



DIRECT CAPITAL

About Direct Capital

- *17 years investing in New Zealand private companies*
- *Market leader in New Zealand. Investment team together since first fund*
- *Raised more than \$800m in 4 institutional funds meeting "international best practice" standards*
- *Invested in 66 companies and current portfolio of 14 companies:*
 - *Aggregate revenues of \$900 million per annum*
 - *Employ more than 3,100 staff*
 - *Generate more than 50% of revenues from exports*
- *17 years of attractive and consistent returns. Net returns to date*

Direct Capital I & II	22.6% p.a.*
Direct Capital III	23.5% p.a.**
<small>• Net return after fees and manager earn-out. ** Net return after fees, provision for manager earn-out, and calculated as at 31 December 2010</small>	



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Topics we'll cover

- *The Private Company market*
- *Why is it a successful investment area*
- *Why Trusts are investing in the market*
- *How does it work?*
- *What are the common issues?*
- *Some specific examples*



Investing in the Private Company market

First of all, what market are we talking about?

- *Companies that are privately owned*
- *With revenues generally between \$30 million and \$250 million*
 - *Profitable*
 - *Market leading positions in their sectors*
 - *Usually with trans-Tasman operations*
 - *Not venture capital*
- *Companies such as.....*



The Private Company Market

Companies such as.....



New Zealand King Salmon

NZ's largest salmon producer

- *Revenue of more than \$110 million*
- *Exports more than 50%*
- *Potential IPO within 12-24 months*



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The Private Company Market

Companies such as.....



Ryman Healthcare

NZ's leading retirement village operator

- *Invested in 1997. Revenue \$9m*
- *Listed June 1999*
- *Today market cap > NZ\$1 billion*



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The Private Company Market

Companies such as.....



Bayley Corporation

NZ's largest full-service real estate firm

- *Invested in 2010*
- *Invested to broaden its range of services and seize market opportunity in downturn*



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The Private Company Market

Companies such as.....



GoBus Limited

NZ's third largest public transport operator

- *Invested in 2007*
- *Capital used to expand from Waikato to Hawkes Bay to Christchurch*
- *Today, national coverage*



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The Private Company Market

Companies such as.....



Express Logistics

Trans-Tasman Freight-forwarder

- *Invested in 2005*
- *Capital used to expand from NZ to Australia – 5 acquisitions*
- *Revenues doubled to more than \$160 million*



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The Private Company Market

Companies such as.....



EZIBUY

NZ's leading multi-channel apparel retailer

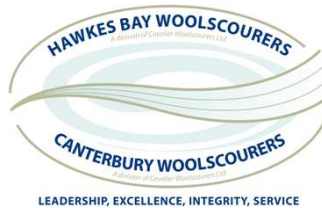
- *Invested in 1999*
- *Capital used to acquire "Myer Direct"*
- *Today, large trans-Tasman business with annual revenues > \$250 million*



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The Private Company Market

Those are just some names you probably recognise, but there are many others – some familiar, some not.....



Max



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What are the common traits?

- *The companies were privately owned when we invested*
- *The companies are all large and profitable*
- *They have professional management teams*
- *They have the governance and reporting standards of listed companies*
- *We invested alongside the owners and management*

They are great companies that just happen to be privately owned



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What drives investment?

All companies require capital to grow or evolve

- *Older owners wanting to retire*
- *Companies wanting to expand their markets*
- *Companies wanting to acquire competitors or complementary businesses*
- *Multi-nationals exiting the country, selling their local subsidiary*

We invest into companies that want to act on their opportunities



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Why is it a successful investment area?

