Investing **equity finance** and **management resources** in **high technology** businesses

MTI

Proventure

Spring 2006

The London AIM market is now the world's most successful small-cap market, with over £1 billion invested in technology companies alone. But what lies behind this?

MTI research puts AIM in the spotlight

As a group of brokers, private equity investors and legal advisers discovered on a snowy morning in February there are some interesting changes taking place in the AIM market. At a breakfast meeting high up in Tower 42 in the City, MTI presented the findings of the research undertaken by David Tu, of London Business School.

MTI partner John Polden, who led the exercise, commented:

"We analysed 156 tech stock IPOs between 2001 and 2005, interviewed 25 City investors or brokers and undertook huge quantities of desk research. We discovered that technology companies represent around 25 per cent of AIM activity and IPO activity is rising. However, while the performance post-IPO is in line with the AIM Index, the liquidity of investments is still poor.

"The reasons for this appear to centre on a few key factors. There is a lack of real technology expertise in the AIM market, giving rise to a gap of understanding of the sector. Furthermore, with most growth in value occurring either pre-IPO or two years post-IPO, it would indicate that the Venture community arguably needs to provide more continuity in nurturing companies beyond IPO. Whereas in the past IPO was seen as an exit point, the lack of liquidity means many investors are now locked into their investments post-IPO, but the VCs need to ensure management cope better with the transition to being a public company – recognising they do not suddenly grow up over night upon entering the AIM market. So the potential for conflicting motivations at IPO need more awareness and better preparation.

"Looking ahead, we announced that we will be updating our data in 2006 with a view to publishing the results more widely and are also seeking closer co-operation with like-minded institutions as our involvement in AIM goes deeper."

Copies of the full research are available from MTI Partners, price £99

We'd like to thank...

Celebrations were in order at MTI after we were named Venture Capital Fund of the Year, 2005

The accolade was presented at the VC "Oscars", The Investor All Stars 2005 at the Royal Lancaster Hotel, London. CEO Ernie Richardson was on hand to collect MTI's award at the ceremony, which featured representatives from European and American companies.

Ernie said: "This is wonderful reward for all the effort by everyone at MTI. It is recognition for the solid guidance provided by our partners to an exciting set of investee companies."

Inside ***Pro***venture

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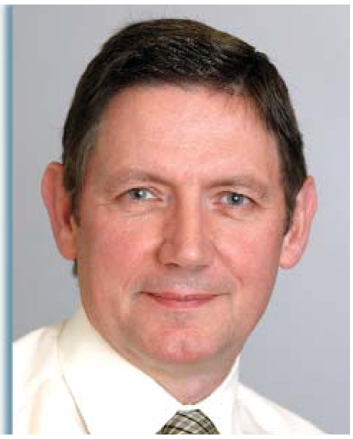
Welcome



Welcome to the Spring edition of *Proventure*, in which we have chosen to focus on the Alternative Investment Market (AIM) and the way that MTI interacts with that market, today and in the future.

AIM is a major phenomenon and its significance to anybody involved in young and developing technology businesses cannot be underestimated. As you can see from the other articles on this page AIM is now raising money for young technology companies on a scale which effectively makes it the biggest venture capitalist in Europe. Furthermore, that fund raising ability is not just for UK companies; it now encompasses small technology companies from Europe, the US and Israel, and there is no reason to think it won't reach further.

The involvement of US companies on AIM is particularly significant since AIM's growth in the small cap area has been co-incident with NASDAQ effectively moving up market. An IPO on NASDAQ now requires a minimum market cap of >$200m, and brings with it the major burden associated with compliance issues such as Sarbanes Oxley. Since financial markets, like nature, "abhor a vacuum" AIM has taken over the role previously effected by NASDAQ in providing a development route for small companies seeking public market status.

