ENTERPRISE

LACOMP BRITISH ENTERPRISE EIS FUNDS

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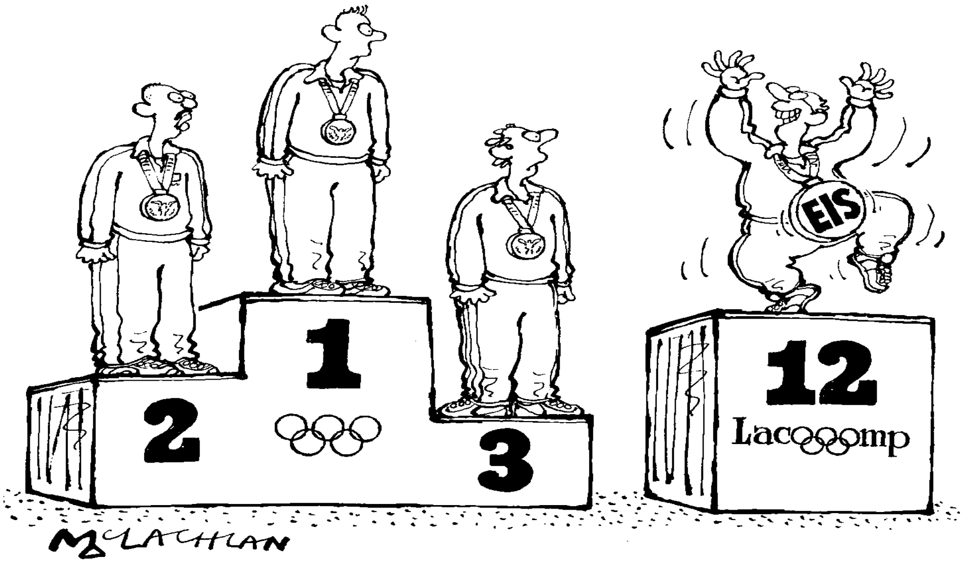
Lacomp plc



The Lacomp British Enterprise EIS Fund 12 is now open for subscription.
Original launch date of 6 October delayed due to market turmoil.
Closing Date 19/12/2008 _or_ 5/4/2009 – dependent on monies raised.

Despite the recent meltdown in the value of quality shares, the valuations of the businesses Lacomp has previously chosen have hardly been affected by the general malaise in the market. There is a distinct lack of correlation between the main stock market indices and the performance of unquoted, early stage companies.

At Lacomp, we have always maintained that our British Enterprise EIS Funds first and foremost represent an exciting investment opportunity. We are aware that some of our competitors design their EIS offerings solely to exploit the tax breaks associated with EIS investments, without even attempting to achieve an uplift in valuations. We, on the other hand, believe in the capability of British entrepreneurs and continually look for investment opportunities that offer significant potential for capital growth. The tax angles, of course, are a bonus.

Talking of tax, people who have paid CGT on a gain that was crystallised in the last two years or so may well be tempted to reclaim the tax paid by rolling over the liability through the use of an EIS investment. This would be particularly advantageous if they paid CGT at the then applicable 40% rate. Rolling over that tax would automatically bring them into today's 18% regime if, indeed, they will ever have to pay the tax.

In this *Enterprise* Newsletter, you can read the opinions of IAP members Simon Pannett and Nigel Milton.

PORTFOLIO DIVERSIFICATION OFFERS RISK/REWARD BENEFITS

Simon Pannett, a member of the Lacomp Investment Advisory Panel and a highly respected expert in the field of smaller company corporate finance, gives a personal view on the use of unquoted shares within an investment portfolio.

"The holding of unquoted shares in early stage companies offers a unique balance of risk and reward and, in my view, deserves greater recognition and inclusion within a larger percentage of private portfolios. That is not to say that such investments should be an automatic choice in all cases as, for example, unquoted shares are unlikely to offer early returns or income generation potential. But, as part of a well balanced and diversified portfolio, they do represent an underused and often ignored asset class when seeking capital appreciation over the medium to longer term.

An EIS Fund, such as the Lacomp British Enterprise EIS Funds, is the ideal vehicle within which to hold unquoted shares. HMRC rules mean that you will have a decent spread of investments that must be held for at least three years, and you will benefit from the many inherent tax breaks, such as upfront Income Tax Relief and Capital Gains free exits. However, in my view, the tax breaks should be viewed as secondary 'icing on the cake' with the potential for well above average capital gains being the primary reason for investment.

