

oxford technology

Combined Seed Enterprise Investment and Enterprise Investment Scheme Fund

OT(S)EIS – The Start-up Fund

The case for investing in OT(S)EIS

Oxford Technology has specialised in investing in start-up science businesses in and around Oxford since 1983. We enjoy the process of helping to create successful science businesses and we believe that we are good at it. We are based in the Oxford Science Park. All our investment managers are scientists or engineers. Almost all our investments are within an hour's drive so that we can be actively involved with our investees to help them get started.

Investing in a start-up science business is extremely risky. There are so many things which can and do go wrong. But the other side of the coin is that when a new science business goes well, the gains can be very large. So this is a high risk/high reward activity, not suited for everyone.

In 2012 the Government introduced the SEIS scheme. This scheme offers huge tax benefits to those who are prepared to take the risks of investing in start-ups. The reliefs include 50% income tax relief at the start, capital gains tax write-offs, further loss reliefs if the business fails and all gains are tax free. Also, the investments are outside Inheritance Tax after 3 years.

This transforms the economics of the business which we have been doing for 35 years, investing in high risk/high reward science start-ups. Essentially, the losses on the failures are reduced (in some cases to as little as 12.5% of the original investment) while the gains on the winners are tax free. The maths says that it should work.

So in 2012 we started a fund - the Oxford Technology Combined SEIS and EIS Fund, OT(S)EIS. The fund is open for investment at any time. Our aim is to invest 1/3 of whatever is invested in year 1 in SEIS start-ups, and then to invest 1/3 in follow-on EIS investments in year 2 in those of the earlier SEIS investments which are showing promise and then the same again in year 3. Although this means that it takes up to 4 years for investors to get their full tax relief and also that the total income tax relief is about 35%, being a mixture of 50% SEIS and 30% EIS, we believe that the benefits of having the money in the bank to be able to make follow-on investments will result in a much better outcome in the long run. We have learnt from experience that it is vital to be able to support start-up companies with additional investment, and that not to be able to do this often results in a bad outcome for the early shareholders.

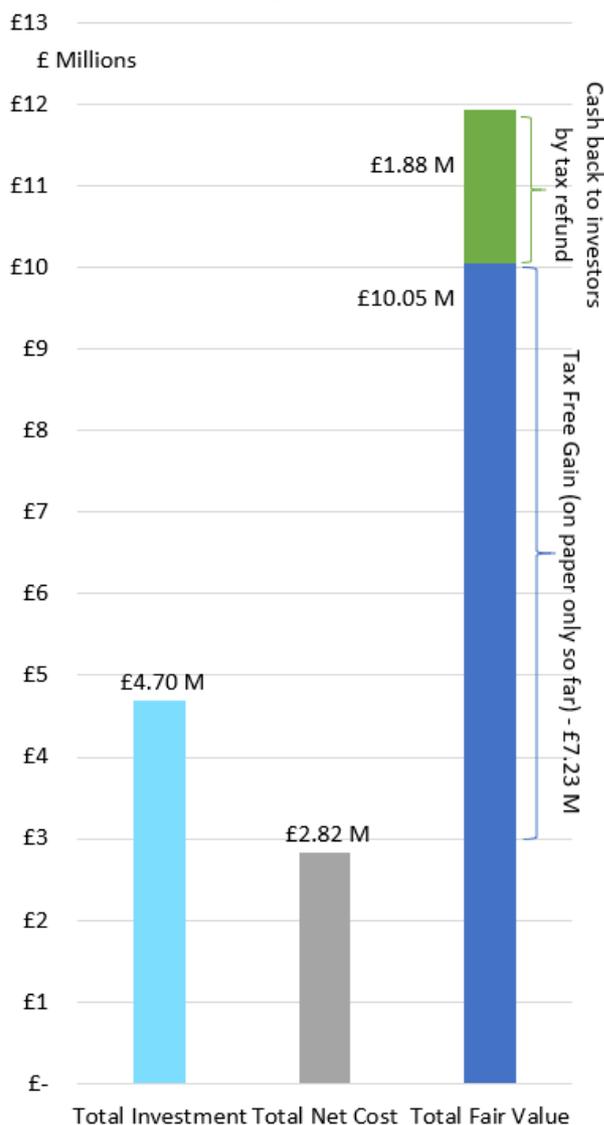
OT(S)EIS made its first investment in December 2012. So how have investors in the fund done? It is a fair question.