This activity is also reflected in the MTI portfolio of companies. During 2005 we listed Sarantel and ScreenTech and also sold MTI investee company iOra to an AIM listed software company called Corpora PLC. In 2006 we have already seen the listing on AIM of MTI investee Eleksen and expect to see at least one other MTI company. The attraction for us is twofold:

- access to significant funding at prices which make AIM highly competitive with the traditional sources of later stage funding for venture backed businesses, and
- establishment of credibility, by means of a public listing, which can be crucial in commercial dealings that our small companies have with much larger organisations.

AIM does have its issues (not least liquidity) and its detractors, but at MTI we regard it as one of the most important market developments of this decade and it provides opportunities which we will do all we can to encourage.

Ernie Richardson
Chief Executive

MTI is a leading UK venture capital firm which provides risk capital and management resources to early stage high-tech companies, and has established itself as one of Europe's principal venture capital fund managers.

The firm has provided equity investment, advice and support to over 60 early-stage and start-up UK technology businesses for over 20 years, all with superior composite net returns to investors.

The MTI investment team are experienced and highly qualified technologists, all of whom have achieved substantial success in commercial business environments at senior management levels.

The team participates actively in the management of investee companies, providing in-depth guidance and advice founded on a wealth of technological business experience at all times.

MTI currently manages funds aggregating over £157 million.

Research results show scale of AIM

MTI's John Polden was instrumental in commissioning the firm's research into the AIM market. *Proventure* asked him about the significance of the findings

Why did MTI instigate the research?
Our experience of and exposure to AIM has been increasing and we have significant portfolio exposure to AIM market. Added to that was the feeling that the market's appetite for technology investments is increasing.

How many MTI companies have been floated on AIM?
Most frequently we sell businesses in trade sales, but in total we've floated nine companies, of which, six were on AIM.

Have you retained shares in those businesses?
Previously we sold at exit or soon after the float; recently we have changed our approach and retained our stake in the business.

How long do you expect to retain those shareholdings?
Recently we have planned to hold the shares several years.

Were you surprised by any of the findings in your research?
The biggest surprise was the amount of money going into technology IPOs - around £1 billion p.a. - and the relatively weak returns these IPOs have been generating.

Spotlight on AIM

How open were City institutions to talking about their experience of AIM?
Very open; they recognise that the issues raised in the report are real and need to be considered.

Will you repeat the survey next year?
Yes, as we build up the number of companies and market changes over time, the research data-base will be much more interesting. We also plan to disseminate the research findings to a much wider audience.

What are the lessons for the VC community?
We believe that AIM has to be a significant factor in any VC's planning. Its scale means it cannot be ignored. How a VC prepares a company for IPO and its approach to the retention or sale of its stake are key factors.

Key findings

- ✔ Technology represents around 25 per cent of AIM activity
- ✔ Technology IPO activity has been going up each year since 2001
- ✔ Returns post IPO are in line with the general AIM index (there is no specific AIM tech index)
- ✔ Liquidity of investments is improving

- ✘ Liquidity of investments is still poor
- ✘ Lack of technology expertise in market
- ✘ Getting true value generation for IPOd companies remains difficult
- ✘ Most value growth is in pre-IPO or recovery phase: 2 year pre…..2 year post
- ✘ Conflicting shareholder motivations at IPO might affect returns

Take AIM: But is it the right direction?

Guest writer Giles Vardey examines the past, present and future of AIM

AIM's success as a source of new funds for smaller companies has been well chronicled. The market celebrated its tenth anniversary in 2005 with listings pushing 2,000 companies and a very strong influx of foreign companies. This success has helped the London Stock Exchange promote AIM as the leading public equity market for smaller companies in the UK, Europe and, now, elsewhere.

Nevertheless, the market's growth raises a number of questions for all those involved in funding smaller companies.

As Markets Development Director of the London Stock Exchange in 1995 I was heavily involved in the design and launch of AIM. Looking back now, many of the debates at the time seem prescient. There was a great deal of concern about the 'lighter touch' of regulation but a clear understanding of the need to lower the costs of listings and place a greater responsibility on the Nominated Adviser (NOMAD). It was believed that this combination would be attractive to smaller companies and investors alike.

