

The inside guide to private equity



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## Introduction

City One Securities Limited is authorised and regulated by the Financial Services Authority to provide corporate advice to businesses. The management team has collectively in excess of fifty years of experience and is well known and respected within the industry. We have written this guide to provide investors with a better understanding of how the UK private equity industry works and why it is relevant to you as an investor.

The term “*unquoted investment*” is a good example of how the industry can unnecessarily complicate things for investors; you may have read this term throughout many documents produced within the industry. It is important to establish that, if an investment is referred to as a unquoted, it does not necessarily mean that it is not listed on a stock market. In fact, many of the UK’s unquoted securities or shares may well be listed on one of the UK’s smaller markets or share platforms such as AIM, PLUS Markets, or ShareMark (details of these markets can be found later in this guide).

The term “*unquoted investment*” can be applied to any investment in UK shares or securities that are in a company not listed on the main London Stock Exchange.

Having established what an unquoted investment is, the next step is to explain what Private Equity is and why is it needed.

Put simply, Private Equity is medium to long term finance provided to an unquoted company in return for an equity stake in the business.

The UK private equity industry has grown steadily over the past two decades and, in global terms, is second only to the US. In fact, over the past six years, almost £70 billion of capital has been raised for investment in unquoted businesses.

One of the main reasons for the increase in this sector in the UK is that high street banks were, traditionally, the first port of call for entrepreneurs to raise finance for business expansion. Over the past 20 years, the UK banks have moved away from equity-based lending and are now only interested in lending to businesses if the directors provide them with personal guarantees and suitable security to cover the amount borrowed.

This presents a significant problem for businesses looking to borrow in excess of £250,000 because banks always want a margin on their security and few, if any, will lend more than 70% against the value of the property for commercial purposes. This has led to what is often referred to as the ‘equity gap’, the figure between where high street banks stop funding small businesses (circa £250k) and where the specialist corporate and merchant banks start operating (circa £3-5m).

The result of this ‘equity gap’ is that there has been a significant increase in Private Equity investment in the last ten years.

## Why Private Equity?

Whilst there are many different tax advantages to investing in Private Equity, such as tax relief on your investment and exemption from Capital Gains Tax (CGT); investors should never lose sight of their reason for investing. Tax advantages are an additional benefit but the main reason for investing should be to obtain a competitive return from your capital.

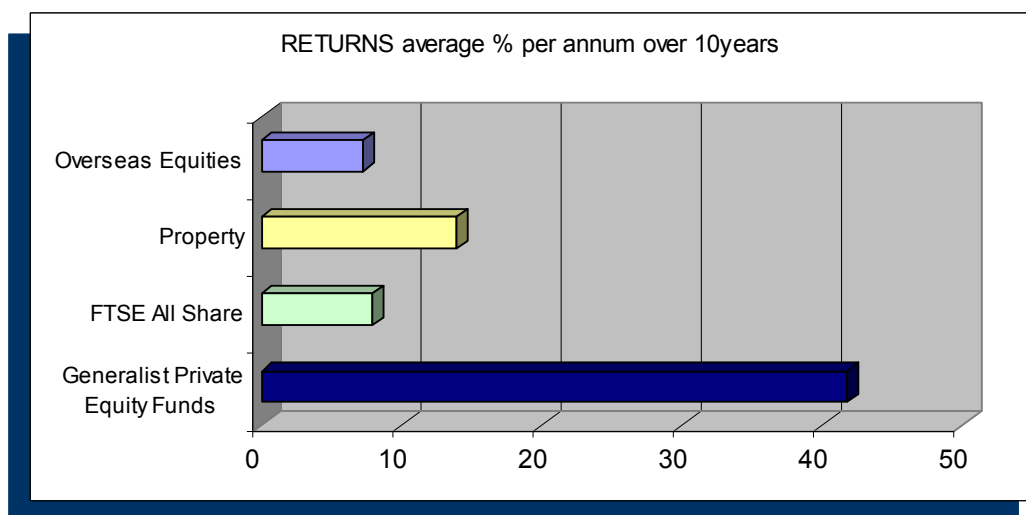
When it comes to returns on capital invested, the simple fact is that the majority of high street brands represented on the London Stock Exchange simply do not have the scope to grow their sales revenue by 20 or 30 % per annum. Consequently, the return you are likely to receive from such companies will be similarly limited. Companies looking for Private Equity funding usually display significant opportunities for growth of their sales revenue and future profits which makes them attractive to investors looking for higher returns.