The figures for the fund to June 2018 are:

| | |
|---------------------------------------|---------|
| Total invested to date: | £4.70m |
| No of companies: | 33 |
| Tax refunds to investors: | £1.88m |
| Net cost of investments: | £2.82m |
| Value of investments (1): | £10.05m |
| Tax free gain (on paper only so far): | £7.23m |

(1) Investments are either written down in value if they are not meeting their business plans, or they are valued at the latest share price paid by an incoming investor. Even if they are doing well, we do not change the valuation until capital is raised at a higher share price. To this extent, the valuations are conservative.

This table is shown graphically below:



The Details

Of the 33 investments, the ten which are showing the greatest returns so far (on paper only) are the following:

| | Company | Current share price/After tax share price of initial investment | Current value of OTSEIS holding / Net cost to OTSEIS |
|----|-----------------------------|---|--|
| 1 | Expend | 4,000% | 2,958% |
| 2 | Lightpoint Medical | 2,166% | 525% |
| 3 | Oxford Nanoimaging | 1,734% | 1,734% |
| 4 | Animal Dynamics | 1,386% | 961% |
| 5 | Electrowinning Technologies | 1,000% | 533% |
| 6 | Molecular Warehouse | 666% | 398% |
| 7 | Combat Medical | 654% | 276% |
| 8 | Ducentis Biotherapeutics | 572% | 235% |
| 9 | Sime Diagnostics | 474% | 363% |
| 10 | Lupe Technology | 442% | 240% |

Brief details of the first 5 of these companies are given below to give a flavour of the kind of things we invest in.

1. Expend

| | |
|-------------------------|------------|
| Initial SEIS investment | £75,000 |
| Date of investment | 23/12/2014 |
| Share price | £0.0050 |
| After tax share price | £0.0025 |
| Latest share price | £0.10 |
| Multiple | 40 |

NB. OT(S)EIS made follow-on EIS investments in Expend of £17,131 at £.06 per share in Feb 2017 and £3,000 at 16p per share in Dec 2017, which results in an overall multiple of 29, as shown in the right hand column of the table above.

Expend is seeking to tackle the problem of expenses. In many companies, this is a monthly headache. Often employees have to use their own cards, keep receipts, make a list of the expenses at the end of each month, together with the receipts, get these approved by their manager, and then wait to be paid. Using the Expend system (which can use either a special Expend Card or a normal card) the expenditure goes into the company's accounting system as soon as the expenditure is incurred, and the user receives an instantaneous message on her phone saying "please photograph the receipt". This too is captured by the accounting system, and that is the end of the paperwork.

The initial investment enabled the two founders to leave their jobs to concentrate on Expend. Expend subsequently raised additional capital to fund expansion.

After a trial period of about one year, real sales to real users, who pay a monthly subscription, started in Spring 2018, and all the graphs (No of users, number of cards, weekly expenditure, etc) are now rising strongly. In addition, several large accounting firms are beginning to recommend Expend to their clients since it saves so much time and makes the accounts easier. In one case study, a company found that the time spent on doing their monthly expenses had reduced from 1 day to 20 minutes.

Expend is not yet at breakeven and risks remain, but the company has come a long way and is making excellent progress.

2. Oxford Nanoimaging

| | |
|-------------------------|------------|
| Initial SEIS investment | £100,000 |
| Date of investment | 29/04/2016 |
| Share price | £20 |
| After tax share price | £10 |
| Latest share price | £173 |
| Multiple | 17 |

Oxford Nanoimaging is a spin-out from the biological physics lab of Oxford University. The purpose of the investment was to manufacture and market a super-resolution microscope, which enables scientists to see and understand certain biological processes which could not be seen by other means.

The company has gone very well from the outset, with sales being ahead of budget, with the main problem being manufacturing enough microscopes to meet orders. The company has now grown to more than 50 people (from 5 at the start) and the company raised \$25m at £173.40 per share in Q2 2018 to fund its expansion. Investors came from the US, China, Singapore and London.

3. Animal Dynamics

| | |
|-------------------------|------------|
| Initial SEIS investment | £75,000 |
| Date of investment | 29/06/2015 |
| Share price | £0.14 |
| After tax share price | £0.07 |
| Latest share price | £0.97 |
| Multiple | 14 |

Animal Dynamics is a spin out from the Animal Flight Group at Oxford University which studies the way birds and insects fly, and the way fish swim, and seeks to use this knowledge to design better flying machines and better propulsion systems for ships.

The company has been a great success from the start and won a large research contract to design a flapping drone, based on a dragonfly. At the Farnborough Air show, a contract was announced for Animal Dynamics to supply flying machines which will allow large loads (eventually up to 3.5 tons) to be flown autonomously to GPS coordinates. The application is to supply front-line troops. There is also an obvious

case for such a vehicle in disaster relief applications where the transport infrastructure has been destroyed.

