Delivering growth: VCT investment in action

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To discuss the issues raised in this paper please contact:

**Guy Rainbird**  
Public Affairs Director  
E-mail: guy.rainbird@theaic.co.uk  
Tel: 020 7282 5553

**Tim Cork**  
Public Affairs Executive  
E-mail: tim.cork@theaic.co.uk  
Tel: 020 7282 5588

**Important information**  
This document has been prepared using case studies provided to the AIC by VCT managers.

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The role of the VCT sector

Venture Capital Trusts (VCTs) were launched in 1995 to encourage private shareholders to invest in small UK companies which need start-up, early stage or expansion capital. They employ a professional fund manager to identify businesses which meet the Government’s investment criteria and provide the best prospects for growth. VCTs invest in companies nationwide. These businesses operate in a diverse range of sectors including leisure and hospitality, media, telecoms, healthcare, biotech, construction and renewable energy.

The size of VCT investment (both initial and follow-on funding) bridges the finance gap of £250,000 to £5m, identified in the Government’s “Financing a private sector recovery” green paper.

SMEs that secure VCT funding also gain access to business experience and advice. AIC research shows that 87% of investee companies had a representative of the VCT’s investment management team join their board of directors. This is an important contribution to the sector’s ability to deliver growth.

The combination of VCT finance and business expertise makes investee companies better able to increase turnover, employment and tax returns, secure access to overseas markets and invest in research and development. AIC research indicates that, on average, companies that receive VCT investment deliver a 16% year-on-year increase in employee numbers.

Demand for VCT funding from SMEs is strong. Arguably, it is greater than before the financial crisis, as bank funding continues to be difficult to secure and companies are increasingly seeking funding from alternative sources. This trend is expected to be maintained.

Since their inception, VCTs have invested successfully in many thousands of SMEs in the UK. A VCT tends to maintain its investment in a company for between 5 and 7 years, although the precise duration is dependent on the performance of the company and the overall economic environment.

The 116 VCTs currently operating have active investments in nearly one thousand SMEs. Of these, approximately two-thirds of the investee companies are private, with the remainder quoted on AIM.

This paper provides examples of 10 recent VCT investments. In a challenging economic environment, each of these companies has been helped to survive and prosper by VCT support.

The Association of Investment Companies (AIC) represents 86 VCTs with approximately £2.4bn of assets under management. This represents around 90% of the sector.

The AIC is keen for policymakers to continue to support VCTs as an important medium to deliver future growth in the UK economy.
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An ‘average’ VCT investment

VCTs typically invest in a diverse range of innovative companies with high growth potential, the ability to create employment, the ambition to secure revenue from abroad as well as the UK and an appetite to invest in research and development.

Company at investment: On investment, an average company is approaching the “medium” sized enterprise category as defined by the European Commission (50-250 employees, turnover between £8.35m and £41m)

- Turnover: £7.9m
- Employees: 68

Financing: The average investment size fits firmly in the finance gap of £250,000 to £5m identified in the Government’s “Financing a private sector recovery” green paper.

- Total investment: £2.3m

Experience: VCT investment offers invaluable skills as well as capital to boost growth prospects. 87% of companies have a VCT representative join the board.

Life of investment: A VCT tends to maintain its investment in a company for between 5 and 7 years (although this is dependent on the performance of the company and the overall economic environment).

- Time since investment: 6 years

Company after 6 years investment: The CBI has reported that firms with a turnover of between £10m and £100m represent less than 1% of businesses in the UK, but generate 22% of economic revenue and 16% of jobs. Investment has helped move the typical VCT investee company into this critical layer of the UK’s economy.

- Turnover at exit: £18.3m
- Employees at exit: 166

Data from AIC survey of 311 VCT investment companies. Full details of the research are contained in the AIC's report “Delivering Growth: The Role of VCTs – Impact of VCT investment 1998-2011"
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Geographical and sector spread of VCT investment

VCTs invest in many hundreds of small UK businesses in sectors as diverse as leisure and hospitality, media, telecoms, healthcare (including biotech), construction and renewable energy. They have the potential to stimulate growth in commercial sectors which have been identified by policy makers as important sources of future economic activity for the UK.

VCTs are also able to invest across the country. With VCT fund managers located in Aberdeen, Birmingham, Bristol, Edinburgh, Glasgow, Leeds, Liverpool, London, Manchester, Newcastle and Oxford they are uniquely able to support companies facing a funding gap wherever they are located.