# Why private equity?

When it comes to delivering higher returns, it is worth bearing in mind that Private Equity as a sector has performed exceptionally well.

According to the British Venture Capital Association (the industry body for UK private equity and venture capital) over the last three and ten years generalist private equity funds have produced average returns per annum of 25.7% and 41.8% respectively.

As illustrated in the graph below, these returns compare favourably against investment in other investment sectors.



Source: BVCA Performance Management Survey ( latest survey 2006 )

It is important to remember that investment in Private Equity companies should be given time to mature and, whilst some companies may show good early returns, investors looking for a quick profit would be wise to look at other market sectors. Additionally, such higher returns do come at a risk as private equity investments are considered higher risk than investments in regular stocks and shares listed on the London Stock Exchange (LSE).

## Investing in Private Equity

There is a variety of ways in which to invest in private equity. The way that is best will depend greatly on how much you have to invest and what experience you have in picking your own investments. Generally speaking, Private Equity investment should be looked upon as part of a balanced portfolio.

Most private equity deals are not generally made available to the private investor as they are usually taken up by City institutions, Private Equity funds, Venture Capital Trusts (VCTs) or are part of a restricted circulation known as a private placing (details of which can be found in the next section of this document).

Private equity investments can be made by an individual in a private placing or public offer or, alternatively, as part of a collection of investors that pool their funds to make private equity investments. This pooling of funds can be done to make a single investment as part of a syndicate (Business Angels Network - see next section) or can be done as part of a professionally managed fund or VCT. These are specially designed investment vehicles that enable investors to benefit from tax reliefs whilst spreading the risk of their investment over a range of companies, usually in a range of different industry sectors, although some funds or VCTs may specialise in a specific niche market such as bio-technologies.

An alternative to investing in a fund is to build up your own portfolio by investing in a number of different placings or offerings. The advantage of building your own portfolio is that you get to choose the companies you feel have the best

potential and you can avoid certain sectors that you might wish to avoid or that do not fit in with your investment strategy. The other advantage is that you are able to save on the cost of having your investments professionally managed.

The downside to this strategy is that you may miss out on some of the best opportunities because, as previously mentioned, many of these deals are taken up before any Initial Public Offering (IPO) is made.

Additionally, knowing when to exit from your investment is an important aspect that is often overlooked; you should always keep yourself informed as to how the individual companies in which you have invested are performing both in terms of their trading results and share price.

When buying private equity investments it is important to know from whom you are buying, what their connection is with the company and what role they play in the industry.

## Corporate Finance Houses

These are authorised and regulated by the Financial Services Authority (FSA) to arrange (bring about) deals in investments. Any public offer that has been arranged by a Corporate Finance House should have been verified to ensure that the information contained within the offer document/prospectus is fair, accurate, not misleading and has no vital omissions.

Investors should always check whether any offer document they receive has been produced by a company authorised by the FSA to arrange deals in investments; investors should always refer to the FSA website – [www.fsa.org.uk](http://www.fsa.org.uk)

## Stockbrokers

These institutions are authorised and regulated by the FSA to advise on investments. If you are being offered unquoted investments by a stockbroker it is important to establish whether it is for a new issue of shares or for shares that have previously been held by an investor or institution.

If the shares have been previously issued to someone else, many of the tax advantages, such as income tax relief and exemption from CGT, will not be available to any buyer of existing shares. Whilst this should not necessarily stop an individual from investing, it is important to establish whose shares are being offered for sale. Some stockbrokers are authorised to buy shares on the open market and (as principal) sell on to investors. If this is the case, always ask at what price they purchased the shares. Keep in mind that, if the shares were purchased at a significant discount to the current market price, this is a likely reflection that the current share price may be over inflated and likely to drop in the future.

