

The professional's view



Andrew Muir, chairman of HG Tech Fund

'We have worked together for over 20 years, building software businesses globally,' says Andrew Muir of HG Tech Fund, referring to his co-chairman Kenneth Nelson. He continues: 'I have started eight, four for myself, and taken and gone with them internationally. Ken has raised over \$1 billion and done over 200 merger and acquisition deals'.

The two men are putting their wealth of experience to work with the new fund, which is an Enterprise Investment Scheme (EIS) designed to invest in early-stage technology firms, and software companies in particular. Their knowledge will be put to the test as they sift through legions of investment opportunities, since the combination of volatile stock markets and recalcitrant banks means many entrepreneurs are finding it very hard to get access to vital capital.

'We are seeing three or four companies a day,' smiles Nelson. 'We've seen 50 in the past month. Of those we like around four and we're working with them. Of the firms we see, we'd be happy if 10% go to due diligence and we close out with half of those'.

A typical investment ranges from £500,000 to £1.5 million, and board representation is seen as a must. HG Tech Fund will provide not just cash, but management expertise and even access to distribution and networking channels – but only if a prospect can pass a *Dragon's Den*-style grilling and the pair's thorough research first.

Both Muir and Nelson are very clear about what they like. 'We love pure software plays,' says Muir. 'We like software as a service as it's deployable and upscaleable with very little incremental cost'.

'But we don't generally like hardware,' interjects Nelson. 'There's obsolescence risk, warranties, capital involved in manufacturing, supply chains to manage,' he shrugs, before going back to what he thinks makes a good tech investment. 'We like intellectual property – it needs to be scaleable and have global appeal – trademarks, copy-right and a brand'.

Since they are targeting very early-stage firms, some of them pre-revenue, valuation tends to be done off multiples of sales and analysis focuses on the total addressable market. Profits on investments are realised when a firm (or its intellectual property) is sold, or even floated on a stock exchange. Muir cites the example of **Vocus (VOCS:NDQ)**, a transaction which saw an initial stake multiply 24 times in value after the public relations software expert listed on NASDAQ in December 2005.

The HG Tech fund offers all the usual advantages of an EIS. Any initial investment attracts a 20% tax rebate, while all gains are free from capital gains tax, assuming positions are held for three years. Inheritance tax relief is also available and – should anything go wrong – any losses are offsettable against gains elsewhere. Yet Muir and Nelson are quick to point out their fund, which is raising money until the end of July, with a minimum investment of £10,000, is also very different from most EIS schemes. Investors are not charged fees, and the fund has to generate a 6% annualised return before the fund managers draw any income. In addition, Muir and Nelson have put in a substantial amount of their own cash. (RM)

for the same period, down 22% month-on-month. If end demand does start to slow, the whole technology foodchain (see *The technology foodchain*, page 17) could start to back up very quickly.

Texas Instruments' (TXN:NYSE) second-quarter update (8 Jun) offered some reassurance here, as the firm guided earnings per share (EPS) estimates toward the top end of the \$0.56 to \$0.64 range, saying it has seen no signs of a PC slowdown in Europe or China. But if ordered components and finished goods do start to sit on the shelves at retailers and distributors and gather dust, then order intake throughout the food-chain could wobble. Such an inflection point in momentum – where tech firms move from beating forecasts and raising estimates to simply meeting them and reiterating future targets – would likely see hot money head for the exit, driving tech-related share prices down.

Long-term gains

But that is why there is another class of technology investor, one who does not care less about the next quarter's earnings growth number or inventory data, but who instead is looking for the 'next big thing'. This tech punter is looking to pick out winners on a five-year or even ten-year view and is prepared to place his bets across a portfolio of potential winners, accepting the risk some will not make it in return for the rewards offered by an investment in what could be the next Apple, Microsoft or ARM.

Over the past forty years, major technology sector booms have been driven by objects that are now perceived as every day, yet at the time were revolutionary because of the productivity gains they offered corporations or the improved experience enjoyed by consumers. Items such as the colour television in the 1960s, pocket calculators in the 1970s, video cassette recorders, CD players and minicomputers in the 1980s, desktop PCs and mobile phones in the 1990s and smartphones and iPods in the early 2000s all shot from nothing to selling over 100 million units a year in no time at all. As a result their creators, and a whole ecosystem of related suppliers, contract manufacturers, software developers and hardware designers and providers, all saw business boom, enriching themselves and shareholders in the process.

These products have stood the test of time, and with good reason as they passed five key tests that, in *Shares' opinion*, will define whether a new innovation has a chance of success or not.

• Productivity and saving money

Managers now run their businesses much more efficiently and cheaply as staff with PCs, mobile phones and email are much more productive than those using quills, ink and ledgers. Customer relationship management (CRM) software is just one example of this, but a topical one given **Pitney Bowes' (PBI:NYSE)** £44.4 million, 31p-a-share all cash bid for **Portrait Software (PST:AIM)**, a deal which highlights the value of the proposition offered by *Shares' Tip for 2010*