All companies face market and economic risks, but there are four key advantages that underpin private company investment success

- *Information*
- *Negotiated investment*
- *Alignment of interest*
- *Influence*

Consider each of these in comparison to investing in listed companies



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Information

Listed companies provide

- *Prospectus when raising capital*
- *Half-year and full-year financial reports*
- *Market updates*
- *Continuous disclosure*

When Direct Capital invests in a private company

- *Usually a 2 - 4 month due diligence process*
- *Financial of course, but also commercial, legal, and environmental*
- *We talk to competitors, customers, suppliers, employees, partners*
- *We see contracts, forecasts, capex plans, marketing plans, strategy documents, board reports and minutes....anything and everything*

We choose the info we see, not what management want us to have



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Negotiated Price and Terms

Listed company investment

- *Generally a buyer or seller “at market”*

When Direct Capital invests in a private company

- *Price is negotiated - what makes sense for us and the vendor*
- *Terms are also agreed that reduce risk to both vendor and investor and incorporate market or trading uncertainties*

Examples

- *Investing at beginning of the GFC*
- *Investing ahead of a potential major contract win / loss*

Price is specific to the company and the situation, not “the market”



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Alignment of Interest

Listed company investment

- *Management not usually significant shareholders and can act in their own career interests or for short term outcomes*
- *Shareholders are often disparate without a “voice” and can be treated patronisingly*

When Direct Capital invests in a private company

- *We invest alongside the owners and management*
- *Our economic interests are matched and we have a significant stake*
- *Through the investment we agree the strategy*
- *We agree the terms and ongoing arrangements through a shareholders’ agreement that maximises this alignment*

Alignment of interest is the #1 issue in protecting and creating value



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Influence

Listed company investment

- *Little or no influence*
- *Proxy votes usually controlled by the board*

When Direct Capital invests in a private company

- *We appoint a director to the board*
- *We are not operators and don't seek to be, but we do become the "Department of Shareholder Value"*
- *We help on M&A, strategy, banking, senior appointments, and introduce our own relationships to the mix*
- *The financial and intermediary markets understand our role*
- *We keep "the blinkers" off*

We know what is happening daily and weekly and can act quickly



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Why are Trustees investing in this market?

This is a a large, successful and standard asset class

- *It is NZ's largest equity market – more than **5x larger** than the NZSX. **75%** of Deloitte Top 200 companies are **unlisted***
- *It offers a broader range of sector exposures*
- *The industry has a 17 year track record of financial success*
- *Institutional investors invest – NZ Super, GSFA, ACC, many others. And now Community Trusts, Energy Trusts and IWI*
- *Internationally, the industry dates back to 1945, it operates in every developed country and is funded from pension, endowment and long term capital pools*