Once again, do not rely on someone telling you that they are authorised by the FSA: always refer to the FSA website.

## To be avoided at all costs - Boiler Rooms

Originally this term was used to refer to small and often less than legal brokerages in pre-1940s USA. They couldn't afford proper offices in Wall Street and thus literally worked out of the boiler rooms.

In the UK today this is a generic term used to describe unregulated, highly pressurised telephone sales operations selling investments to UK investors. They are usually based overseas and are not regulated by the FSA (Spain is a favourite location for such activities). With modern technology it is relatively easy to disguise the fact that they are operating from abroad; it is, therefore, important to distinguish them from a UK regulated broker by checking with the FSA.

Boiler Rooms are not compliant with the rules and regulations of the UK, hence why they operate from abroad and the investments they sell are unlikely to provide investors with any positive returns; in fact, the likelihood is that investors often lose a significant proportion, if not all, of the capital invested.

## The types of investments

### Initial Public Offering (IPO)

An IPO is an invitation to subscribe for a new issue of shares at a set price via a public offer document admitting the company to a market such as AIM or PLUS Markets (see section on Unquoted Markets). The type of document and rules to which it must adhere depends on the amount being raised.

If the figure to be raised is in excess of €2.5m, the document must comply with the rules of the UK Listing Authority and the prospectus must be approved by the Financial Services Authority (FSA). This means that the prospectus has to comply with the rules for companies listed on the main London Stock Exchange. To comply with these rules and provide supporting documentation that has been verified by lawyers and accountants is an expensive and time-consuming process for small companies trying to raise finance.

For companies raising less than €2.5m the document must comply with industry best practice and it must be issued by a person authorised and regulated by the FSA to '*bring about and arrange deals*'. Importantly, the document must be 'true, fair, not misleading and have no vital omissions'. An offer would usually remain open for 40 days but can be extended once the minimum subscription has been received.

### Private Placements

This is a way of raising funds by restricting the number of individuals that are to be offered the shares. Any documentation for the placing must be approved by an FSA regulated person unless, as is often the case, the placement is only to institutions or Sophisticated Investors / High Net Worth Individuals (see Business Angels).

### Pre IPO Funding

As the name suggests, this money is raised prior to any IPO issued by a company. Usually this type of Private Equity is supplied by family/friends, Business Angels or Venture Capitalists. Additionally, Venture Capital Trusts and EIS Funds like to invest at this stage as they can negotiate a lower share price than by subscribing at a set price, such as an IPO or private placement.

### Business Angels

This type of investment is where Sophisticated Investors and High Net Worth Individuals are able to invest, pre IPO, in companies requiring finance. The companies requiring investment are sourced by a Business Angel Network and can only be offered by that particular Business Angel's investor network to individuals who are one of the following:

- Sophisticated Investor – someone who has invested in at least one unlisted company within the last two years, has been part of a network or syndicate of business angels or worked in a professional capacity within the Private Equity sector.
- High Net Worth Individual – someone who has an annual income in excess of £100,000 per annum or who has net liquid assets in excess of £250,000 (excluding property & pensions).

### VCTs & EIS Funds

For Investors looking to spread their risks or have their Private Equity investments professionally managed, there are two main types of investment available: Venture Capital Trusts (VCTs) and EIS Funds.

## VCTs

A VCT is a public limited company quoted on the LSE that raises money from shareholders to invest in Private Equity. VCTs were introduced in 1995 to encourage individuals to invest in UK smaller companies.

The advantages of VCT are that an experienced team of experts selects which investments to make on behalf of investors and, due to the pooling of funds, enables larger investments to be made, coupled with the ability to spread the amount to be invested over a larger number of deals. Investors may receive up to 30% of their investment back in the form of income tax relief and any dividends received from a VCT are tax free.

