Corporate Essentials Seminar

24th April 2017, 3pm
Osborne Clarke LLP

#ITSPA

Corporate Essentials Seminar

Agenda

3pm – Raising Finance: An introduction to funding options for ITSPs – A presentation from Adam Zoldan (Director, Knight Corporate Finance)

Followed by a panel on recent industry experiences of institutional investment: Trefor Davies (Chair), Paul Billingham (Director, Knight Corporate Finance) Steve Harris (MD, SIPHON), Peter Gradwell (CTO, Gradwell), Adrian Bott (Partner, Osborne Clarke LLP)

4pm – Coffee break

4.15pm – An introduction to R&D tax credits – Rupert Mayo (Director, Knight R&D)

4.40pm – Corporate governance: The compliance essentials and the pitfalls to avoid– Adrian Bott (Osborne Clarke LLP)

5.30pm - Drinks

What Funding Options are available today?

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Introduction

- Market Recap
- Recent Trends
- Finance Raising
- Case Studies - real world examples

Deal Recap

In 12 months there have been 197 deals across the technology spectrum.

Number of Deals	**Q2 2016**	**Q3 2016**	**Q4 2016**	**Q1 2017**	**Total**
M&A	36	37	36	33	142
Buy Out	1	9	6	4	20
Fund Raise	17	2	10	6	35
Total	**54**	**48**	**52**	**43**	**197**

£12.5 Billion has been invested in the sector

Value (£Bn)	**Q2 2016**	**Q3 2016**	**Q4 2016**	**Q1 2017**	**Total**
M&A	1.1	7	2.1	0.7	10.9
PE Buy Out	0	0.2	0.4	0.2	0.8
PE Growth Capital	0.7	0	0.07	0.02	0.79
Total	**1.7**	**7.2**	**2.6**	**0.9**	**12.4**

Key Trends of the last 12 months

- The high level of transactional activity has been driven by an increased availability of funding in the sector

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  - Largest deals:
    - Acquisition of HP Enterprise software deal by Micro Focus - £6.6Bn
    - Acquisition of HEG (Host Europe) by Go Daddy - £1.4Bn
  - Continuing Consolidation:
    - Maintel triples in size after acquiring Azzuri
    - Daisy acquires Alternative Networks
  - Acquisitions for expertise
    - GCI acquiring Freedom
    - Metronet acquiring M247
    - Sabio acquiring Rapport
    - Chess acquiring FourSys
  - Fully priced Deal
    - Hutchison 3G acquired UK Broadband at a valuation of 91 x sales

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    - Arrow Business Comms investment from GCP
    - Wavenet investment from Beechtree
    - Sabio investment from Lyceum
    - Southern Comms investment from Living Bridge
    - Timico investment from Lyceum
    - MBO of Indigo Telecom by Maven
    - MBO of Giacom by LDC

    It is becoming commonplace for existing shareholders to retain a high level of control whilst also achieving a significant "cash-out"

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  - Some of the largest deals of the year were acquisitions by International Acquirers

    - Netnames exits to CSC (USA)
    - Adapt exits to Datapipe (USA)
    - Attenda exits to Ensona (USA)
    - Annodata exits to Kyocera (Japan)
    - Host Europe to Go Daddy (USA)
    - Nomad Digital to Alsthom (France)
    - Sepura to Hytera (China)
    - Clearswift to RUAG (Switzerland)

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Funding 101

- Funding is an exercise in measuring Risk against Reward
- Aspects of risk are measured:
  - Market Risk – conditions in the industry sector
  - Credit Risk – credit history, debtor & creditor days,
  - Liquidity Risk – P&L/cash flow and conversion of profit into cash
  - Operational Risk – management team, business model, fraud/litigation
- Reward is measured by the Return on Investment
  - Higher risk demands a higher return on investment

Funding Types

	Secured Debt	Unsecured Debt	"Mezzanine"	Equity
	Loan guaranteed by collateral	Loan without collateral	Typically unsecured debt with an element of equity	Common Shares in a business
Seniority	Highest			Lowest
Return	2% to 6%	5% to 10%	10% to 20%	20% plus
Key Risk factors	Liquidity risk Credit risk	Liquidity risk Credit risk	Operational risk Liquidity risk	Operational risk Market risk

Funding Types

	Secured Debt	Unsecured Debt	"Mezzanine"	Equity
Headline	If assets are available for collateral	Lowest cost unsecured funding	Equity style investment without the dilution	Least impact on cash-flow
Issues	Lack of suitable asset	Banking Covenants Profit History	High cost of debt Covenants	Dilution of Equity Share of Control "Preferred instruments'
Cashflow Impact	High	High		"Low'

