brought to you by:

every investor

in association with:

APPBOX MEDIA

Report on Investing in Tech and EIS

CONTENTS






CURRENT TECHNOLOGY IPO MARKET

September tends to mark a surge of activity with new listings on the stock exchange – and many investors will hope the level of activity seen before the summer lull will be recreated in the latter part of 2014.

> *With the results this quarter, the first half of 2014 has now witnessed more tech IPOs than the whole of 2013. Barring major market disruption, 2014 has the potential to surpass even pre-financial crisis global tech IPO activity*
>
> **Raman Chitkara**, global technology industry leader at PwC

The increase of the amount of cash allowed in an ISA to £15,000 will boost the ammunition of fund managers to invest in new shares – and investors will be looking out for the next big thing.

Tech IPOs are big business – and the global tech industry is worth billions. Indeed, the number of global technology initial public offerings (IPOs) has increased this quarter, with 43 tech IPOs and US$12.3 billion in proceeds – a year-on-year increase of 153% in IPOs and 327% in proceeds.

According to PwC's second quarter 2014 Global Technology IPO Review, strong capital markets in the US and steadily improving worldwide economic conditions provided tech companies with an ideal base on which to grow. It added that improved conditions in the Eurozone supported the return of tech IPOs in Europe, with listings on the London Stock Exchange and Euronext in Paris.

More dollars were raised by tech company IPOs in the first half of 2014 than any full year since the financial crisis in 2008. Eight European tech companies went public in the first half of 2014, raising US$4.02 billion. Of these, five listed in London, one on the Euronext in Paris and two on NASDAQ.

NURTURING THE UK'S TECH INDUSTRY

Research by GP Bullhound, an international technology investment banking group, discovered that 30 tech companies worth a billion dollars have been founded in Europe since 2000. With the UK's digital economy growing faster than the average across the G20 countries, it's unsurprising that 11 of these 30 are based in the UK.

The UK has built a strong international reputation as a world-class destination for firms that were founded elsewhere. Over the last few years, a number of growth-stage international companies have chosen to set-up headquarters in the UK – such as eToro and Just-Eat, founded outside the UK, are now taking advantage of and contributing to the UK tech scene.

There is a new breed of tech firm emerging on to the scene – dubbed 'the unicorn' by Tech City UK Future Fifty director Philipp Stoeckl. The unicorn, according to Stoeckl, is a startup that grows exponentially to reach a billion-dollar valuation within a few years of being founded.

Growth firms can also benefit from an increasingly favourable investment climate. There has been a sharp rise in the venture capital available to UK-based companies. Index, Accel and Balderton raised a combined £820 million in the past year, dedicated to investing in the UK and Europe. Google Ventures' recent decision to launch a £100 million investment fund in London, its first outside the US, provides further evidence that the UK is an attractive place to scale a business.

The London Stock Exchange has launched a number of initiatives to increase the attractiveness of listing in the UK: the introduction of the High Growth Segment, the establishment of the Elite management training programme, and working with the government to abolish investor stamp duty on traded Aim shares. Funding for growth businesses has also been boosted by the Enterprise Investment Scheme and Seed Enterprise Investment Scheme.

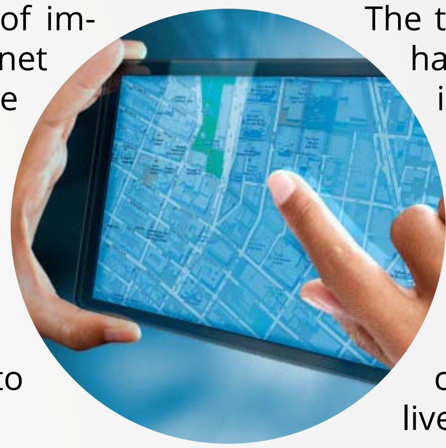
FUTURE TECH

A recent report from EY states that the technology industry appears to be splitting along two lines: mature hardware and software infrastructure providers increasingly influenced by industry megatrends, and younger, high-growth companies that created those megatrends or launched to take advantage of them. EY identifies those five megatrends as smart mobility, cloud computing, social networking, big data analytics and accelerated adaptation.