Nearly 11 years on, and despite some high profile company failures, that objective has been achieved: smaller companies can get to market in a matter of weeks and keep costs well below that of a full listing. They also have a close relationship with their advisers, who in turn have seen a revival in small and mid-cap business. This has allowed a number of smaller brokers and investment banks to thrive on AIM business and promote the market still further.

> **"the most startling shift in recent years has been the growing interest of institutional investors and the desire of larger companies to access AIM"**

For many companies, an AIM listing has given their business greater impetus and offered them broader strategic options. The liquidity of some shares remains limited but that is hardly surprising given the market capitalisation of some and the restricted free float of their shares. Changes in regulation of other smaller company markets around the world have also boosted AIM's attraction, such as the USA's Sarbanes-Oxley legislation.

What about the investors? Perhaps the most startling development in recent years has been the growing interest of institutional investors and the desire of larger companies to access AIM. This has produced an interesting perception change amongst all the players involved in smaller company financing.

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Take AIM

At the launch of AIM, the debates were centred on whether VC and private equity firms could use AIM as an exit for their investments: it depended on the market attracting high-growth companies.

Now an AIM listing for many companies is more of a funding round in the public equity markets rather than an exit for existing investors. This has also been reinforced by nearly 150 companies moving from the Official List (the main UK equity market) to AIM in order to enjoy its perceived benefits. The presence of several companies on AIM with market capitalisations of over £1 billion can testify to that.

What about the future direction of AIM? Its global attractiveness is obvious and demonstrated by increasing numbers of overseas companies listing on AIM whilst investment opportunities across the market have been lacklustre in recent times. This should not detract from the broader role of AIM: more companies and more investors can access more opportunities in a diverse public equity market for smaller companies at a relatively low cost.

Let's see what the next ten years bring for AIM - it should be exciting.

– Giles Vardy is the chairman of Hunter-Fleming Ltd.

Going public... the

David Wither, CEO of Sarantel

Peter Smyth, Chairman of Screen Technology

Q: How far in advance did the company start serious plans for IPO?

Peter Smyth, Screen Technology: Thomas Swan and Tom Jarman for MTI, our two non-executive Directors, led the Company's funding planning. An AIM IPO had been considered for about a year alongside other funding options. In early 2005 it became clear that the timing was right for a summer float and the exercise to configure the Company for this started in earnest then. Once introduced to Screen Technology I soon became persuaded of the tremendous product and opportunity and joined the Company in the run-up to IPO.

David Wither, Sarantel: We floated in March 2005 and we started serious work on funding possibilities in Sept 2004. But the flotation option became a real runner around Christmas 2004.

Q: Was there one critical event that formed the tipping point for the IPO decision?

PS: There was no one event which led to IPO. However, it became apparent in the preceding months that there was a need to move more quickly from R&D mode to production, and this would require substantial funding at a level that the pre-IPO investors would not wish to bear alone. An AIM fundraising was the natural solution.

DW: The tipping point in favour of IPO over further private funding was late in the process. We ran a two-horse process until the road show was well underway and we saw there was good appetite for the story and the stock.

Q: How did you select advisers for the process?

PS: Our non-executive Directors led an extensive exercise of Nomad meetings. Some were ruled out by one party or the other and eventually Charles Stanley was chosen from a short list of two who were felt to best fit the Company and the investor base we were seeking. Other professional advisors were similar selected by meetings with a short list of the most likely. The non-execs weighed up three key factors in the choice of advisers: Fit to the Company, its goals and the market; personal relationship, skill and enthusiasm for the principles that would run the deal; total and contingent costs. This process worked very well and resulted in an excellent (and right priced) team of advisors.

Q: How long did the IPO process take – and was the timescale in line with what your advisers had predicted?

PS: It was a three-month process that ran in line with the timetable set by the advisers.