Funding Types

	Secured Debt	Unsecured Debt	"Mezzanine"	Equity
Key Criteria	Historic Profit	Historic Profits	Historic Profit and Growth	EBITDA Growth
Funding Metrics	Value of Collateral	1.5 to 3 x EBITDA	Interest Cover Min Level of EBITDA	Market Value
Typical Uses	Growth Capital	Growth Capital Acquisitions Where cash flow can support amortising loan	Growth Capital Acquisitions Where cash-flow can support interest only on loan	MBO Partial Exit Buy and Build

Example 1

Profit & Loss (GBPm)	FY-09	FY-10	FY-11	FY-12	FY-13	FY-14	FY-15	FY-16
Revenue	34.8	54.9	57.8	65.5	65.1	63.8	59.0	57.9
EBITDA	6.8	11.5	12.4	14.1	15.3	17.5	13.8	14.9

2008

£6.63m funding from Zeus Capital to exits minority shareholders

2009

Debt raise to acquire OneBill Telecom shareholders

2010

MBO to ECI Valuation est **£80m-£90m**

2014

SBO to GSO Capital Partners Valuation est **£140m-£150m**

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Example 2

Profit & Loss (GBPm)	FY11	FY-12	FY-13	FY-14	FY-15	EST-16
Revenue	-	20.2	51.5	68.9	66.6	>100.0
Adj EBITDA		5.2	11	[illegible]	17.2	20.0

2011

£60m funding from Penta
Acquires
UK solutions
Network Flow
Protel
KAM

2012/13

£25m Debt raise Acquires
Ultraspeed
Telstra UK assets
First Serv
ServerStream
Datahop
Cloud Computing gp
Aurora
BIS

2014

SBO to CharlesBank

Valuation est **£180m-£200m**

2015/16

Acquires

CSG
Sunrise
C24
Carrenza

Case Study

- Founded 1903 — 100 yrs
- Sales $152 Billion — 22x
- Profit $ 4.6 Billion — ∞
- Employees – 201,000 — 7x
- Cars sold – 6,651,000 — 87x
- Stock Market Value:

$44.8 Billion

- Founded 2003
- Sales $7.0 Billion — 350% growth
- Loss $ 0.7 Billion
- Employees – 30,000
- Cars sold – 76,230 — 77% growth
- Stock Market Value:

$52.1 Billion

Case Study

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- Sales $
- Profit $
- Employ
- Cars so
- Stock M

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Value is being driven by

1) Strong Management and Significant Growth
2) Ability to achieve aggressive business plan
3) Well articulated, communicated and exciting strategy
4) Illustrating and Mitigating Market Risk

Lessons

Additional funding can assist in delivering value, but you will have to demonstrate you can:

1. Articulate a clear and compelling strategy
   - Mitigate Risks
   - Illustrate the Reward
2. Demonstrate and Communicate that you are able to deliver your strategy
3. Achieve growth - in the UK this means profitable growth

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Raising Finance: Recent industry experiences of institutional investment

Trefor Davies (Chair)

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RESEARCH & DEVELOPMENT

An introduction to R&D tax credits for ITSPA members

RUPERT MAYO

DIRECTOR

KNIGHT R&D LTD

THIS PRESENTATION IS BEST UNDERSTOOD THROUGH A CONVERSATION WITH KNIGHT R&D AS IT HIGHLIGHTS A NUMBER OF AREAS IN THE R&D GUIDELINES THAT REQUIRE DISCUSSION TO UNDERSTAND AND WHICH HAVE BEEN INTERPRETED IN DIFFERENT WAYS BY HMRC AND VARIOUS R&D TAX CONSULTANTS OVER THE YEARS

The purpose & benefit

Relief designed to attract and encourage investment in engineering, science and technology in the UK

The benefit for Small & Medium Enterprises (SMEs)

Profit making companies – 26p/£ of qualifying expenditure as a tax saving

Loss making companies – up to 33p/£ of qualifying expenditure as cash

The benefit for Large Companies

Profit and loss making companies – 11p / £ taxable credit (8.8p / £ after tax benefit).

SME criteria for R&D

Limits:

- Less than 500 employees (in terms of full time person years); and
- Annual turnover ≤ EUR100m OR annual balance sheet total (i.e. gross assets) ≤ EUR86m

To establish status need to aggregate turnover with linked and partnered entities within the group.

Large Company criteria

Any company that does not meet the SME criteria.