Number of VCT investments in UK regions

Data from AIC survey of 311 VCT investment companies. Full details of the research are contained in the AIC’s report "Delivering Growth: The Role of VCTs – Impact of VCT investment 1998-2011"
Summary of VCT investee companies case studies

**Swiftkey**
- **Sector:** IT services
- **Investment:** £1.77m (since 2010)
- **Impact:** The VCT investment has allowed the company to develop new products and markets and grow the team to over 50 people.

**Abcodia**
- **Sector:** Healthcare
- **Investment:** £750,000 (2012)
- **Impact:** From no employees at investment, Abcodia now has 7 employees and is expected to turn over £1m in its first full year of operations.

**Biofortuna**
- **Sector:** Healthcare
- **Investment:** £1.25m (2012)
- **Impact:** Employee numbers have increased since investment by 25%. The management team is in the final stages of negotiating expansion into adjacent premises.

**Inspired Thinking Group**
- **Sector:** IT services
- **Investment:** £3.2 (2010)
- **Impact:** In the year immediately prior to the investment, sales were approximately £9m. Sales for 2012 are expected to exceed £30m.

**The Bunker**
- **Sector:** IT services
- **Investment:** £4m (since 2006)
- **Impact:** Since investment, turnover has increased by nearly 600% and employee numbers by nearly 150%.

**Home Nightclub**
- **Sector:** Leisure/Hospitality
- **Investment:** £2.5m (2010)
- **Impact:** The site was not trading before the investment and is expected to turnover in excess of £4m in its first 12 months of trade. Home now employs 84 staff as well as 13 DJs and musicians and 22 weekend door staff.

**Secret Escapes**
- **Sector:** Leisure/Hospitality
- **Investment:** £1.36m (since 2010)
- **Impact:** Since investment employee numbers have grown by more than four times.

**Radnor House School**
- **Sector:** Education
- **Investment:** £8.7m (2010)
- **Impact:** Turnover grew from nil to £3.1m and, as at September 2012, staff numbers are 32 (from nil at investment).

**App DNA**
- **Sector:** IT services
- **Investment:** £771,000 (2008)
- **Impact:** App DNA grew from 7 staff at investment to 80 in 4 years. The company was sold to Citrix Inc. in 2011 for $92m.

**Pho Café**
- **Sector:** Leisure/Hospitality
- **Investment:** £5.15m (2012)
- **Impact:** The company plans to grow to over 20 sites by 2016 using this investment. This is likely to lift employee numbers from c.170 today to over 500 in 4 years.
1 Abcodia

Sector: Healthcare

Location: London

Abcodia offers services to assist with the earlier diagnosis of cancer. The company is a spin-out from University College London ("UCL").

It offers services based on the use of serum samples and patient data. Abcodia’s serum bio-bank, the largest of its kind in the world, is a unique collection of samples gathered from 200,000 patients.

Companies developing biomarkers work with Abcodia to access this bio-bank and perform studies which they would struggle to carry out independently. This helps replace or shorten the clinical trial process, saving time and money and bringing cancer diagnostic and screening products to market that might otherwise not have been commercialised.

Securing funding

Being too young and with an unproven commercial model, the company was not appropriate for bank finance. Other sources of private equity were not ideal as the investment size was relatively small for many institutional investors, but too large for others which might be prepared to invest at such an early stage.

VCT funds managed by Albion Ventures invested £750,000 of equity finance in June 2012.

VCT value added

Albion funds invested alongside UCL Business Ltd as the primary founder investors. The investment enabled the provision of services with the potential to improve and lengthen lives through a more rapid detection of cancer.

Albion was able to spread the investment across several VCT funds, thus limiting their exposure to an early stage company whilst providing sufficient capital in aggregate to launch a unique set of services to the global life sciences community.

The company, which had no employees at investment, now has 7 employees and is expected to turnover close to £1m in its first full year of operation.

http://www.abcodia.com/
2 AppDNA

Sector: IT services

Location: Headquartered in London

AppDNA has become the global leader in computer application intelligence software, with customers including blue chip companies around the world. It was spun out of Camwood, a Foresight portfolio company, in 2008. AppDNA’s products automate the process of updating IT systems.

Securing funding

As an early stage software developer the company was not able to raise bank term loans or overdraft facilities. Invoice discounting was also not possible due to the nature of the company’s services and the international spread of its customers. AppDNA therefore turned to the VCT sector for funding.

The company received growth capital investment of £771k from VCT funds managed by Foresight. Foresight, along with the management shareholders, then re-invested the profits from the Camwood consulting operations into the creation and development of AppDNA.