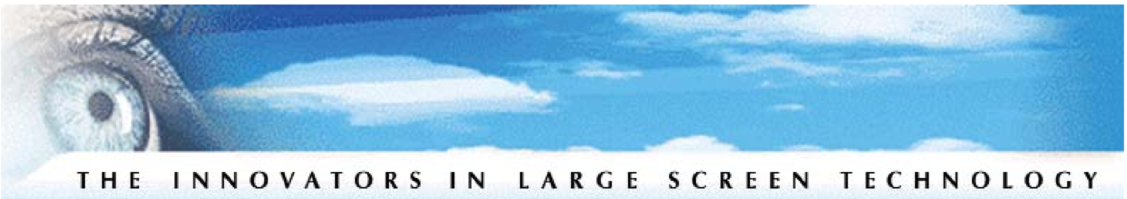
DW: The IPO took about three months, and yes, it was in line. Although one further piece of advice – learned the hard way – concerns the importance of the pre-float note. This is a research note issued by the house broker confirming the forecasts, etc. It is critical that this is in line with the lower end of management forecasts because this sets the City's expectations for post-float performance, and if you don't hit or exceed those numbers, your share price can take major punishment.

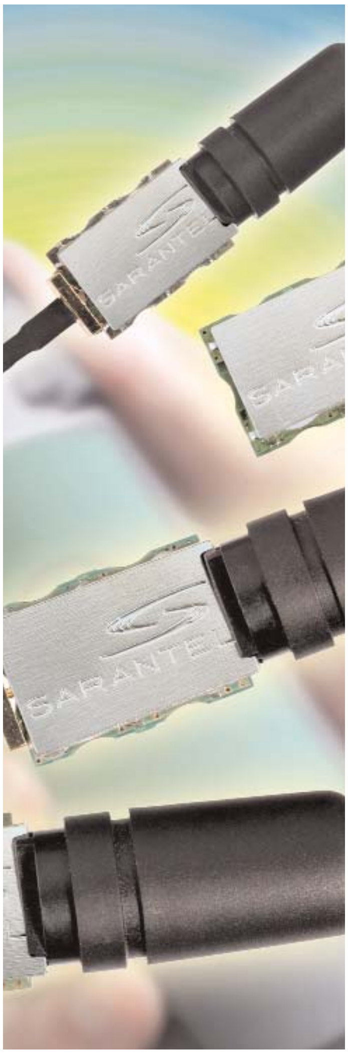
Q: Did all the management have roles in the IPO process or just some of the board? If some, how did you decide who was involved?

PS: Among the executive team, the CEO was totally involved but all other executives were kept out of the process and were only consulted when their particular expertise was required. It is hugely time-consuming and although exciting, is also very distracting so it is important that the management team ensure the business continues on track.

flotation game

So you think it may be time to float? *Proventure* asks the CEO of Sarantel and the Chairman of Screen Technology about their experiences of the IPO process





Before IPO we had a part-time FD but during the early stage of IPO we hired a full-time FD with quoted company experience. We also had extensive support from the non-execs, which was a great help and reduced the time demands on management.

DW: The IPO was driven by CEO and CFO, although the CFO did most of the painful work. The CTO also had input into documentation. During the early phase of the process the business was rather left to run itself, although later in the IPO a COO was brought on board to handle day-to-day matters. The IPO process is a major distraction for any business and you need a good core management team to mind the store.

Q: Was the indication of value from the advisers accurate?

PS: Yes.

DW: Yes, pretty accurate.

Q: How long did your road show take? How many institutions did you see and how many participated in the offering?

PS: The road show took about two weeks and was extremely intensive – we saw 50 institutions in 40 meetings. While the bulk of the presentations took place in London it also involved a day in Glasgow, a day in Edinburgh and a half day each in Birmingham and Manchester. The meetings were mainly with venture capital firms and private client brokers. Twenty new shareholders bought stock at IPO.

DW: Two gruelling weeks on the road seeing 60 institutions, of which ten came in at IPO.