I have found that unquoted shares tend to be less volatile than quoted stock in times of market turbulence. This is primarily due to them being below the horizon of most City analysts and unquoted shares not usually forming part of the stock positions within larger, actively managed collective vehicles such as unit trusts. As a result, they are not subject to general and often arbitrary 'marking up' and 'marking down' to reflect macro rather than micro circumstances and can remain largely immune to periods of adverse market sentiment.

As an example, companies within the household cleaning and general healthcare sectors have not, in the main, enjoyed great performance in recent times. Nevertheless, Lacomp completed the sale of its holding in *Greenbridge Environmental Control* in May of this year (credit crunch and retail implosion notwithstanding) with a return of well over 100% profit for our Fund investors. There is also quiet confidence within the Investment Advisory Panel of equal and indeed better results to come with other shares within the EIS Funds.

However, I believe I should also offer a 'risk warning' about valuations of unquoted shares held within a Fund awaiting realisation. Even in a volatile market it can be possible to give a prospective seller a realistic estimate of what they may achieve if they were to sell, for example, their position in Sainsbury's or Marks & Spencer. But that is rarely the case with unquoted shares where time and effort must be invested by the Fund Manager prior to exit in order to identify and secure potential buyers. I am sometimes appalled by some of the valuations I see of unrealised unquoted stock held within some portfolios. Inflation of investors' hopes by careless use of overly optimistic valuations only makes any subsequent downward revision all the more painful, and I am fully supportive of the conservative assumptions applied by Lacomp in this regard.

Carrying on the thoughts about valuation and selling, it is true that one of the potential difficulties in holding unquoted shares is that they can be illiquid. For the inexperienced seller, it can be particularly difficult to find a number of competing purchasers in order to maximise the sale proceeds. That is why, quite deliberately, the Lacomp Investment Advisory Panel includes a member who specialises in doing just that – Paul Finnigan has run a successful Mergers and Acquisitions company for many years now, focussing on the unquoted sector. One of the consistent differences between realising one's investment in unquoted shares rather than quoted stocks and shares, is that a purchaser is more often a trade buyer rather than a private or institutional investor. This can give a significant premium to the seller, as the buyer is acquiring the entire company rather than a small minority stake in a listed company.

I have been a supporter of, and active investor in, the early stage unquoted company sector for many years now and firmly believe that careful selection from a diverse and sustained deal flow with focused due diligence followed by ongoing monitoring (including attendance at every monthly Board Meeting) and specialist advisors working towards an exit, can and very often will result in very pleasing results. Whilst the BBC television programme 'Dragons' Den' gives an incomplete picture of the process and the opportunities, it nevertheless has widened the public's awareness and interest in the unquoted sector – and this can only be a good thing! "

SELECTING ATTRACTIVE EARLY STAGE COMPANIES

Nigel Milton, another member of the Lacomp Investment Advisory Panel, is a well known stock picker and contributor to *Investors Chronicle* and *Money Week*, as well as the former Editor of *Investing for Growth*. Here he lists some of the criteria of selection and refers to some constituents of our EIS portfolios.

"In contrast to some other "approved" EIS funds, which appear to offer little or no prospect for any capital gain, the Lacomp British Enterprise EIS Funds are predominantly geared towards capital growth, which surely should be the main objective for any would-be EIS investor.

If one accepts the above premise, ideally how should one go about identifying such opportunities for capital growth and what are some of the key steps in identifying a great growth company of the future?

Competitive advantage: a powerful indicator

Whilst a sound management team is important for a company to succeed, that alone does not guarantee that a company will flourish. Warren Buffett, the richest and most successful investor ever, is quoted as saying that 'when a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact'. So for Mr. Buffett a company's 'crocodile moat' or 'business model' plays a crucial role.

Arguably, the first step, therefore, in identifying a great growth company of the future is gauging its competitive advantage.

As part of this process and whilst undertaking commercial due diligence on a prospective investment, investors should consider the underlying economics of the company and its business model, the structure of the industry and the intensity of competition, barriers to entry, the substitutability of products and/or services and the company's ability to exercise pricing control over both its suppliers and its customers. Moreover, as an additional check, one should make sure that margins projected by management are not too out of step with the average for the industry sector.

In essence, competitive advantage is a weapon that companies use to create, add and retain as much value as possible and to also obtain maximum pricing power over suppliers and customers. The more unique a company's offering, the more control it is likely to have over its revenues and the more predictable its earnings are likely to be.