The downside to investing in a VCT is that you are not directly investing in Private Equity deals and, as such, you lose many of the additional tax reliefs available, such as loss relief and exemption from Capital Gains Tax (CGT) on any gains your investment makes. Furthermore, you cannot defer any existing CGT liability through your investment and your investment is not exempt from Inheritance Tax.

Additionally, investors in VCTs pay for the costs of running the listed PLC. These are usually in the region of 3 - 3.5% of the money raised for each year the VCT is in existence and the investment management team are usually paid circa 1.5% p.a., on top of the set up costs of the share offer, circa 6% of funds raised. Thus, for a five year holding, costs could account for in excess of 25% of the amount originally invested.

The rules for VCTs allow the investment team to take up to 3 years to fully invest the funds. This is not necessarily a positive aspect, as the benefit of being able to take your time to invest means that investors' money is, for a significant period of time, earning bank deposit interest which is likely to be less than the annual management fees.

## EIS Funds

Technically these are not Funds but managed portfolios of EIS qualifying investments (see section on EIS). As with a VCT the benefit of having investments professionally managed is attractive to the Private Equity investor who may not have the time or experience to source and research investment opportunities.

Investors can claim income tax relief on the amount of their investment and additionally the investment is exempt from CGT, previous CGT can be deferred through it and it is exempt from Inheritance Tax (see section on Tax incentives for investing in private equity). Importantly, the individual investments qualify for loss relief (not available through a VCT), so even if your portfolio makes you a substantial gain overall, you can claim income tax relief (at 40% for higher rate tax payers) for any individual loss within the portfolio, irrespective of how the other investments have performed. The cost of running an EIS Fund is much less than a VCT in both real terms and as a percentage of the amount invested, so more of your subscription ends up being invested in Private Equity.

The downside is that most EIS Funds are not as large as VCTs and, therefore, the spread of investments tends to be smaller and thus will have less diversification.

The investment manager has less time to invest the funds which means a higher percentage of investors' money must start working sooner as Funds have to invest subscription monies within 12 months whether the Fund is an Approved or Unapproved Fund.

An approved EIS Fund enables investors to have their EIS tax relief treated as one lump sum investment which for tax purposes is deemed to have been made as at the date of subscription to that fund (even if the subsequent investments are made in the following tax year). An unapproved fund only attracts EIS relief for investors as each individual investment within that fund is made (this could mean that the income tax relief is spread over two different tax years).

# The types of investment

Additional terms or type of offers include:

## Rights Issue

A new issue of shares, exclusively offered to existing shareholders at a set price, usually at a discount to any existing share price.

## Entitlement Issue

An issue of shares at a set price that has been offered to existing shareholders, but has not been fully taken up and, therefore, subsequently offered to other investors. This is still a new issue of shares and therefore qualifies for EIS tax reliefs.

## MBO (Management Buy Out)

A deal that enables the current management team and investors to buy a sufficient shareholding in the company that effectively gives them control of the business.

## MBI (Management Buy In)

A deal that enables a manager or group of managers from outside a company to buy into it (not necessarily giving them control of the business).

## Venture Capitalists (VCs)

VCs can be either private individuals or firms specialising in this arena. Typically they look to take a significant shareholding in any company they get involved with and will want a seat on the board of directors. For larger investments (£2m+), the VC may want control of the company as part of the deal.

Whilst they usually bring experience to the table and often the ability to open doors that would otherwise have remained closed to the business, it is worth remembering that a majority holding means control of the business. In effect, the company could be sold off whenever and to whomever the VC prefers. This, therefore, may conflict with the original entrepreneur's wishes or long-term vision for the company.

## What makes a good private equity investment

It is important that any potential private equity investments have certain characteristics that would define their ability to deliver sustained capital growth.

The best starting point with any business is to fully assess the management team:

It is important to understand that even the very best business ideas will fail if the management do not have the ability or experience to generate revenues from their proprietary products or services. The inability of companies to deliver sufficient income in terms of sales revenue is almost certainly the most common reason for smaller companies failing.