Q: Did you make any form of investment exit at IPO? Was this in line with your plans?

PS: There was no form of exit at IPO and there was no intention of this. The shareholders are locked in for 12 months post IPO and undertake to abide by a further 12-month orderly market rule. So any sales by major shareholders during that period have to be carefully planned. In my experience, once the company gets through the first two or three years of life as a quoted company and can show it is on track, then as new shareholders buy in so existing shareholders can exit, but it needs to be well planned.

DW: No one exited at IPO; everyone stayed in which was very helpful.

Q: How have you adapted to life as a quoted company?

PS: It has been pretty straightforward as we were well run before IPO and had good governance procedures.

> **"It is hugely time-consuming and although exciting, is also very distracting so it is important that the management team ensure the business continues on track"**

DW: It's been painful growing up in the public eye. Shortly after IPO we had a delay on delivery of new equipment - a not unusual event - but because it had a short-term impact on sales numbers, there was a very real impact on share price.

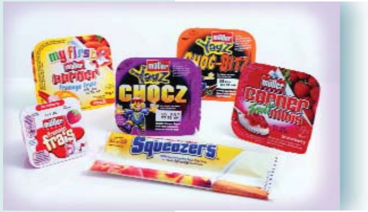
Q: What are the specific things that have changed?

PS: It is still early days and the reason for IPO of gearing up for production takes time, so we are still in the planning and setting up phase. What is different is that we have cash in the bank and can think and plan for the longer term.

DW: Having raised a substantial amount of money (£18m) from the IPO was very helpful in terms of growing the business. Flotation has allowed Sarantel to focus on its technology and not on fundraising.

Investee News

By any other name...



Müller Dairy packaging carries DataLase coding.

Sherwood rebrands to DataLase to reflect award-winning product

What's in a name? Phenomenal brand success, that's what...

Sherwood Technology has enjoyed such success with its indelible imaging technology that it has changed the company name to reflect the brand – DataLase.

The name change coincides with the opening of premises in the USA and precedes the launch of a significant portfolio of products this year.

Award-winning DataLase® is a process that uses a combination of colour change chemistry and low power laser light for a wide range of applications. MTI is the lead investor in Datalase and David Ward currently chairs the board of the company.

Plans for 2006 also see the existing coding and marking process rebranded DataLase® PACKMARK™, while the DigiVU™ range of security applications will now be known as DataLase® GUARDMARK™.

> "The name change precedes the launch of a significant portfolio of products this year"

The product suite set to launch this year will comprise: DataLase® CASEMARK™, cost-effective label replacement for secondary packaging; DataLase® FOODMARK™, for marking foodstuffs; and DataLase® PHARMAMARK™, for tablets and pills.

Heading up the new DataLase operation in Atlanta, Georgia is Vice President and General Manager Kevin Murray.

Kevin has more than 16 years' experience in the coding and marking and general packaging industries. For the past 12 years he has held sales and management roles at both Domino Amjet and NTS, Inc.

Opening a site in the USA has become essential thanks to the success of DataLase technology there. Following the US launch at Pack Expo 2004, Sherwood signed several license agreements with major international organizations, two of which are based in North America. A US patent, granted last year, has also stimulated growth.

iOra sale nets Corpora share

MTI has acquired a significant share interest in Corpora plc following the sale of web access and data synchronisation developer iOra in December.

Corpora, an AIM listed company, specialises in text search and analysis tools and has an extensive list of large and geographically dispersed clients.

iOra software enables users to work with enterprise applications locally, on a disconnected laptop, in exactly the same way as they would when connected to the corporate LAN, with the same speed, the same functionality and the same enormous range of information.

> "iOra has become part of a much more significant global player and Corpora has acquired a unique technology"

MTI invested £2 million in iOra in 1999 and has helped the company develop into an organisation with substantial global sales, to clients which include the US Navy.