VCT value added

Foresight was represented by one of its partners on the board of AppDNA, and has added value in a number of ways:

- Strengthening the board through bringing in Patrick de Smedt as Chairman (former Chairman of Microsoft EMEA) and Alan Howarth (former EY partner and experienced NED of venture backed technology companies).
- The knowledge that there was a supportive institutional investor enabled the company to take more risks and run cash more tightly than it would have been able to as an independent owner managed company.

AppDNA grew from 7 staff to 80 in the period from 2007 and 2011 and opened offices in USA, France, Germany and Australia.

The company was sold to Citrix Inc. in 2011 for $92m. Foresight played a key role in the positioning, timing and negotiation of the exit and introduced the corporate finance and legal advisers on the transaction.

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<th>March 09</th>
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<td>£3m</td>
<td>£8.2m</td>
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</table>

http://www.citrix.com/appdna
3  Biofortuna

**Sector:** Healthcare

**Location:** The Wirral

Founded in 2008, Biofortuna has developed a unique range of molecular diagnostic products using proprietary freeze-dried technology. Current genetic tests are stored and transported frozen and must be carefully prepared before the addition of patient DNA. Biofortuna's tests can be transported without temperature controls, making the tests simpler, cheaper and more reliable. Its first products have been targeted at the UK organ transport market.

Biofortuna has partnered with the molecular diagnostics business of the global life sciences giant Abbott, who are already distributing their freeze-dried kits.

**Securing funding**

As an early stage life sciences business, Biofortuna was unable to secure bank financing for growth.

Foresight invested £1.25m as part of a £2.1m fundraising round in March 2012, with the balance put up by existing investors, seed funds, private investors and management.

This investment sees Foresight reunited with Biofortuna CEO, Simon Douglas, formerly CEO of DNA Research Innovations and Executive Chairman of Lab 901, both previous Foresight investee companies. DNA Research Innovations, a DNA purification business, was sold to Invitrogen for $65m in 2004.

**VCT value added**

The new capital will enable the business to expand its manufacturing operations in line with sales growth, support applications for regulatory approvals, most notably in the US market, and broaden the product range to address companion diagnostics, antibody screening and disease identification.

Since investment earlier this year, headcount has increased by 25%, capital equipment by more than double, manufacturing capacity has been ordered and the management team is in the final stages of negotiating expansion into adjacent premises.

4 The Bunker Secure Hosting Limited

Sector: IT services

Location: Kent and Berkshire

Established in 2004, The Bunker Secure Hosting provides ultra-secure IT data centre services to some 200 companies and organisations from Europe’s most secure data centres. These are based in two ex-MoD nuclear command and control bunkers in Kent and Berkshire.

Securing funding

Data centres are particularly capital intensive when growing due to the need to invest in operational infrastructure and IT hardware.

Bank funding was sought but did not materialise despite strong internally generated cashflow and recurring annual revenue.

Since May 2006 three of Foresight Group’s VCTs - Foresight 2 VCT, Foresight 3 VCT and Foresight 4 VCT - have invested a total of £4m of development capital.

VCT value added

The rate of growth achievable from internally generated funds would have been restricted. VCTs have provided periodic injections of capital which have funded capital investments and working capital requirements.

VCT investment has also enabled The Bunker to modernise and upgrade its power supplies and secure planning consent for a new greenfield 180,000 square foot facility.

As the model has been proven thanks to the VCT funding, The Bunker entered into leasing arrangements for its IT hardware and a further £2m leasing facility is being secured for the installation of a state of the art energy efficient chiller system and the purchase of further IT hardware.

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<th>2006</th>
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<tr>
<td>Annual Turnover</td>
<td>£1.3m</td>
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<td>Employees</td>
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<td>Customers</td>
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<td>300%</td>
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</table>

http://www.thebunker.net/
5 Inspired Thinking Group

**Sector:** IT services

**Location:** Birmingham

Inspired Thinking Group (ITG) provides services to the marketing departments of large consumer facing businesses.

It seeks to put clients in full control of their marketing processes, assets and data. This enables them to reduce their external spend, improve operating efficiency, get to market faster and deliver more powerful and relevant messages to their customers.

The company uses technology to document, transform and join up marketing activities, putting their customers in control of essential operational data in real time. This enables customers to purchase marketing services more efficiently. At the time of the investment, ITG was supplying these services to clients such as M&S, Morrisons, KFC and Spirit.

**Securing funding**

At the time of the investment, ITG’s MediaCentre software solution was held by another business called TMS. ITG acquired TMS to significantly improve the development of the MediaCentre tool and accelerate its growth.

The CEO of ITG considered several options for funding. He needed a partner who could quickly deliver the funding to secure the acquisition opportunity and who would support rapid growth. He considered EIS and bank debt to be inappropriate.