When looking at companies that require expansion it is essential that the management have the business acumen and experience to avoid the classic mistake of overtrading - which inevitably leads to cashflow difficulties for that company.

Crucially, the management must be people that are trustworthy, diligent and have the desire and drive to succeed, preferably with a successful track record.

# What makes a good private equity investment

The business itself should have a proprietary product or service, preferably with a simple operating model – the more complicated the business model, the harder it is for the management to control the day-to-day operational issues and, therefore, the less likely it is for the business to succeed. The marketplace in which the business operates should be either a new or growing market, the company itself must be able to demonstrate that it can establish itself within that market and gain significant market share or preferably has done so already. The company should have a robust operating model that can be expanded or franchised and is future-proofed i.e. it will not become obsolete within the foreseeable future.

Current profitability should not necessarily be viewed as a pre-requisite for investment; indeed, companies that are already showing high levels of profitability are less likely to have conservative valuations agreed by their existing owners and thus future returns are likely to be smaller as a result. Any potential investment should be able to demonstrate that it has the capability to grow both revenues and profitability that will add significantly to the future value of that company.

Investors need to know how any funds raised will be deployed by the investee company and what its impact will be in relation to the growth of that company's future valuation. Additionally, any proposed investment in a company should fit in with the investor's timescales; for instance, there is no point in investing in a private equity offer if that capital is required within the next two years.

For companies whose main function is primarily research and development or building intellectual property, working capital will always be an issue unless the company in question is able to sell on or license the developed technology. Anyone looking to invest in such a company should do so on the understanding that the company is unlikely to have any revenues to help pay the operating costs of the business. Often the route to market takes longer or the cash burn is higher than originally expected and, as a result, such businesses often have to go back to investors for additional funding. This does not mean that such companies should be avoided but it is important for investors to understand the problems associated with this type of investment as many run out of funds before they can get their product to market.

The current valuation of any private equity investment should be assessed to ensure that it is realistic given the prevailing market conditions; some offerings are overvalued to justify the fees charged by the advisers/brokers to the company in question. An investor should look to actively monitor the company's growth throughout the term of their investment. If the company's growth model is successfully sustained, this should enable a secondary market to be established, thus providing investors with the ability to exit.

When investing in private equity it is always worth remembering that individual investors will have different preferences for different sectors. Additionally, each investor tends to have his or her own calculations or theories as to how to value a company. In the Private Equity arena there is no golden rule as to whether one sector is better than another. Therefore, a consistent approach to assessing a prospective investment is imperative; before considering how to value companies and businesses, any prospective investor should look to satisfy himself or herself as to:

- the strength of the management
- the inherent risks of the chosen business model
- the market addressed
- the sector
- the stage of development

Subsequent valuations and the way they are derived vary greatly depending on these points; for instance, established retailers such as Tescos are valued primarily on their ability to generate profits for their shareholders whilst property businesses are valued on the net asset values of their company. The stage of development will make a significant difference to the valuation placed on a company, with early-stage companies discounted because of the larger risks involved and ex-growth companies discounted through lack of prospects. Ideally, most investors would prefer to look at companies that have positive cashflow, profits and assets that additionally can demonstrate a high growth potential. Whilst such companies deserve the best ratings, investors often find that such businesses are overvalued.

When valuing private equity deals most people working within corporate finance would look to establish the following:

- P/e ratios (price to earnings) and P/e to Growth (PEGS) ratios;

# What makes a good private equity investment

- Net Assets;
- EBITDA (earnings before interest, tax, depreciation, and amortisation);
- Goodwill against Fair Value accounting;
- NPV (net present value) of dividend or cash flow; and IRR (internal rate of return) based on exit values (venture capital model).

Finally, there are the companies listed on the UK's unquoted markets, where the share price and subsequent valuations are predominantly about supply and demand. The majority of trades in unquoted shares are matched bargains. This means that there is a buyer and seller for the particular trade to be concluded without the need for a market maker. The supply and demand factor can lead to dramatic variations in unquoted share prices: demand can drive the price and subsequent valuation up steeply. Conversely, shareholders looking to sell without any corresponding buyer can cause the share price to drop significantly as market makers mark the price down accordingly.

