investee companies, but also flow through to the investors participating in the various PE funds such as the NZ Super Fund, ACC, and many Kiwisaver funds. When PE funds perform well, so do the many private investors who have trusted them with their savings.

PE firms who focus on 'Value Creation' are more likely to have better returns than those that don't, as shown by our global research Creating value beyond the deal: private equity.

Where next for private equity?

Opportunities for PE firms include:

- **Partnering with the Crown** – History has shown us that governments do not always possess the requisite skills to 'pick winners' or manage investments in entrepreneurial high growth companies. PE firms however focus 100% of their attention on exactly that. COVID-19 presents an opportunity for the Government and PE firms to work together on joint investment initiatives.
- **Growing by acquisitions** – Many PE funds will seek to accelerate a business's growth through strategic bolt-on acquisitions. Potential acquisitions are often in the same or adjacent industries, in complementary areas, or in an area where some element of the business is needed to further the company's long-term goals. PE firms possess extensive deal experience and capability to manage the acquisition transactions and post-closing integration processes.
- **Rethinking old norms** – The COVID-19 environment has forced all of us to reassess our old ways of working and what the new world should look like. Our expectation is that PE investors will place a much greater focus on two important societal areas:
    - **Sustainability** – placing environmental, social and governance factors at the forefront when making investment decisions
    - **Diversity** – more and more the evidence shows greater diversity (in all its forms) enhances performance. New ways of working, new societal norms and a new economy all mean that different voices, different experiences and different views around board tables and among executive teams are a must, and not simply a 'nice to have'.

Like most parts of New Zealand's economy, PE has been impacted by COVID-19. This will be different for each firm and will undoubtedly impact investment decisions in the coming months and years. But, the current environment provides clear opportunities for PE to play a key role in rebuilding New Zealand and in a way that is about more than purely capital.

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Contact us

PwC has strong relationships with key Australasian private equity firms, and specialises in matching private equity firms to the right investment opportunities as well as assisting with successful exits. Our team has been ranked the number 1 firm for the amount of M&A deals by Thompson Reuters for the last 15 years.

We can provide advice at every stage of the private equity deal lifecycle. We have extensive experience in working with private equity investors, funds and portfolio-backed businesses, so we are well-versed in the fast-paced demands of the industry. Our private equity services cover due diligence, mergers & acquisitions, IPOs, tax services, fund structuring and more.

If you would like to talk about the role that private equity can play in relation to your business, or if you think there may be a potential investment opportunity, please get in touch with us.

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