In order to fund the acquisition and to provide further investment into the business, Baronsmead VCTs (managed by ISIS EP LLP) invested £3.2m in 2010.

**VCT value added**

One of the ISIS partners has joined the board of ITG. ISIS was also able to introduce a finance director to the business who had previously worked at another ISIS investee company. The funding package has enabled continual investment to improve the MediaCentre product.

Since investment ITG has gained new key clients including Boots, Sainsburys and Pets at Home. In the year immediately prior to the investment, sales were approximately £9m. Sales for 2012 are expected to exceed £30m.

http://www.inspiredthinkinggroup.com
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6 Pho Holdings Ltd (trading as Pho Café)

Sector: Leisure/Hospitality

Location: London and Brighton

Pho is the national dish of Vietnam, a tasty and healthy spicy noodle soup. Husband and wife entrepreneurs, Stephen and Juliette Wall, set up the business as a single site in 2005. From that date to 2012, they have developed the business into the leading Vietnamese café style restaurant group. The cuisine is highly rated by its customers as authentic and fresh.

At the time of investment the business had 6 sites - 5 in London and 1 in Brighton. It was in the process of opening a 7th site.

Securing funding

The initial funding was provided by Stephen and Juliette in 2005. As the business grew, they accepted some EIS funding from entrepreneurs Ed and Tom Martin who had previously built and operated a successful gastro-pub group. Barclays Bank had also provided a small amount of funding.

However, there was a need for another investor to deliver the significant financial commitment to strengthen the balance sheet and fund an accelerated roll-out. This was beyond the capabilities of the EIS funders or a bank.

The Baronsmead VCTs, managed by ISIS EP LLP, agreed a £5.15m commitment in August 2012. There was a £4.4m initial investment and an agreement to follow with a further £750k if required at a later stage (after year 1). Of the total investment, the vast majority is to fund a new site roll-out plan and the balance mainly to repay some founder loans.

VCT value added

ISIS has considerable experience of supporting consumer businesses and their growth through site roll-out. An ISIS executive who has spent considerable time within the restaurant sector will join the company’s board. The business will appoint a new chairman, with ISIS’s support, and will invest in building capability within the team and developing the infrastructure to support an accelerated growth plan.

The “fast-casual restaurant sector” is an affordable and growing part of the economy due to changing consumer habits. Pho’s target is to grow to over 20 sites by 2016. This is likely to lift employee numbers from c.170 today to over 500 in 4 years.

http://www.phocafe.co.uk/
7 Radnor House School

Sector: Education

Location: Twickenham, Greater London

The company was formed to establish a new independent co-educational day school for children aged 7 to 18. When mature, the school will provide 440 student places in the refurbished historic buildings on the site of Alexander Pope’s villa, providing modern facilities in an inspirational setting.

The school provides education to children with a wide range of abilities, focusing on individual development plans and providing a wider range of curricular and extra-curricular activities.

At its first inspection by Ofsted the school was rated “Outstanding” in all categories, putting it in the top 0.5% of all UK schools inspected by Ofsted. The school prides itself in the close links developed with the local community and actively encourages participation in community and charitable work.

Securing funding

The company was a start-up venture and due to the lack of trading history, no bank funding or equipment lease finance was available to it. Total investment of £8.7 million was made in September 2010 by VCTs managed by Albion Ventures. The investment includes a mixture of equity and secured loans.

VCT value added

The VCT capital was used to acquire the premises, fund the refurbishment and fit out work, provide working capital and fund losses until the company became cash generative.

Albion Ventures worked closely with the entrepreneur to form an outstanding senior leadership team, including the recruitment of an experienced headmaster, a high calibre chairman and a commercial finance director. Albion was instrumental in formulating and refining the strategy for the school, combining high quality education and a strong commercial framework.

Albion led the negotiation for the acquisition of the building as part of a competitive process and at the same time arranged and negotiated with suppliers for a £1m refurbishment programme to start immediately post completion of the investment. Led by Albion, an innovative appraisal and incentive scheme, aligned with the core values of the school, was put in place to help staff retention and recruitment. Albion continues to provide regular strategic input through its board representation.

Turnover grew from nil to £3.1m annualised and as at September 2012, staff numbers are 32 (from nil at investment).

http://www.radnorhouse.org/
8 Redmed Limited ("Home" nightclub)

**Sector:** Leisure/Hospitality

**Location:** Lincoln

"Home" is a nightclub in Lincoln’s city centre, and is owned and managed by Redmed Limited. The site, occupying 23,000 square feet, is a former MoD building. Prior to reopening, the site had stood unoccupied for almost three years after the previous tenant had experienced financial difficulties.