Many investors in private equity are keen to see unquoted companies in which they invest progress to unquoted markets, however, companies seeking a quote prematurely can suffer from a sliding share price if they are unable to establish positive results early enough. A depressed share price can jeopardise future fund raising and thus adversely affect the future of that company.

## Tax incentives for investing in private equity

The tax incentives for investing in Private Equity can be in certain circumstances extremely advantageous in that they can reduce:

- the cost of the investment
- losses that could occur
- inheritance tax liabilities and provide tax free gains.

Whilst these tax benefits often make an investment more attractive, it should always be kept in mind that they are not, in themselves, the primary reason for investing.

### Which Companies Qualify for EIS Relief?

As previously stated, in order for a company to qualify for EIS it must be unquoted, i.e. not listed on any recognised stock exchange such as the London Stock Exchange (companies traded on AIM, PLUS Markets or Sharemark count as unquoted). For an investment to qualify, the 2007 Budget has imposed a restriction in that the company must have raised no more than £2 million (as a qualifying investment) in the 12 months preceding the date of the investment. Furthermore, the number of employees of a company which is raising capital via EIS or VCT schemes will be restricted to 50 full time employees at the date when the shares or securities are issued.

It must be a trading rather than an investment company and activities such as banking, insurance and financial activities, legal or accounting services and letting of property are all excluded.

A holding company may qualify for EIS provided its subsidiaries carry on a qualifying activity or it carries on a qualifying trade itself. Start-up companies have to be seen to be preparing to carry on a qualifying activity to start trading within two years. These companies can only get provisional approval from the Inland Revenue; tax relief will not be available for investors until the company has been trading for four months. The company need not be in the UK but its activities must largely be carried on in the UK. Qualifying companies may use EIS as a source of start-up and expansion finance by issuing new ordinary shares. Once the company has received the funds, trading must start within twelve months from issue of the shares or from when the qualifying activity is started.

## Restrictions on Investors

An investor may not be connected with the company. Therefore, neither they nor certain close relatives may be an employee or partner, own 30% or more of the shares or in any way control the company or any subsidiary. The Inland Revenue's definition of 'connected' is quite complex and, if in doubt, please seek expert advice.

To receive EIS tax relief the minimum anyone can invest in a company is £500, but the companies themselves may choose to increase the minimum to control the number of shareholders. The maximum an individual can invest in one company is restricted up to 30% of each company's share capital. The investor can buy shares in as many qualifying companies as he or she likes, up to a maximum of £400,000 in any tax year. Husbands and wives can apply separately for the full individual subscription amounts that qualify for EIS relief.

Up to one half of the amount invested between 6<sup>th</sup> April and 5<sup>th</sup> October in any year may be carried back to the previous tax year if that individual did not invest the full amount during that year, subject to a maximum of £50,000.

## The Tax Reliefs Available

Whilst considering higher risk investments, some opportunities offer investors the possibility of substantial capital growth and additionally the EIS scheme does allow certain tax reliefs for investors who invest in qualifying shares in qualifying companies. There are six main tax advantages potentially available to individual investors relating to investments in unquoted companies that qualify for the Enterprise Investment Scheme (companies whose shares are traded on PLUS and AIM are classed as unquoted for tax purposes).

- An investor can reduce his income tax liability by an amount equal to 20% of his share subscription. The maximum qualifying investment per investor is £400,000 per annum (**EIS relief**).
- No Capital Gains Tax is payable on disposal of shares after three years, provided the EIS initial income tax relief was given and not withdrawn (**Exemption from CGT**).
- Deferral of gains realised on disposal of a different asset, where the disposal of that asset occurred less than 36 months before the EIS investment or less than 12 months after it. (**CGT Deferral relief**).
- If EIS shares are disposed of at any time at a loss, such loss can be set against the investor's capital gains or his/her income in the year of disposal (**loss relief**), even if other EIS investments within the Fund are still held on behalf of investors.
- EIS investments should qualify for 100% exemption from UK Inheritance Tax (**IHT relief**).
- Where unquoted shares purchased do not qualify for CGT exemption they will qualify for a reduction in any CGT liability that may arise (**Business Asset Taper Relief**)

## EIS relief

Individuals may obtain EIS Relief. This effectively reduces their UK income tax liability by up to 20% of the amount subscribed for investments in EIS qualifying companies, with a maximum qualifying amount of up to £400,000 in any tax year. Husbands and wives can each make separate investments up to £400,000 in any year.