Definition of R&D for tax purposes

- Likely to be broader than you realise.
- Most claims comprise of applied developments with technical challenges and constraints specific to the given project.

Two key criteria:

1. **Seeking an advance in science or technology:**

- Tested against the solutions, know-how or techniques readily available from the public domain

Can include:

- Appreciable improvements to existing products, processes, methods or technologies
- Extension of current knowledge or capabilities

2. **Attempting to resolve scientific or technological uncertainty:**

"…knowledge of whether something is scientifically possible or technologically feasible, or how to achieve it in practice, is not readily available or deducible by a competent professional…"

"Turning something…scientifically feasible, into a cost effective, reliable and reproducible…"

Qualifying R&D expenditure categories

Staffing costs

- Employees and directors
  - Cash remuneration (including salary, bonus, cash benefits, reimbursed expenses)
  - Employers Class I NIC
  - Employer pension contributions

Externally Provided Workers

- Agency staff, contractors & other external workers under claimant's direction, control or supervision

Software

- Payments for software used in R&D including licences

Subcontracted work

- Work subcontracted to other entities or individuals
- Large companies may only claim if it is a payment to a qualifying body such as a university, charity or a scientific research organisation.

Consumables

- Materials used up or transformed in R&D (e.g. utilities, certain hardware)
- Can't be sold as part of an output in the ordinary course of business post 1 April 2015

Common misconceptions & areas of underclaiming

Some examples include:

- Unnecessarily narrow the definition of R&D to only claim world or industry firsts.
- Exclude projects where they don't own the resulting IP.
- Don't claim when the work relates to a project the claimant is contracted to do.
- Exclude projects that are subsidised in any way.
- Only claim software, staff and contractor costs when used directly in resolving technological uncertainty.
- Only include work carried out in the UK.
- Only claim for consumables when not sold or reimbursed, narrowing what is meant by "transferred in the ordinary course of business".
- Mistakenly constrict the definition of software used in R&D.

Drivers for qualifying R&D relating to ITSPA

Projects involving any of the following examples are worth assessing to determine whether to include in a claim.

- Projects where investigative, design, development, prototyping, modelling, trialling or testing activities were undertaken to prove or test a solution
- Collaboration with a supplier to broaden the application of one of their technologies or to test it under certain conditions in the field
- Integrating or applying off-the-shelf technologies in a new way
- Improving the performance or extending the functionality of an existing technology
- Improving or adapting legacy technologies for a new or complex application
- Proving theoretical best practices under unusual on-site constraints

Examples of successful claims relating to ITSPA (delivered to customers)

Work claimed as part of solutions delivered for customers. Examples include development of:

- Seamless integration of technologies with target IT infrastructures (e.g. integration of voice mail systems etc.)
- Improved security to combat telecommunications fraud (e.g. fixed line fraud)
- Fixed Line Business Switching within a set of technological constraints (e.g. system of number portability)
- Fail-over capabilities and the capability for SIP endpoints to evenly share traffic
- Replacements for legacy technologies (e.g. Transition from ISDN (Integrated Services Digital Networks) to multiple SIP) without impacting existing systems during the transition
- Data traffic processing solutions to enhance performance and flexibility of Point-to-Point networks, MPLS (Multi-Protocol Label Switching) and IP VPN (Internet Protocol Virtual Private Network) solutions

Examples of successful claims relating to ITSPA (business process related)

Work claimed as part of improvements to business systems and processes. Examples include development of:

- Online billing portals
- Databases with enhanced performance and scalability (e.g. development of deduplication and matching mechanisms)
- Unified platforms through the integration of software suites across CRM, SAP, Billing, order management etc
- Extended or adapted off-the-shelf software for specific applications (e.g. CRM or SAP)
- Web applications with enhanced performance or functionality

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Rupert Mayo- Director

Rupert leads the team in all aspects of the claim process. He has more than 15 years' experience in R&D, initially as a scientist in manufacturing prior to spending over 9 years as an R&D Incentives specialist at one of the "Big 4" accounting firms. Through his professional services career Rupert has built a reputation for excellence in his technical application of the qualifying criteria for the construction industry and in his capacity to effectively communicate his clients' qualifying costs and projects to HMRC.

Rupert's experience compiling claims on both the industry and professional services sides of the claim process has been a significant contributor to his status as a leading advisor in this field.

Since leaving the Big 4 environment Rupert has relished the opportunity to work predominantly with SMEs.

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HMRC Guidance can be found at:
https://www.gov.uk/guidance/corporation-tax-research-and-development-rd-relief

ITSPA Corporate Essentials Seminar – 24 April 2017

"Corporate Governance – Compliance Essentials & Pitfalls to Avoid"

Adrian Bott – Partner, Head of Digital Business Sector, Osborne Clarke LLP

Corporate governance?