MTI Chief Executive Ernie Richardson commented: "This is an excellent opportunity for both companies. iOra has become part of a much more significant global player, at just the time it needs international scale, and Corpora has acquired a unique technology and a range of new client relationships.

"With this potential benefit in mind, we have chosen to retain our consideration in Corpora shares, so that we can share in the upside."

Eleksen in reverse takeover bid

Smart fabric sensor firm set to join AIM

Eleksen is set to join AIM following the announcement that it is to be taken over by Bora Communications plc in a deal that values the Group at readmission at approximately £20.5 million.

The company, which was named one of the Top 50 Technology Innovators of 2005 by *IT Week* earlier this year, was recognised for its patented interactive fabric, ElekTex.

Bora, a cash shell whose shares were suspended in April, plans to seek readmission to AIM under the name Eleksen Group plc, with Eleksen shareholders owning 93 per cent of the new company

A recent £4 million funding round, to which MTI contributed, will allow Eleksen to expand and meet growing demand for its 'smart fabric' products.

Made up of five layers of electrically conductive fabric, ElekTex forms a highly flexible touch sensor only 0.6mm thick. It can be used to control electronic devices, such as MP3 players or mobile phones.

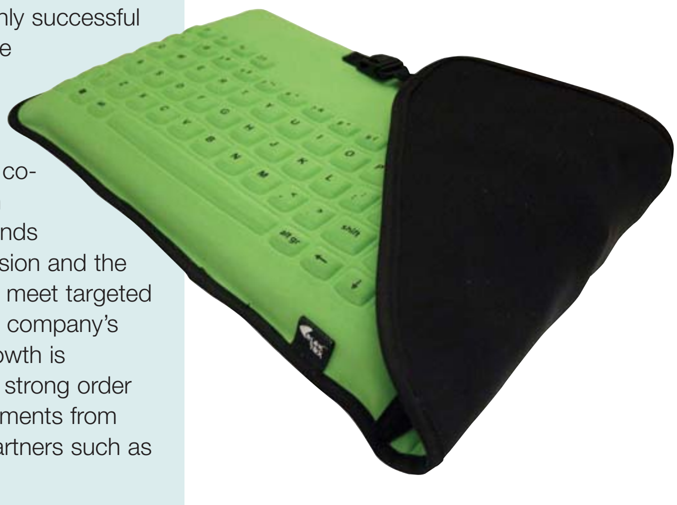
The sensor can detect where and how hard it is being pressed, so that the fabric can be used to 'plug into' and control devices direct or via Bluetooth.

There are numerous other potential applications in the consumer electronics market, as well as in other areas such as the military, automotive, industrial or healthcare markets, as demand for a new generation of interface between people and electronics develops.

Eleksen's product range was showcased at the Consumer Electronics Show, held in Las Vegas in January.

Robin Shephard, Eleksen's chief executive, said: "The company's admission to AIM is an important stage in its corporate developments and one which offers a great opportunity to the company and its shareholders."

MTI originally invested £4m in Eleksen alongside existing investors 3i, Siemens and several other VC firms and this group was joined by new investors, including Hotbed, for the recent funding round. MTI Senior Partner David Ward commented: "MTI has led a complete and highly successful restructuring of the business since it invested in June 2003, a process supported by our co-investors. Eleksen already has the funds needed for expansion and the working capital to meet targeted sales growth. The company's major planned growth is underpinned by a strong order book and commitments from customers and partners such as Microsoft."



Big new funding for Hunter Fleming

Pharmaceutical development company Hunter Fleming has announced the completion of one of the largest private biopharmaceutical financing deals in Europe in the last year.

The Bristol-based MTI investee attracted £15.5 million through a Series B round and the financing of a strategic joint venture. MTI led the £6.9 million Series B round, which attracted a blue chip international syndicate comprising Advent International (US), ITX Corporation (Japan), Omega Advisors (Switzerland), Pharmabio Development (US) and Finance South West Growth Fund (UK).