The report continues that technology may be entering a new phase, empowering all industries with "sense and respond" digital customer relationships in which new opportunity emerges from the analysis of big data.

Sense and respond economies must know where you are, which means many different technologies must work together. And since this technology is mobile-based, mapping and location-aware technologies are essential. In the second quarter of 2014, Alibaba struck a $1.6 billion deal to acquire the 72% of AutoNavi that it did not already own, obtaining one of only a limited number of government licenses that allow mapping of China's cities and roads. Alibaba competitors Baidu Inc. and Tencent Holdings Inc. also recently acquired minority interests in mapping companies.

Furthermore, Google Inc.'s $500 million pending acquisition of high-resolution satellite imaging company Skybox Imaging, Inc. brings it an orbiting satellite that can help improve the company's maps right away. It also includes a technology that could contribute to Google's long-term 'moonshot' goal of improving internet access in remote areas. Google also acquired drone maker Titan Aerospace Holdings, Inc. for an undisclosed value in 2014 to further that goal.



Also for undisclosed values, Nokia Corporation's HERE business unit (formerly known as Nokia Maps) made two mapping app acquisitions: one a so-called 'cognitive map' that understands the environment within a map and uses predictive analytics to anticipate how users want to interact with it, and another that mines place descriptions and reviews to generate personalized recommendations for tourists and business travelers.

London Stock Exchange-listed Seeing Machines recently announced a partnership with Takata Corporation, to further its quest to develop its eye and head tracking technology to advance driver safety technology.

The two companies have been working together on advanced driver safety systems (ADAS). Takata has recently secured a contract to deliver its first ever mass-manufactured implementation of a driver-monitoring system that will warn drivers of lapses in attention, reducing the risk of potentially fatal accidents. The contract is to supply General Motors with tracking devices for up to 500,000 vehicles over the next 3-5 years.

The formalisation of the companies' alliance is a result of a joint stance that driver-monitoring systems are one of the next major innovations in automotive safety due to the number of in-vehicle infotainment and mobile devices, which all compete for the driver's limited attention.

HOW TO SPOT A COMPANY OR MARKET **WORTH INVESTING IN**

New markets and new technology are usually new sources of growth and potentially ripe for investment. Shifting social values, behaviours and expectations create new market spaces. In the tech sphere, it's clear to see that the move to pared down, hands-free technology – and the desire to multi-task – is fuelling upcoming 'headsets' such as the Google Glass. Similar technology is also being employed in other areas, such as driver safety and monitoring.

Emerging markets means richer markets – and markets with more cash to invest in technology. By 2030, it is predicted, Asia's economy could be larger than that of the US and the European Union combined, with the region's share of world GDP swelling from a little under 30% to more than 40%. Latin America, which, like Asia, had its financial crisis earlier, is also growing at speed.

Economists Willem Buiter and Ebrahim Rahbari of Citigroup have used a number of indicators based on economic development literature to identify the 11 countries that were likely to grow most quickly over the next 40 years. China and India are on the list along with Indonesia and Vietnam. The list, surprisingly, also included two African countries – Nigeria and Egypt – with Iraq and Bangladesh. Buiter and Rahbari believe that these economies can achieve sustained per-capita growth of five percent (at PPP exchange rates) to 2050.

Look out for new and innovative business models. The combination of changing values and changing technology platforms can create opportunities for new business models, which take value from existing players. This, in turn, creates big opportunities for investors. Famously, iTunes captured value that used to belong to high street music retailers. Mobile and cell technology makes possible the pay-per-use car market, and the rise of companies such as car-sharing club Zipcar.

Available research and development (R&D) spend is extremely important with a tech company. A tech company that isn't spending a lot on R&D is unlikely to reach or maintain a leadership position, although it can sometimes be difficult to determine the amount of cash set aside for this due to the ways in which companies treat expenditure for accounting purposes.