This is a standard asset class to invest in



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NZ's largest equity market

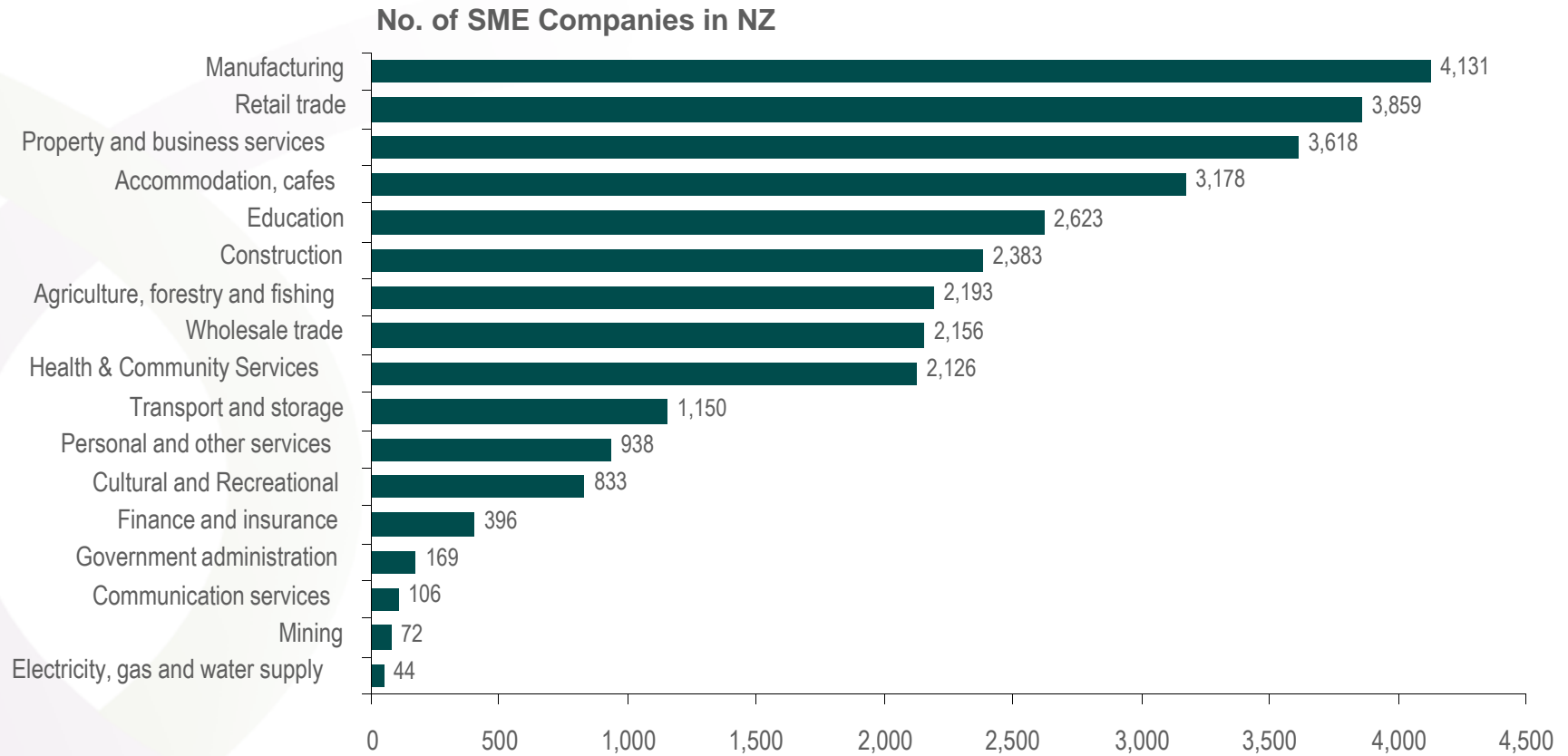
- *More than 30,000 private companies with >10 employees*
- *Large pool of mid-market companies*
 - *3,500 companies with annual revenues > \$10m*
 - *1,500 companies with annual revenues > \$25m*
 - *850 companies in Direct Capital's market*
- *NZSX comprises 162 companies*
- *Private company market 5 times larger than the NZSX*
- *Deloitte Top 200 companies – 75% are unlisted*

If you only invest in NZ listed equities, you only invest in 20% of the NZ equities market



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And, it represents a broader market



After 17 years, a well-established market in NZ

The market has depth

- *Direct Capital, Maui, Pencarrow, Waterman Capital, Pioneer, Knox Partners, Mercury Capital...and others*
- *The market offers different styles – high leverage and low leverage, control or partnership, expansion or buy-out....*

And, a financial track record

- *Direct Capital has consistently achieved >20% per annum returns*

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• Net return after fees and manager earn-out. ** Net return after fees, provision for manager earn-out, and calculated as at 31 December 2010	

Our style is low risk, low leverage, partnership based



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How does it work?

- *We get “due diligenced” ourselves by institutional investors*
- *Investors allocate a commitment of capital to a 10-year fund*
 - *e.g. Direct Capital IV raised \$325m in 2009*
- *Investments made over the first 5 years and capital drawn down as required*
 - *Direct Capital expect to make 3-4 investments investing ~20% each year, creating a portfolio of 10-15 investments*
 - *Capital retained post year 5 to enable follow-on capital for continued growth*
- *As dividends received and liquidity achieved, capital is returned to investors*
- *Investors receive detailed quarterly reports on fund activities and performance plus annual AGM and/or one-on-one meetings with the Manager*
- *Fees comprise a management fee and an earn-out. Earn-out is only payable when Investors have received 100% of their capital back plus a hurdle rate*