Low cost base versus differentiation
Essentially companies fall into two overall categories: to succeed they either need to be differentiated from the competition or be the lowest cost producer or supplier, which of course is usually dependent on size and scale (i.e. the ability to generate high volumes of business). Clearly by their very nature, Lacomp's early stage investee companies tend to fall mostly into the former category except where a new disruptive process also offers the potential for massive cost savings.

So what are some of the main ways that companies typically differentiate themselves?

Top-class brand names
One classic way that companies differentiate themselves is through top class brand names.

Such an example amongst the Lacomp British Enterprise EIS Fund portfolios is **Pulbrook & Gould (P&G)**, which is the leading up-market florist in the UK with an enviable international reputation for excellence and an elite client base. Lacomp's recent investment in the company is aimed at assisting it with the initial development of its new range of carefully selected top-end natural remedies to be marketed under the P&G brand. Essentially this entails a 'brand extension' exercise.

Patents and copyrights
Provided that they have been proven to be defensible, patents are one of the most effective barriers to entry and one of the most potent ways of limiting a competitor's ability to operate in a given market.

Good examples of investee companies with patented products within the Lacomp British Enterprise EIS Fund portfolios include **Greenbridge Environmental Control**. Greenbridge has developed a patent protected, independently tested, non-toxic cleaner marketed under the brand *Activ8*. It is specifically designed to kill viruses, including the Noro and avian flu viruses as well as potentially deadly bacteria, such as MRSA, and fungal spores, such as the superbug clostridium difficile (also known as C-diff). Lacomp has already successfully exited from this investment, realizing over 100% return for its British Enterprise EIS Fund investors.

Another Intellectual Property play in the Lacomp British Enterprise EIS Fund portfolios is **DualGlo**. DualGlo has invented and patented a technique for colouring high performance 'glow in the dark' materials enabling them to be added to a range of plastics, paints, synthetic rubbers, powder coating and coated cloth. This latest generation of photoluminescent materials enable end products to glow in the dark for up to 20 hours after exposure to natural or artificial light for just a few minutes. Bright daylight colours, meanwhile, include white, orange, yellow, pink, green, blue and purple. The unique characteristics outlined above enable end-customers to differentiate their products across a wide range of consumer markets as diverse as children's toys and adult's watches and for a whole host of other industrial applications, such as lifesaving safety materials. Looking forward, licensing of DualGlo's technology is expected to form an increasingly important part of the company's future revenues.

Disruptive technology
A good example of a Lacomp investee company with disruptive technology is **Artificial Lift Company (ALC)**. This oil services company has developed a range of products designed to improve the efficiency of 'brownfield' oil wells. By utilising electric submersible pumps in conjunction with a revolutionary clamping and delivery system, it is estimated that production per well could be raised by some 5,000-6,000 barrels per day. The delivery system is also very portable and quick to install thus saving valuable rig 'downtime'. Traditionally, it is possible for an installation to be out of commission for up to 90 days in the event of a breakdown or some routine servicing requirement. The ALC rig, on the other hand, can be installed within 2 to 3 days, allowing production to resume very quickly. In addition, by basing the pump below the surface within the existing shaft and utilising the ALC cabling system, it should be possible to replace the surface structure (e.g. nodding donkeys) with something less visually obtrusive. According to ALC there are potentially 500,000 wells in North America alone for which the new efficient pumps would be suitable. If testing of the pumps is successful, the pumps could be commercially available during 2009, which should result in a further massive uplift in the company's valuation – already up *eightfold* based on the last funding round. Given the surge in oil prices and issues over peak oil and new sources of supply, there is a clear 'capacity gap' opening up. The increasing dependence on deep sea oil drilling to access new reserves, such as the recent discovery off the coast of Brazil, suggests that the days of cheap oil are probably gone forever, underpinning demand for ALC's products for the foreseeable future.

Highly scalable business model
Certain sectors naturally lend themselves to a much greater degree of scalability than others and as a result have more attractive economics. The software sector is a case in point.

Software companies have the ability to create a product (software package) that can be readily replicated, with limited additional overheads other than marketing and distribution. Once a software package has been written it can be sold countless times over and as a result, such companies have the potential for highly scalable business models.