### Example:

Initial Investment	£ 50,000
Less income tax relief at 20%	(£ 10,000)
Net Cost of Investment	£ 40,000

# Tax incentives for investing in private equity

## Exemption from CGT

Any capital gains made on investments in EIS Qualifying companies are exempt from CGT, provided the shares are held for three years from the date of subscription, subject to a maximum qualifying investment of £400,000 per tax year, provided that the EIS Relief obtained has not been withdrawn.

### Example:

Realised value of investment after 3 years	£ 80,000
Less initial investment	(£ 50,000)
Tax free gain	£ 30,000

## CGT Deferral relief

Investors with a Capital Gains Tax liability can defer this liability by investing the amount of the capital gain in EIS Qualifying Companies at the higher tax rate, currently 40%. The individual Qualifying Investments must be made within thirty six months from the date of the asset disposal to which the CGT liability relates. Investors can also defer a liability twelve months before the date of the asset disposal to which the CGT liability relates. The liability will recrystallise on disposal of the investment, unless there is a further CGT deferral. There is no limit on the amount that can be deferred; however, only the first £400,000 will qualify for EIS relief.

### Example:

Initial Investment	£ 50,000
Less income tax relief at 20%	(£ 10,000)
CGT Deferral	(£ 20,000)
Net cost of Investment	£ 20,000

## Loss relief

If shares in an unquoted company are sold at a loss or if the Company fails, the resultant loss (less any income tax relief the investor may have received on the original investment) can be set against taxable income in that year or the previous year. If this is not appropriate, the loss can be set against capital gains in future years.

If the shares have become of 'negligible value', the shares do not need to be sold for a loss relief claim to be made. To claim the loss relief if the shares are of negligible value you will need to provide HM Revenue and Customs with supporting information such as letters from any appointed administrator, receiver or liquidator.

### Example:

Initial Investment	£ 10,000
Less income tax relief at 20%	(£ 2,000)
Net Cost of loss on investment	£ 8,000
Loss relief at 40% on loss	(£ 3,200)
Total loss to investor	£ 4,800

## IHT relief

Investments in unquoted companies count as 'business property' and so should be excluded from any UK inheritance tax calculation, provided that the investment has been held for at least two years. IHT is generally concerned with an individual's status and the regulations are complicated, so specialist advice is recommended.

### Example:

Initial Investment	£ 100,000
Less income tax relief at 20%	(£ 20,000)
Capital Gains Deferral at 40%	(£ 40,000)
IHT Relief at 40% on loss	(£ 40,000)
Net cost of Investment	£ NIL

## How Do Investors Claim Their EIS Tax Relief?

After a subscription to a qualifying offer has been accepted, the relevant tax certificate (either an EIS 5 or EIS 3 certificate) will be issued by either the Fund Manager or the qualifying company, depending on whether your investment is in a Fund or a single qualifying company. The appropriate certificate is then forwarded by the investor to the Inland Revenue and the appropriate rebate in income tax is granted. The tax may be repaid by cheque, by adjusting a PAYE code or by deducting the relief due from future income tax payable. The method used will depend on the investor's personal circumstances and independent professional advice should be sought. Investors should also be aware that EIS relief can be lost if either a shareholder sells his or her shares or if the company loses its EIS status within the first three years. Both of these situations would lead to investors having to repay any EIS tax relief received.

## The risks involved in investing

Unquoted securities are considered higher risk than investments in the securities or shares of companies quoted on the London Stock Exchange. Whilst the shares may be traded on markets such as PLUS or AIM, they would still be considered unquoted investments, and may be difficult to sell. Investors should also note that there may be no market maker or that any market maker available may not be prepared to deal in them.