Animal Dynamics' main problem has been to recruit enough sufficiently qualified engineers and to find new premises to accommodate the rapidly growing staff.

In July 2018 Animal Dynamics raised £6m at 97p per share to fund expansion. The issue was oversubscribed. Animal Dynamics has asked that early shareholders offer some or all of their shares for sale (at 97p or better) so that they could accommodate the desire of some US companies to become shareholders. It is believed that having these companies as shareholders will be helpful in securing US orders. So this may provide an exit for those OT(S)EIS investors who would like this, at a 14-fold gain over the initial after-tax share price.

4. Electrowinning Technologies

| | |
|-------------------------|------------|
| Initial SEIS investment | £25,000 |
| Date of investment | 06/02/2017 |
| Share price | £0.10 |
| After tax share price | £0.05 |
| Latest share price | £0.50 |
| Multiple | 10 |

Electrowinning Technologies seeks to apply modern methods of accurately controlling the large currents which are used in plants where metal is recovered from ore and then refined. The founders are an academic electrical engineer and an engineer who consults to large mining and electrorefining/electrowinning plants. In theory the system proposed by EWT could be worth £ms to such companies each year, by producing more copper (the first metal to be tried) per ton of ore, at a higher purity (and so more valuable) and with lower energy consumption.

This was a very small initial investment (it was followed with a further SEIS investment of £35,000 at £.50 per share taking OT(S)EIS's holding to 39%) and is certainly an investment of the high risk/high reward type.

The first task was to get an electrowinning plant to agree to try the new system. This is far from easy since, like all such large companies, the engineers in charge of large plants (£bns of investment) are fearful of making changes. Why change what is working today? But, much to the credit of the founders, a contract for £50,000 was secured from a large European copper electrorefining plant to test the system in a single cell of its huge production plant. At the time of writing (Sep 2018), the system is being built and, all being well, will be switched on at some point in 2018. But complications involving safety certification, for example, have arisen and it is possible that further delays will occur. The company has no full-time employees so monthly overheads are low.

5. Lightpoint Medical

| | |
|-------------------------|------------|
| Initial SEIS investment | £75,000 |
| Date of investment | 04/06/2013 |
| Share price | £0.047 |
| After tax share price | £0.0235 |
| Latest share price | £0.50 |
| Multiple | 21 |

NB. OT(S)EIS also made the following investments in Lightpoint:

| Date | Amount | Share Price (before tax relief) | Type |
|------------|----------|------------------------------------|------|
| 10/03/2014 | £75,000 | £.190 | EIS |
| 07/11/2014 | £10,000 | £.238 | EIS |
| 04/12/2014 | £125,000 | £.238 | EIS |
| 10/03/2016 | £100,000 | £.509 | EIS |
| 24/03/2014 | £20,000 | £.509 | EIS |

OT(S)EIS was the first external investor in Lightpoint, whose objective is to enable surgeons to be able to see which tissue is cancerous and which is not, during an operation. Before Lightpoint, surgeons had to operate blind - cancerous tissue looks the same as non-cancerous tissue. Patients take a standard (used for 30 years and medically approved) radiolabelled sugar which concentrates in cancer cells. Lightpoint's novel imaging modality then enables surgeons to see which cancer is cancerous and which is not. The first application was in breast cancer surgery, where c 20% of operations have to be repeated (at great financial and emotional cost) because not all the cancerous tissue is excised in the first operation. The second area of use of Lightpoint systems is in prostate surgery. Here the consequences of cutting out too much are dire for the patient. But if the growth is cancerous then it is necessary to cut it out, Lightpoint enables surgeons to know whether to cut or not. Without Lightpoint they have to guess.

Lightpoint has won numerous awards and numerous grants (more than £10m since we first invested including from the US govt), and Lightpoint systems are now in daily use in the UK, US and Germany and elsewhere.

Good progress has been and is being made, but the regulatory process grinds slowly and trials are expensive.

Failures

Since its inception in 2012, OT(S)EIS has made SEIS investments in 33 start-up companies and a further 70 investments, mainly EIS investments to support their growth.

So far there have been two failures. The total investment in these two companies was £41,000 and £50,000, so quite small, and, because the companies did not meet their objectives, we did not invest more so that the net losses were also small. But because of the loss reliefs, the total loss to OT(S)EIS investors on these two companies was only £33,000. The gains on the winners (only on paper so far) are now over £7m. The SEIS scheme makes a huge difference.

Financial Returns to Investors

There have been no exits so far so the only returns to investors so far have been the tax reliefs, which total £1.93m to date.