A good example of a Lacomp investee company with a potentially highly scalable business model is Sheffield based software developer **Infoflow**. Infoflow has developed a unique role-based report distribution capability that can be tailored to the customer's requirements delivering business intelligence to key personnel within an organization on a precise, need-to-know basis. Earlier this summer, in what is seen as a strategic move, Infoflow became a SAP certified partner in the UK, and its SAP Report Manager product has now been added to the SAP Packaged Services catalogue. Because of its unique offering, Infoflow was invited by SAP UK to become one of only 20 strategic partners to be listed in the catalogue. As the sales jargon puts it, Infoflow's SAP Report Manager 'is a centrally managed enterprise-wide, report scheduling and distribution solution that also has intelligent content management'.

SAP is the world's leading provider of business software best known for its Enterprise Resource Planning (ERP) applications. With more than 41,200 customers in more than 120 countries, becoming a SAP partner potentially opens up a vast new market for Infoflow. Lacomp fully supported the decision to enter into a relationship with SAP as this promises to accelerate the acceptance and market penetration of Infoflow's product. The SAP UK catalogue is distributed to no less than 12,000 UK and Irish SAP users and decision-makers across more than 1,500 companies and appears to offer Infoflow an excellent potential opportunity to scale up its business significantly.

Exploiting global trends

Positive global trends also throw up significant opportunities for growth. When identifying and selecting growth companies of the future as part of its investment strategy, Lacomp also looks to exploit these positive themes and trends.

The **Artificial Lift Company** discussed above, with its innovative technology promising significant cost savings and efficiencies for oil and gas producers, is, for example, well positioned to take advantage of the trend in oil prices and the approach of 'peak oil' production.

Another area that looks certain to grow in the future is healthcare, driven by positive demographics in developed economies, in particular the aging population. Healthcare markets are also largely insulated from the economic cycle and the current global slowdown. In this field, Lacomp is a lead investor in **Sky Medical**. Sky Medical is in the process of successfully developing revolutionary, patented medical technology, which addresses the huge world-wide problem of deep vein thrombosis (DVT) not just for air travellers but also for long stay hospital patients. Sky Medical now appears to have the market largely to itself with no effective competition.

Yet another phenomenon that benefits some Lacomp investee companies is the worsening global security situation. One such company is **Auxetix**. Its unique anti-blast curtains should be a major beneficiary of the current war on terrorism. The defence-related applications for the award winning textile produced by Auxetix are potentially huge. Chief among these is the provision of blast-proof curtains for public buildings and key strategic installations. The market in London alone has been estimated to be worth $1 billion whilst the General Services Administration in the US is responsible for 182,000 public buildings, such as court houses, many of which will be considered for protection. This provision is likely to be extended dramatically in the States because of the Sarbanes-Oxley Act, which also imposes responsibility for homeland security measures on individual corporations. Conceivably the market could reach many billions of dollars, particularly if inhabitants of storm-vulnerable areas (estimated at 50 million) are included in the calculation.

In addition to protection for buildings, Auxetix has also identified the potential for the provision of ballistic protection for military tents, which could significantly reduce the incidence of shrapnel injuries and deaths. Again, the potential market is huge. The US spends $250 million a year on tents, NATO $100 million and the UK a further $25 million. Many US tents are supported by air-pressurised fabric tubes which are particularly vulnerable to fragmentation damage and the ability to retro-fit Auxetix's protective tent linings to the existing installed base would open up the market even further. The material is also being considered as a liner inside armoured vehicles in order to prevent 'spalling'. This is the process whereby parts of the inner lining of a vehicle fly off, often at ballistic speed, when the exterior structure is hit by a projectile. It is thought that such a lining would enable cost and weight savings through the use of thinner external armour without compromising the safety of the crew. Spalling is also experienced in aircraft, ships and buildings, all of which provide potential applications. Lacomp is optimistic that Auxetix has positioned itself to secure a significant proportion of the global defence-related market and are actively supporting the company in its development.

In summary, Lacomp believes that unquoted EIS investments, such as the ones outlined above, that offer the potential for significant capital growth (albeit higher risk in nature), present a strong case for inclusion within any well diversified portfolio, particularly where investors are able to benefit from the attractive UK EIS tax regime."

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Founded in 1985 by Swiss Managing Director Peter Buxtorf, Lacomp provides a discretionary investment management service to an international clientele. As well as managing an authorised unit trust, CF Lacomp World, for its own clients, Lacomp is the fund manager to a series of Approved EIS Funds which are marketed via IFAs.

The Lacomp British Enterprise EIS Funds invest in a minimum of four EIS qualifying companies and aim to combine attractive tax breaks with the potential for significant capital appreciation.