The value of shares can go down as well as up. Unquoted investments, in particular, can be subject to sudden and significant changes in value both downwards as well as upwards.

It is, therefore, worth bearing in mind that gains in EIS qualifying companies are exempt from Capital Gains Tax.

Whilst unquoted shares are considered higher risk, investors should keep in view that any loss crystallised from the sale of an unquoted investment can be reduced by claiming income relief (at 40% for higher rate tax payers) on the amount of the loss.

## The Unquoted Markets/Platforms

### AIM

The Alternative Investment Market was launched by the London Stock Exchange in 1995 to provide smaller companies with access to new funds for expansion and to create a market where shares can be traded. Since its launch in 1995, over 2000 have joined AIM raising almost £20 billion. AIM has become hugely successful over the last five years and now

has more companies listed than the main London Stock Exchange. For smaller companies looking to raise in excess of £2m in one fundraising, it has become the natural default choice of market; however, the cost of joining can be prohibitive for smaller and start-up companies.

## The Costs of joining AIM

Whilst there is an admission fee of £5,870 for companies with a market capitalisation of up to £5m, this figure rises to between £11,873 and £20,584 for companies with a market capitalisation of between £10m - £50m, plus an annual fee of £4,340 payable to AIM. Companies looking to list on AIM require an AIM Nominated Adviser (Nomad), as well as the services of law and accountancy firms conversant with the rules and regulations of AIM. Additionally, the services of a broker and PR or Investor Relations company may well be required. The likely total cost of attaining an AIM listing will probably exceed £350,000 and at least twice that if a fundraising is involved.

## PLUS Markets

Plus Markets Group (PMG) is an independent UK provider of primary and secondary equity market services and currently trades over 1000 small and mid-cap company shares, representing a combined market capitalisation of over £195 billion. Formerly known as Ofex, this market was created in 1995 to provide a share dealing platform for unquoted securities. This facility was operated by JP Jenkins Ltd, a member of the London Stock Exchange but has since been turned into a public limited company whose shares are traded on AIM: Plus Markets Group plc was established in November 2004

PLUS Markets has 7 market makers offering competing prices on the quoted companies committing their own capital to the market, playing a key role in providing price information and liquidity. On 19th July 2007 PLUS became a Recognised Investment Exchange, giving it the same status of exchange as AIM.

## Costs of joining PLUS Markets

Whilst there is a highers admission fee of £6,000 and an annual fee of between £4,900 and £8,000 per annum depending on the market capitalization of the company, payable to PLUS Markets, companies looking to be quoted will need to have a PLUS Markets Nominated Adviser. The likely total cost of attaining a PLUS Markets quotation will normally be in the region of £100,000.

## ShareMark

ShareMark is a stock market for infrequently traded shares or loan stock. It is designed to offer a simple, lightly regulated, cost-effective and flexible service. It provides shareholders with an exit route and valuation, and may be used to introduce new investors. ShareMark executes trades at a single price, overcoming the wide bid-offer spreads suffered by infrequently traded investments. ShareMark is suited to companies who want:

- to provide an exit route for existing shareholders, including employees;
- to provide an internal market;
- assistance with valuing the company for taxation or estate valuation purposes;
- to raise their profile and gain experience before moving to a more senior market.

Established in 2000, ShareMark is a trading division of The Share Centre, which is regulated by the Financial Services Authority. Companies using ShareMark include London Irish Holdings Limited (parent company of London Irish Rugby Club), Dairy Farmers of Britain, the UK's largest farmer owned co-operative, Replizyme, an early stage bio-tech company and Countrywide Farmers.

## Notes

This guide is for information purposes only and has been written to provide an outline guide for investors in Private Equity and, as such, should not be taken as any form of advice or as to whether a particular investment may be suitable for an investor. The tax details and examples given only apply to UK taxpayers and details given about Inheritance Tax apply only if you are UK domiciled.



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