'Recovery' stocks can also make good investments as they can often have excellent prospects. Often, technology companies early in their development stage can often hit a glitch of some kind, especially if it's growing quickly. Shareholders may jump ship if the stock wavers, but they could well maintain their upward arc and become a very good investment for someone willing to stay the course.

For those investors excited to invest in tech but perhaps looking for more of a hands-off approach could do well to consider putting their cash in a fund specialising in investing in tech companies, such as Techinvest Technology Fund. The £42 million fund was 343.56p a share at the end of August 2014, a gain of 286% since the start of 2009, and more than 105 percentage points ahead of its nearest rival in the Technology & telecoms IMA classification table.

Darren Freemantle, co-fund manager of Techinvest, recommends for those who'd rather go it alone to read 'Super Stocks' by Kenneth Fisher, ideal for those interested in investing in technology.

"*Super Stocks focuses on the importance of margin growth, price to sale ratios and the importance of R&D spend to investment analysis as well,*" said Freemantle. "*There is plenty in his book on recovery plays where he talks about where tech stocks hit a glitch in their development and how that can be a great time to pick up a smallcap stock.*"

HOW TO **JUDGE AN IPO**

The H-Score, developed by Company Watch, is a tool based on discriminant analysis, a statistical technique originally developed in the US. It can be used to analyse the financial structure of a company, and can be useful in determining whether or not it may be a sound investment.

The H-Score uses information from a company's published financial results, focusing on three main areas:

- **Asset management covers liquidity, working capital and current asset cover**
- **Funding management covers the equity base, current funding and debt dependency**
- **Profit management covers profitability**

It then analyses the data to see how closely it resembles those from companies that have subsequently gone bust.

Each firm is given a ranked percentile score, between zero and 100. If a company's H-Score is 25, then only about 25% of companies have characteristics more indicative of failed companies. Therefore, the company is judged to be weak.

Companies with an H-Score of zero to 25 are described as being in the 'Warning Area'. This does not mean that every company that has a score of zero to 25 will go bust. While it does pick up nine out of ten companies that eventually fail, only one in four companies with an H-Score below 25 will fail within three years.

More positively, any company with a score above 25 is apparently estimated to have only a 0.5% risk of failure. Although, there are three instances where it isn't fool-proof:

- **Where there are major post-balance sheet events**
- **Rapid deterioration in trading**
- **Massive fraud**

GLOBAL IMPACT OF ALIBABA

Repercussions of the much-anticipated launch of Alibaba onto the stock market are likely to extend far beyond its impact on the NYSE – some investors are hailing it as a wake-up call for US tech companies.

"*The Alibaba IPO represents a tectonic shift in the new world order,*" said David Chao, Derwent Capital Markets (DCM), a venture capitalist known as an early pioneer in the use of social media sentiment analysis to trade financial derivatives. "*We have two companies from China that are now worth more than $100 billion.*"

Alibaba's dominance of the Chinese market will soon look towards the rest of the world. The numbers for e-commerce in China are enormous – some $5.75 billion dollars were spent on the Chinese equivalent of 'Cyber Monday' – and Chao believes the Alibaba IPO will pave the way for a wave of Chinese companies to come to the US and expand their global reach.

"*For venture capitalists who have already been investing in China we've known this all the time. For those who went to China and stepped back, I think they need to recognize that there are some markets that have significant tech sectors that are bigger there than they are here,*" said Chao.

H-SCORES FOR UPCOMING IPOS

Below are the H-Score ratings for 9 companies that are planning, or rumoured to be planning, an IPO in the near future. Some companies appear quite weak financially although with the money they raise this should be ameliorated in the short term.

The pick of the bunch appears to be Alibaba which is expected to float on the New York Stock Exchange in the next few weeks.