Following an extensive refurbishment, Home was launched in November 2011. The site now consists of six themed rooms, eight bars and a roof terrace. In addition to a nightclub, the site also trades during the day as a restaurant/bar and hosts comedy nights. Its many rooms are also available for private/corporate hire.

**Securing funding**

Despite the owner’s best efforts, bank funding for redevelopment of the site could not be secured as a result of a high loan-to-value requirement, the high risk nature of the sector, the failure of the previous licensed business at the site and an unwillingness to take on any redevelopment risk.

A £2.5m investment from Downing VCT funds allowed the building to be redeveloped and brought back into use. Previously, Lincoln had been served by only one major nightclub, which was in poor condition and of limited appeal outside the younger/student demographic.

**VCT value added**

Downing introduced a highly experienced non-executive director to Redmed Limited, who in turn brought in an award winning general manager for Home.

As Downing VCT funds have investments in a number of other nightclubs, the management team has also been able to benefit from Downing’s support network and expertise. Downing organises a forum for the various nightclub management teams in its portfolio where they can meet, discuss trends and strategy, and share best practice and resources.

The site was not trading before the investment and is expected to turnover in excess of £4m in its first 12 months of trade. Home now employs 84 staff (including part time), as well as 13 DJs and musicians, 22 weekend door staff and other performers.

http://www.homelincoln.co.uk/
9 Secret Escapes

**Sector:** Leisure/Hospitality

**Location:** London

Secret Escapes negotiates exclusive rates for luxury, hand-picked hotels and holidays in the UK and abroad, at up to 70% off the price that would be paid by booking elsewhere. The company curates these members-only offers for anything from boutique city hotels, beautiful country houses, spa breaks or luxurious five-star exotic destinations.

**Securing funding**

Bank finance is often unobtainable for start-up businesses and the Secret Escapes business plan required national marketing from launch.

The business was introduced to Octopus as a seed investment through its relationships with a number of angel investors. In April 2010, VCTs managed by Octopus provided £109k of seed investment. In October 2011, they provided a further £1.25m of development and working capital.

**VCT value added**

The VCT investment has enabled the company to draw upon the network and expertise of the fund management team at Octopus so that it can meet the challenges of growing and succeeding in a very competitive market.

The business has grown its audience reach by agreeing partnerships with a number of organisations including Teletext, The Independent and The Telegraph. Secret Escapes has also been running a successful television advertising campaign that has helped drive a wider audience to the site. The VCT investment has supported the company’s marketing campaign which has supported business growth.

Since launching in February 2011, the business has featured more than 2000 hotels (four and five star) and suppliers. Having seen similar models work in France and the USA, there is an opportunity for Secret Escapes to dominate the emerging UK and wider European ‘flash sales’ travel market.

Employee numbers have grown by more than four times since Octopus’ initial investment. The email subscriber base has grown to in excess of two million travellers, expanding month on month.

http://www.secretescapes.com/
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10 Swiftkey

Sector: IT services

Location: London

SwiftKey software enables fast accurate touchscreen typing. The underlying technology predicts what a user wishes to write with a high level of accuracy, boosting typing speeds by up to 50%.

SwiftKey, its consumer app, offers world-class error correction and next word predictions for Android smartphones and tablets. The app is a global bestseller having been installed more than 15 million times.

Securing funding

Bank lending and finance has been and remains unavailable for the company despite its significant progress over the last two years. Without investment the company would have had to rely upon existing angels for further investment, which would have constrained the company’s technology innovation and its growth prospects.

The company was established on a small amount of grant funding and business angel funding. Octopus led a further round in August 2010, in which existing angels also participated. Octopus was impressed by the management team, its technology and its traction in the market given the company’s stage of development.

In August 2010 Octopus managed VCTs provided £275k of seed funding. In August/September 2011 they provided £1.5m of further investment covering development and working capital.

VCT value added

The VCT investments have allowed the company to develop its SwiftKey offering with the launch of SwiftKey3, grow the team to over 50 people, explore new markets and sign several further deals with well-known manufacturers.

As of August 2012, over 250 billion characters have been entered using SwiftKey, with nearly 170 billion key strokes saved. SwiftKey has won numerous awards, including a Webby Award and a Mobile World Congress award.

This year the company launched its first enterprise product, SwiftKey Healthcare, which is designed to improve the speed and accuracy of notetaking on tablets for medical professionals. It has recently won best enterprise app at the Appsters awards and deals have been signed with ten clients in the United States with further negotiations on-going.

http://www.swiftkey.net/
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Acknowledgements

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