Advantages of Corporate Governance

- Enhanced Performance – helps a company improve overall performance
- Without corporate governance, a company tends to be weak and sluggish
- Access to Capital – the better corporate governance a company has, the more easily it can access outside capital that the business can use to fund its projects
- Since corporate governance includes major shareholders, it connects investors with the business itself, and these investors use their resources and contacts to support the company monetarily

What We Will Aim to Cover:

- Context – Raising Finance, M&A and other transactional scenarios
- Planning
- Stakeholder Alignment
- Regulatory Compliance
- Clearances & Consents
- Due Diligence
- Insurance?
- After the Event …

Planning

To do all this planning in advance is the imperative.

Ken McGee

Stakeholder Alignment

Stakeholder Alignment

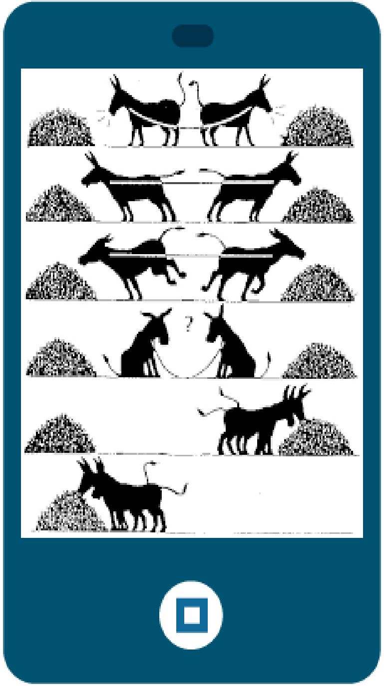
- Your Board:
  - Executive
  - Non-Executive
- Your Shareholders:
  - Management
  - Institutional
  - Others (Employees, Family, etc)
- Constitutional Documents
- Creditors?
- Regulators
- Others? Nomads?

Stakeholder Alignment

Stakeholder Alignment

- Planning, Strategy and insight can turn opposing forces into aligned interests
- Keeping everyone pulling in the same direction takes on-going effort. Just because everyone pulls together at the start doesn't meant that they will keep pulling in the same direction
- **Many things can happen to change aligned interests to opposing forces**

Getting It Right



Stakeholder Alignment

Board of Directors – Duties

The 7 General Duties under the Companies Act 2006

- To act within powers
- To promote the success of the company
- To exercise independent judgment
- To exercise reasonable care, skill and diligence
- To avoid conflicts of interest
- Not to accept benefits from third parties
- To declare interest in proposed transaction or arrangement

This statement of General Duties is <u>not</u> a complete statement of all the duties of directors.

For example, the 2006 Act does not codify the important duty of directors to consider the interests of the company's creditors where the company may be at risk of becoming insolvent, nor the fiduciary duty of confidentiality that directors owe to their companies.

Board of Directors - Duties

Non-Executive Directors

All directors are subject to the General Duties contained in the 2006 Act – the legislation makes no distinction between executive and non-executive directors. However, given the necessarily narrower scope of the role of the non-executive director, the manner in which a non-executive director discharges some of their duties will be different.

Ex-directors

A person who ceases to be a director continues to be subject to:

- the duty to avoid conflicts of interest as regards the exploitation of any property, information or opportunity of which he became aware whilst a director; and
- the duty not to accept benefits from third parties in relation to things done by him before he ceased to be a director.

In addition, a director's fiduciary duty of confidentiality to the company will continue to apply after they have left office.

Board of Directors - Duties

"De facto" and "shadow" directors

The General Duties (and the other obligations on directors set out in the 2006 Act) apply to anyone who occupies the position of a director, by whatever name called. So someone who acts as a director although they have never formally appointed as such –a "de facto" director – will be liable for breach of those duties.

They also apply to "shadow directors" - people in accordance with whose direction or instructions the directors of the company are accustomed to act.

Constitutional Documents

Articles of Association

- Pre-emption Rights & Anti-Dilution
- Preference Rights
- Class Rights
- "Drag Along" and "Tag Along"

Shareholders' Agreements?

Creditors

Debt Providers -

- Security
- Ranking
- Financial Covenants
- Consents needed?


Regulatory Compliance

Regulatory Compliance

"Hi, I'm Hugo — I'll be your compliance officer."