It is rumoured to be the biggest tech float in history, raising up to $20bn to be valued at $200 billion (£121 billion). This would surpass Facebook's 2012 IPO, which raised $16 billion and valued the company at $104 million. Alibaba is an extremely profitable company, recently reporting second-quarter profit to June 30, 2014 of 12.4bn renminbi ($2bn; £1.3bn), compared to 4.4bn renminbi last year.

However, on some measures US markets look overvalued and funds have been increasing cash levels recently.

COMPANY	BUSINESS	CURRENT H-SCORE	COUNTRY
Scout 24	Classified advertising	**62**	Germany
Virgin Money Holding	Banking	**66**	UK
SPIE	Energy	**15**	France
Rapid Biosensor	Medical diagnostics	**0**	UK
Jimmy Choo	Luxury shoes	**82**	Hong Kong
EE	Mobile telecommunications	**62**	UK
DFS Furniture*	Furniture	**15**	UK
Alibaba	E-commerce	**79**	China
AS Watson	Retail	**60**	Hong Kong

ONES TO WATCH

US stock exchanges continue to dominate global tech IPO activity. Twenty-seven companies completed IPOs on the NYSE and NASDAQ in the second quarter of 2014, compared to five in China (including three in Hong Kong) and 11 across other exchanges, according to PwC. And 15 US companies went public compared to 12 in the first quarter of 2014 and proceeds surged by 162% to US$4.1 billion.

At the recent beGLOBAL tech conference held in Korea, several companies tipped for potential success in the US technology market included:

1

KAIROS WATCHES: The team that developed Kairos has deep technology and manufacturing expertise. Kairos CEO Sam Yang said: “Kairos is the only company that is able to bridge the multi-billion dollar watch industry with wearable technology”. The company has already raised over $1million with customers in Switzerland and Japan making online pre-orders worth over $1million.

2

NF LABS: NF Labs represents one of only a small handful of enterprise software startups that are emerging from Korea. Sejun Ra, CEO of NF Labs, has said that his company is building an enterprise data analytics tool that aims to capitalise on the opportunities presented through big data analysis. His tool is already enabling departments across organisations to gather and process data without the need for development expertise. While already in profit, NF Labs is looking to secure strategic investment to roll out their US market entry.

3

BAIDU: This company is developing a wearable device – the Baidu Eye – which looks set to rival Google Glass. While still in design stage, the device is designed to support voice and gesture-based commands, connecting to the internet via a WiFi connection, enabling the wearer to identify items or find products on e-commerce sites. It’s likely to be integrated with social networks, gaming, and other ‘traditional’ phone related activities.

THE APP IMPACT

The grand opening of Apple's App Store in 2008 inspired thousands of technically-minded people to launch their own home-made apps. One such example is Stuart Hall, an Australian developer recently interviewed in the Financial Times about his 7 Minute Workout app – which made him A$60,000 (US$56,000) in revenue and took him just six hours to code. Fast forward to 2014 and individual developers are concerned that only large companies can get noticed on the App Store.

According to the Financial Times, a recent study of more than 10,000 app makers by market analysts VisionMobile found that 1.6 per cent of developers make more money from their apps than the other 98.4 per cent combined.

While the research estimates there are almost 3 million mobile developers in the world today, more than half make less than $500 per app per month.

"It seems extremely unlikely that the market can sustain anything like the current level of developers for many more years," the report from VisionMobile concluded.

Apple says the app economy has created more than a million jobs in Europe and that it has paid more than $20 billion to developers since the app store launched in 2008. A report commissioned by Google forecasts revenues from producing smartphone applications to exceed $51 billion by 2025.

Recently, sentiment has been negative among the independent coders and small businesses that make most of the apps now available for Apple and Google devices, with some commentators expressing concern that the app 'gold rush' may be waning. But the September launch of Apple's line of watches has opened up a whole new market to chase.

The line of watches gives developers and software makers a chance to create a new class of app – an opportunity not seen since Apple's iPad launch in 2010. The Apple Watch, which only works in conjunction with an iPhone, can collect data on the wearer through an accelerometer and built-in heart rate sensor, and includes voice commands and text-message notifications.