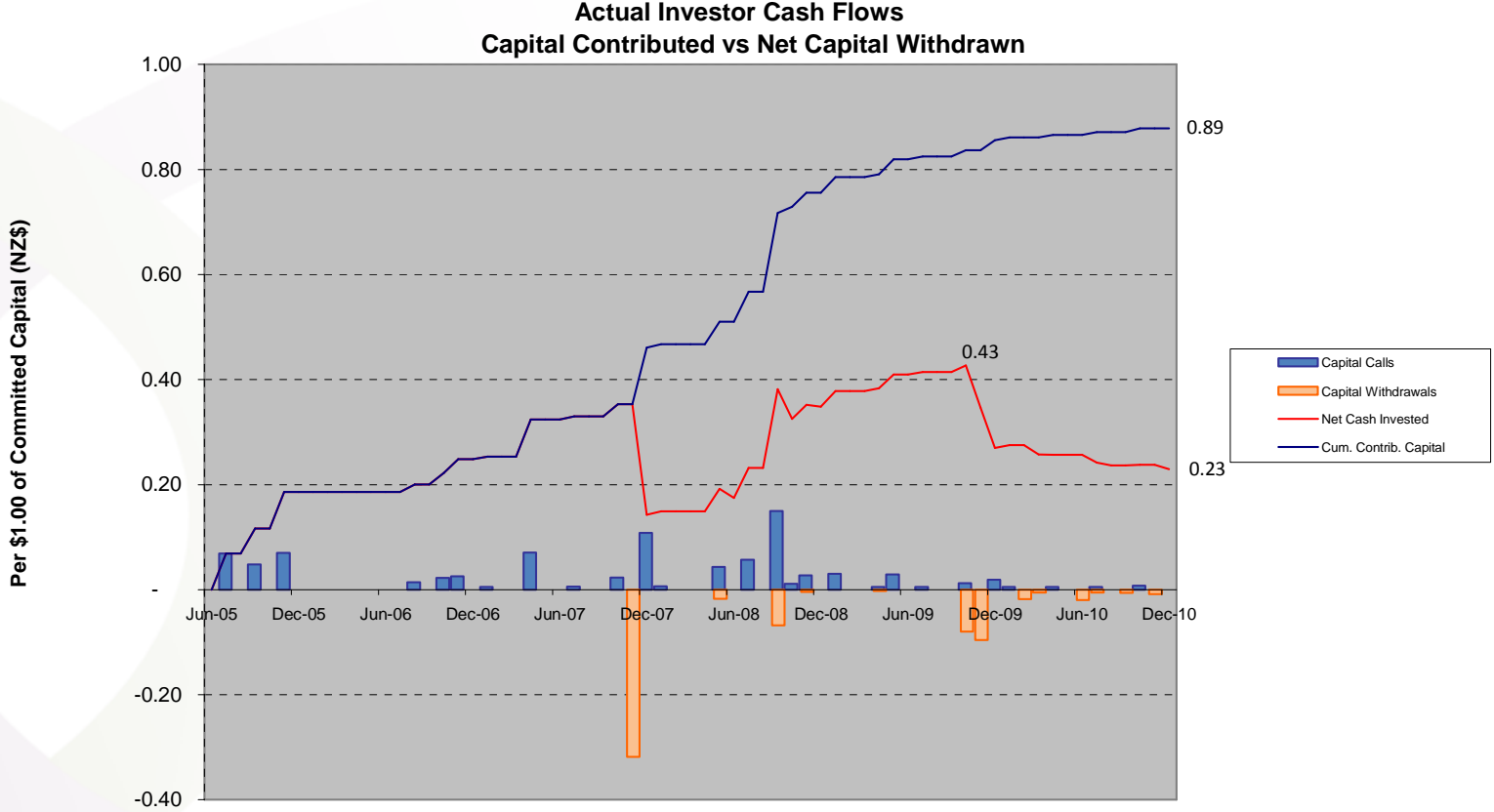
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Key features?

- *Capital is drip-fed over time, investors don't have to take a "current year" view or try to pick market tops or bottoms, but invest consistently across all cycles and across a range of companies*
- *Liquidity is regular*
- *Manager remuneration is linked to actual cash performance*
- *Institutional investors ensure latest industry-standards are met (reporting, management arrangements, fees, etc)*
- *Low volatility compared to listed markets. Volatility usually comes from views on earnings (rather than the valuation basis) and often very reactive to short-term events. The "efficient market" theory doesn't value psychology efficiently.*



Cash distributions are regular



Common Issues for Trustees?