The returns to each investor are different since investors get their share of the next crop of investments which are made in the months following their investment. I myself have invested in the fund 5 times so I have shares in almost all of the investments (I missed out on one of them).

Below is my own financial summary report for my own first investment in the fund. This is as much so that you can see the information contained in the report and the format, as for the numbers.

| Financial Summary Report | | | |
|--|------------|---|--------------------|
| Name | Lucius | Cary | Fund |
| Subscription Number | 1 | | OTSEIS |
| Date of Subscription | 06/06/2012 | | 11-09-2018 |
| Subscription | £50,000.00 | Where the money has been spent | |
| Interest accrued (less bank charges) | | Net Commission | |
| NB A management fee of 2% is charged for the first three years. Thereafter no further management fees are paid out of the fund, but a fee of 1.5% pa is accrued in years 4-7. This will be paid out of the proceeds of exits if and when these occur. If there are no exits the fees will not be paid. The cum accrued management fee is shown on the right. After year 7, there are no more fees. | | Initial Fees | £500.00 |
| | | Funds Invested in SEIS | £23,872.03 |
| | | Funds Invested in EIS | £21,541.88 |
| | | Funds invested in Non SEIS/EIS | |
| | | Custodian Fee | £1,013.54 |
| | | Management Fee (first 3 years) | £3,000.00 |
| | | Remaining to invest | £72.55 |
| | | | |
| | | Total Fair Value | £94,726.97 |
| | | Cash in account | £241.47 |
| | | Tax break Return | £18,398.58 |
| | | Cum accrued Management fee | £2,125.00 |
| | | Performance Fee | £10,248.40 |
| Totals | £50,000.00 | = Total of above | £50,000.00 |
| | | Tax break Return | £18,398.58 |
| | | Net cost of Investment | £31,601.42 |
| | | Total Return (tax free) after payment of all fees - on paper only until there are exits. | £100,993.62 |
| The Custodian Fee is the total custodian fee that will be collected. "Remaining to invest" does not include funds still to be used for paying custodian fee. If "Remaining to invest" is negative we have over-invested for you and we will recover the balance from exits. | | Performance fee: After investors have received back £1.20 including income tax breaks only (assumed to be for a 40% taxpayer) for each £1 invested, Oxford Technology Management will receive a 20% share of all further distributions. | |

I invested £50,000 on 6 June 2012. £23,872 of this was invested in SEIS investments and £21,514 in EIS investments, so £45,386 in total. The balance of the £50,000 was fees. I have so far received £18,398 back in tax refunds, so that my net investment in the fund is now £31,601. The value of the remaining investments is now £94,727.

Below this is a summary of my other reports:

| Subscription | Date | Amount Invested (inc fees) | Remaining to invest | Cash back in Tax Reliefs | Net at Risk | Value of Investments |
|--------------|--------|----------------------------|---------------------|--------------------------|-------------|----------------------|
| £25k | Nov 13 | £25k | £0 | £9.3k | £15.7k | £67.0k |
| £30k | Jan 15 | £30k | £0 | £10.8k | £19.2k | £65.0k |
| £50k | Feb 17 | £20k | £26k | £9.3k | £40.6k | £23.0k |
| £40k | Feb 18 | £6.9k | £29k | £3.1k | £36.8k | £7.9k |

So the returns on the investments in the fund which were made more than 3 years ago and which have been fully invested have been good and I hope will get better as the companies grow and increase in value. The most recent two investments in the fund have not yet been fully invested and there hasn't been enough time for the valuation of these investments to change very much yet - as one would expect. The only return so far has been in the form of a reduced tax bill.

Summary

I believe that it makes sound financial sense for investors to make a conscious effort to put part of their investment portfolio each year into SEIS investments. There has never before been such a generous government scheme and I think it is sensible to take advantage of it while it endures. There is no sign that that the scheme will be stopped but history shows that governments change, and new governments often change the rules.

Obviously, we would like to encourage you to put some of your own eggs into our basket. We receive more good opportunities to invest each year than we have funds to invest (because we have been investing in science start-ups in Oxford for such a long time, we are well known in our niche and receive a large deal flow - some saying that they know us and would like us to invest and if we will they won't talk to anyone else.)

So far OT(S)EIS has gone well and investors in the fund are showing large gains on paper. Will this success continue into the future? I cannot know, but I think that the track record is beginning to show that the system works, just as we predicted that it would at the outset.

Please call or email if you have any questions.

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For you to invest in OT(S)EIS, OTM must be able to treat you as an [elective professional investor](#), which means you lose certain rights of "retail investors". The Information Memorandum and Application Pack for OT(S)EIS are available to download at www.oxfordtechnology.com