"It's a new transformational device, and there's more opportunity," said Roger Entner, an analyst at Recon Analytics LLC.

"It's going to be another gold rush, and some of the little guys have a chance at winning."

Other analysts are suggesting that yet more niches within the market are still capable of rapid and strong growth, from health and fitness to corporate apps, even new mobile payment services – such as Apple Pay, Barclays' Pingit.

App-based payment services allowing mobile vendors to take card payments using their smart phone, such as Intuit QuickBooks Payments, also have room to grow. Even the overcrowded photo-sharing app market is still seeing new entrants, in the wake of Instagram

EIS INVESTMENT OR INVESTMENT THROUGH A FUND?

Direct investments can be attractive if you know about the business or industry and feel you can make an informed decision. However, with direct investment strategies, an investor is generally committed to a limited number of businesses and may find that they have to provide additional support in terms of capital and time.

Through a fund an investor will benefit from the knowledge, experience and resources of the fund manager and portfolio exposure, reducing risk and limiting the 'all eggs in one basket' worry.

The fund will generally have access to more cash, and so able to provide the capital necessary to unlock the value of an investment and therefore maximise returns.

ENTERPRISE **INVESTMENT SCHEMES (EIS)**

The Enterprise Investment Scheme is a highly tax efficient vehicle for investing with substantial downside protection in the form of loss relief.

EIS is designed to help smaller, higher-risk companies raise finance by offering tax relief on new shares in qualifying companies. For the investor, this offers a tax-efficient way to invest in small companies – up to £1,000,000 per person per year in qualifying companies.

What makes it even more attractive is the 'carry back' facility where investments can be applied to the preceding tax year.

"*The purpose of Enterprise Investment Schemes is to recognise that unquoted trading companies can often face considerable difficulties in realising relatively small amounts of share capital,*" explained Michael Portillo, Chief Secretary to the Treasury when the scheme was launched in 1993. "*The new scheme is intended to provide a well-targeted means for some of those problems to be overcome.*"

CAPITAL PRESERVATION OR CAPITAL GROWTH?

There are two types of EIS funds: capital preservation and capital growth.

With capital preservation, returns are usually modest but risk of capital loss is expected to be low.

Capital growth is where the fund manager or investor seeks capital gain on their investment typically over a 4-7 year period. Benefits include income tax relief on their investment in the short term, tax-free capital gains and inheritance tax relief in the medium to long term and substantial loss relief should their investment fail. The perceived risk of such investment structures is higher, therefore the investor needs assurance that they will benefit from a balanced portfolio with high probability of a capital gain.

This latter investment structure is greatly favoured by the government and most advisors see stability and certainty that the government will not intervene to reduce these benefits.

HERE IS A SUMMARY OF THE TAX BENEFITS FOR THE EIS INVESTOR:

INCOME TAX RELIEF:
30% income tax relief on a maximum investment of up to £1,000,000. The income tax relief can only reduce the income tax liability to zero

TAX-FREE CAPITAL GAINS:
As long as shares held for at least three years, the sale of the shares at a profit will be capital gains tax-free (a reduction of the current rate of 28% to 0%)

CAPITAL GAINS DEFERRAL RELIEF:
Any size of capital gain made on the disposal of any kind of asset can be 'deferred' by re-investment into EIS-compliant companies. The deferred gain is then due on the sale of the EIS shares unless the sale is to a spouse or on the death of the shareholder

CAPITAL LOSS RELIEF:
Capital loss on EIS shares can be set against income in the year the loss arises or the previous tax year. For a high tax rate payer this equates to 35% value of the EIS shares. Combined with income tax relief, the investor has a downside loss protection of 65p in the £1 invested

INHERITANCE TAX (IHT) PROPERTY RELIEF:
Investments in EIS-compliant shares can attract IHT business property relief (BPR) of 100% value of investment on gift or on death

Fergusson House,
124-128 City Road,
London,EC1V 2NJ

0207 502 8220
www.everyinvestor.co.uk