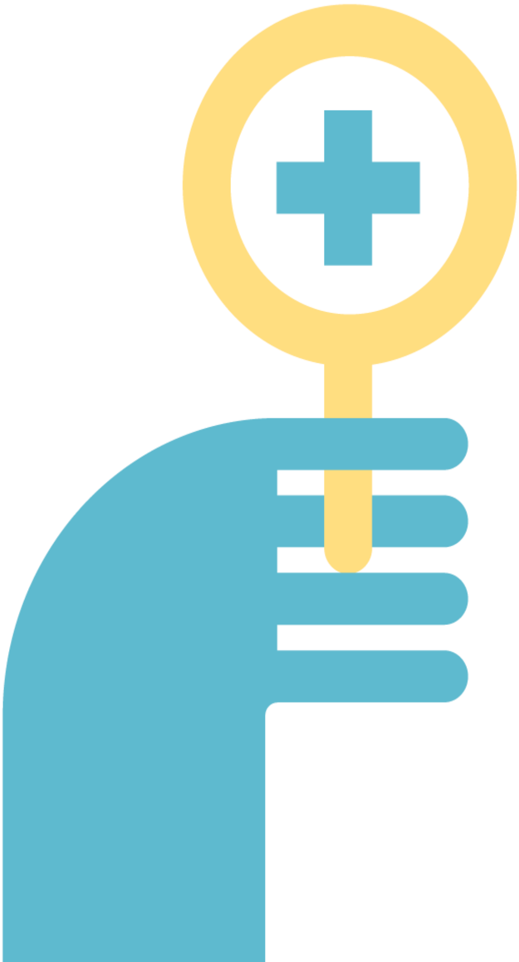
Regulatory Compliance

- Data, Data, Data! – GDPR;
- Ofcom – Communications Act 2003, Investigative Powers Act 2016 etc – Standards;
- Listing, Disclosure and Transparency Rules of the UK Listing Authority, including the "Model Code" on directors' dealings;
- AIM Rules published by the Exchange;
- UK Corporate Governance Code maintained by the Financial Reporting Council (the "FRC") and, for small companies, the corporate governance guidelines of the Quoted Companies Alliance;
- Financial Services and Markets Act 2000 ("FSMA") (particularly with regard to offering shares to the public and market abuse);
- Various provisions of the Financial Services Act 2012 (particularly with regard to misleading statements and impressions); and
- Takeover Code of the Panel on Takeovers and Mergers.


Informed consent
Do you have it?

Additional Clearances & Consents

- Regulatory
- Joint Ventures & Commercial Partners
- Tax
- Competition / Anti-Trust
- Pensions



Due Diligence

Due Diligence – Typical 5 Phases of Due Diligence Projects

1. Initial Situation

1. Clarification of objectives and areas of analysis
2. Definitions of expected results and time plan
3. Legal, Financial & Commercial

2. Baseline Study

1. Adaption of checklists to the individual case
2. Picking up information and data of the actual situation
3. Interviews, questions & answers

3. Evaluation

1. Site visits, where appropriate
2. Plausibility of priority data
3. Interviews, questions & answers

4. Analysis & Evaluation

1. Analysis of first findings
2. Plausibility of all findings, questions & answers
3. Evaluation of data and findings with risk benchmarks

5. Reporting & Actions

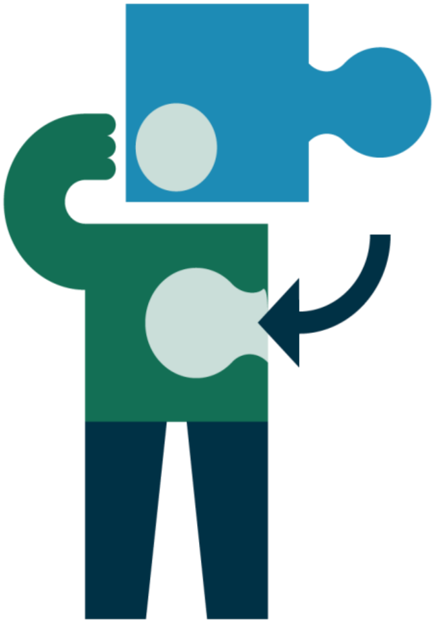
1. Establish the final position and report
2. Formulate the key issues, risks and red flags
3. Key actions and recommendations

Insurance

- Warranty & Indemnity Insurance
- Directors' & Officers' Insurance

After the Event …

Integration Planning & Governance



After the Event …

It takes less time to do things right than to explain why you did it wrong.

Henry Wadsworth Longfellow

After the Event …

"If you think compliance is expensive – try non-compliance."

Former U.S. Deputy Attorney General Paul McNulty

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