- *Liquidity – distribution program dictates*
 - *with sequential vintages liquidity becomes self-funding*
 - *secondary sales of commitments becoming more common*
- *Perceptions*
 - *High debt? Quick Flips? Cost-cutting mentality?*
- *Transparency and Valuations?*
 - *International best practice and UNPRI*
 - *Returns are ultimately cash on cash. Quarterly valuations are marked to market under IFRS and International industry guidelines*
- *Expensive fees? Need to assess on a net basis*
 - *It is an expensive asset class to access and manage*
 - *Managers need to be top quartile, not market average*
 - *Compare passive, active equity funds and property funds and the fee denominator*



Common Issues for Trustees...continued

- *Manager reliance*
 - *“would rather rely on 20 analysts following Fletchers, than a manager with discretionary investment” But do 20 analysts reviewing the same company-presented financial info really reduce risk?*
- *Trustee appointments*
 - *Not usually financial / investment experts*
 - *Appointments are shorter duration than fund commitment*
- *Trustees tend to rely on asset consultants*
 - *Requires Active Management belief and ability to evaluate*
 - *Asset allocation model is flawed – if it allocates to private company market, it does so on global basis but NZ doesn't get its reciprocal.*
 - *It might be mathematically pure, but we all lose*
 - *But, more consultants are understanding sector & home bias requirement*



What do other large investors do?

- *Internationally – Pension and Endowments allocate 5%-6%*
- *NZ Super Fund - Investing 20% in “alternatives”, 5% in PE, currently committed to three NZ Managers*
- *GSFA*
- *ACC, a long time investor in PE*
- *Australian Pension funds – 5%*
- *9 Community and Utility Trusts*
- *2 Religious and Welfare Trusts*
- *5 IWI groups*
- *Kiwisaver*

Private Equity is a standard asset for Community Trusts to invest in



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So should Trusts invest?

- *Yes, capital pool is long term and so is the private company market*
- *It provides diversification*
 - *complements a listed portfolio adding diversity and reduces risk*
- *It supports “NZ Inc” by funding growth in our private companies – the engine of New Zealand*
- *Ultimately your communities and beneficiaries benefit*
- *It grows our capital market*
- *The returns from an experienced, proven manager have outperformed listed equities*



Direct Capital III Company Snapshots

Description: Largest integrated salmon producer

Features: Excellent exposure to food commodities, protein. Strong market share & brands, high barriers to entry, large market opportunity

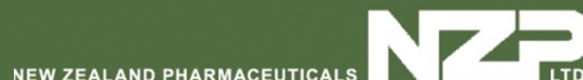
Highlights: Partnership qualities, potential listing



Description: Specialty manufacturer of pharmaceutical intermediates

Features: Succession deal, strong export focus & market position

Highlights: New manufacturing facility completed, diversified product base



Direct Capital III Company Snapshots

Description: Leading women's apparel chain

Features: Succession deal. Strong brand, operational excellence, Australian expansion plans

Highlights: Sold to EziBuy, 5x return on invested capital

The logo for Max, featuring the word "Max" in a white, cursive script font with a registered trademark symbol.

Description: Public transport operator, urban and school bus focus

Features: Succession deal. Strong defensive features (long term contracts), positive fundamentals and growth opportunities

Highlights: Significant new urban and MOE contract wins

The logo for go bus, featuring the word "go" in a white, lowercase, sans-serif font with a registered trademark symbol, and the word "bus" in a white, lowercase, sans-serif font inside a white circle.

Direct Capital III Company Snapshots

Description: Specialty manufacturer of coated material for packaging industry.

Features: Succession deal. Strong trans-Tasman opportunity

Highlights: Completed Australian acquisition broadening product range



Description: Consumer pest control product, RoboCan

Features: Competitive advantage (MicroMist™). Achieved strong market share in New Zealand, well-positioned in Australia

Highlights: Sold to US multi-national, SC Johnson. 4x return on invested capital

Innovair



Direct Capital III Company Snapshots

Description: Integrated logistics management, including freight handling and warehousing

Features: Succession deal. Strong market position, roll-up strategy with strong trans-Tasman growth opportunity

Highlights: Expansion of Australian network, 5 acquisitions completed



Description: Audiology services, hearing aid retail products

Features: Strong demographic fundamentals, growth opportunity

Highlights: Partnered with recognised health sector/retail specialists, extended branch network