Dr David Holbrook, who leads MTI's Med Tech practice, said: "To have MTI's investment decision endorsed by such eminent co-investors gives us great satisfaction. Hunter-Fleming has made great strides since we first invested in July 2002 and this additional funding will enable the company to unlock an exciting array of new partner and finance opportunities."

Specifically, the new funds will be used to continue the clinical development of three compounds targeted at Alzheimer's disease, neuronal repair and spinal cord injury and treatment of pain.

Hunter-Fleming has also established a novel strategic joint venture with dedicated funding from Advent International and Omega to fast track the development of HF1020, an early-stage compound which embraces a novel concept for treating asthma and allergic conditions.

"This deal validates Hunter-Fleming's business model and its ability to construct novel partnerships to optimise its pipeline," David added.

Profile

Proventure talks to MTI Finance Director **Richard Henderson**

QUESTION
Why did you join MTI and what does your role entail?

ANSWER
I was attracted by the variety offered – I have responsibility for our own finances and IT systems as well as providing ad hoc support for our investee companies.

My main roles in investment support are in pre-investment diligence, often running the legal process and assisting on exits. In addition I attend board meetings of some investee companies and occasionally sit on their boards. Often I am asked to specify and source accounting systems for investees and help them recruit financial staff from Finance Director down.

QUESTION
What did you do before before joining MTI?

ANSWER
I joined MTI in January 2002 but prior to that I was financial controller for Setfair, a maritime e-procurement start-up funded by Inmarsat, the satellite company.

Much earlier, I worked for, and qualified as a chartered accountant with, Ernst and Young in Edinburgh before taking over as financial controller of the UK divisions of John Swire and Sons Ltd. Subsequent to an MBI and spinout of one of its divisions I joined SMH Ltd, a national asset rental company, as FD.

QUESTION
Does MTI bring anything to its investee companies beside finance?

ANSWER
Very much so, primarily, and unusually for a European VC, operational experience. All entrepreneurs and early stage companies find themselves with challenges that can often become difficulties, despite the best efforts of all involved. All MTI's executives, including myself, have real operational experience in VC-backed companies and can appreciate not only what needs to be done but how to do it without causing a drama or crisis.

QUESTION
What is your view on the current UK VC market?

ANSWER
The venture industry needs to close the perceived gap with the US. We need to continue to increase the healthy rate at which we create and develop world-class value from technology companies in the UK and make more noise about the success we do have. There is nothing so different about the environment in the UK compared to the US but, as always, improvements could be made and the government could help.

It's really not the government's role to subsidise start-ups, and everyone is probably better off the further it keeps out of it, but one way to help create a virtuous cycle of innovation, growth and job creation is to mandate that proportions of public sector procurement contracts be granted to smaller companies. This works well in the US and a similar arrangement has been suggested for the UK.

The rude health of the AIM market and its current role as a provider of fairly early stage development capital via IPOs presents both opportunities and challenges. Perhaps VC's traditional role of developing companies to beyond the early stage and then IPO-ing (or selling) them may need to be re-examined in light of the AIM effect and in particular the extent to which VCs continue to support and nurture them once they are on-market?

QUESTION
What would your advice be to a potential investee?

ANSWER
Take full advantage of the help and advice MTI can offer. It's valuable and borne out of more than 20 years' experience – as shareholders together with management we have a mutual interest in value creation. Break down the initial barriers – get us onside and keep us there!

QUESTION
Away from MTI what are your interests?

ANSWER
I played bagpipes and enjoyed much folk music in Scotland, which probably had some influence on my taking up the banjo since joining MTI. The attraction may be that a lot of old-time and bluegrass banjo music is related to Irish and Scottish music, particularly the fiddle tunes and rhythms. I also take a fairly active part in politics.

My wife doesn't share my banjo passion, which is good in a way since I don't have to listen to anyone else practice, but I am hoping to pass it on to my two young children.

"All MTI's executives, including myself, have real operational experience in VC-backed companies and can appreciate not only what needs to be done but how to do it without causing a drama or crisis"