

2007 to 2008: How things have changed

Welcome to the latest edition of Insight.

This time last year Labour were confident of securing another term, Hilary Clinton was a certainty for the Democratic candidacy, diesel was 95 pence per litre, the more complex and remote from the underlying financial transaction the better the deal and Alastair Darling thought that becoming Chancellor of the Exchequer was a good career move. Summer had been cold and wet.

At the same time we had just realised £7.5 million from 6 investments, our focus remained on seeking to divest with strong corporate balance sheets, buoyant markets, generate high exit multiples and producing liquidity in our portfolios.

Remarkably the English weather is one of the few things to have performed consistently since then. The past few months have seen events unfold that have resulted in a number of the UK's banks seeking record levels of funding from investors, meaning the provision of debt finance for new lends has been severely reduced, and the hardening of credit terms for businesses and consumers alike. We have also seen the first signs of large scale redundancies and upward inflationary pressures driven by commodity prices, as well as a short term distortion to the sale of private businesses caused by a surprise change to the rates of capital gains tax.

Against this backdrop our Venture Capital Trusts have seen an increase in realised and actual values throughout their portfolios and their dividends have maintained or increased over the period. Investments in developing companies, which tend to be less hungry for debt, have remained stable. In addition, the fundraising for British Smaller Companies VCT plc (BSC VCT) was over-subscribed and, as a result, was increased to accommodate the excess demand. This was very welcome and we are exceptionally pleased to continue to carry this level of support.

The change in the economic climate will undoubtedly have an impact, but previous experience suggests that the short to medium term (1-3 years) is likely to be the prime period to invest. Asset prices should reduce and investing at this stage in the economic cycle is more likely to result in an upswing when investments are targeted to be realised. In the short term there is a need to be patient in looking at new investments as currently price expectations have not significantly adjusted and in many cases businesses are deferring investment and expansion decisions until they feel they have a clearer view of the economic direction. So now is the time for private equity investors to seek to further back their own portfolios.

Our investment strategy has been not to take on too much debt. A feature of the smaller private equity investments is that, return is driven more from underlying profit growth and building businesses with a competitive advantage in their market sector, than through leverage and financial engineering. Consequently, it is rare that the investments we make will have more debt than equity. If we can give the management teams behind our investments the ability to focus on how to increase their market share and outperform their competitors, rather than being forced to concentrate on whether there are enough sales coming in next week to avoid another visit from the bank, then there is a much better chance of creating and enhancing value. It is in these more challenging economic times that a strong capital base can be a real benefit and that is a role that we can play.

There is no magic formula to delivering strong investment performance, but patience, not being deflected from your core investment criteria, backing good teams, supporting your winners and the occasional slice of good fortune, has historically separated the good performers from the bad.

I hope you enjoy reading this issue of Insight.

David Hall - Managing Director - YFM Private Equity

VCT Performance

As we enter the second half of 2008 the performance of the two Venture Capital Trusts has proved somewhat resilient in the current economic climate.

We continue to seek new investments that are operating in markets out performing the economy or where we see value and can fund them without over exposure to debt.

The financial performance can be summarised as:

	BSC VCT ¹	BSTC VCT2 ¹
Net Asset Value	97.8p	82.9p
Dividends	43.0p	12.0p
Total Return	140.8p	94.9p
Dividends last 12 months	5.0p	3.0p

NAV Growth ²	BSC VCT	BSTC VCT2
1 year	4.7%	10.2%
3 years	36.3%	4.5%
5 years	78.7%	6.5%

Fund Size	BSC VCT £m	BSTC VCT2 £m
Unquoted	8,994	5,765
Aim	5,009	1,613
Equity fund	17,097	6,235

¹ As at 30 June 2008

² Source: www.trustnet.co.uk as of 26th August 2008

To Watch For

Dividend Reinvestment Scheme – British Smaller Companies VCT will be offering a reinvestment scheme to shareholders in the next few months.

Advantages of these schemes:

- qualify for 30% up-front tax relief
- any gains are exempt from capital gains tax

Future Fundraising

It is again likely that BSC VCT may seek to raise limited funds through a small top up issue and this year the improving performance of BSTC VCT2 may see it seeking funds in a similar way.

These will be available on a first come first served basis with priority given to existing Shareholders. Watch out for details later this year.

YFM Acquired by GLE

YFM's success has been recognised by GLE Group who acquired YFM in April 2008, taking the funds under management by the group to over £330 million.

Both companies have similar backgrounds and with three members of the YFM Board taking the decision to retire it was important for us to find a partner such as GLE to develop and expand our reputation for being the principle provider of equity finance for growing businesses throughout the UK.

GLE comprises four business areas each focussed on maximising the potential of individuals and growing businesses. This new partnership will expand the wealth of expertise and increase our geographical spread, giving access to greater opportunities.

"Both companies share a similar history and a passion for innovative solutions for businesses. The union will further build on the national presence and strong reputation of YFM. I very much look forward to a very positive future for GLE and YFM."

Martin Large, Chief Executive, GLE

"Joining forces makes logical sense for YFM employees, clients, partners and the wider community. YFM's businesses fit very well alongside GLE's activities. With their commitment to expand our business YFM's growth is under pinned."

David Hall, Managing Director, YFM Private Equity



North West Business Investment Scheme (NWBIS) celebrates 5 years since its first investment



The NWBIS was launched in April 2003 to meet a need identified by the NWDA for a flexible fund to invest in high growth business across the North West in a wide variety of sectors and stages.

As an innovative step the fund was structured as a co-investment fund which has been a cornerstone for investors in a wide range of deals that otherwise might not have happened.

The fund's investments have been made alongside co-investors from company management, through banks, other venture funds and private investors. To date the fund has invested £17.5m in 53 companies in deals worth over £160.2m to the North West.

The £26.3m co-investment fund is managed by YFM Private Equity and can invest up to £1m per deal.

The first investment, completed only months after the fund launched, was a management buy-out of an aerospace engineering business, Didsbury Engineering, who make handling and lifting equipment for the aerospace and industrial sectors.

Since then the fund has invested in a wide variety of high growth businesses across the North West that have developed into class leading businesses, such as Intempo a leading UK brand of DAB radio and iPod consumer electronic devices and Eclipse Energy the company behind the Morecambe Bay world first combined wind and gas energy farm.

In addition to these investments the fund has already exited from others and has already returned a substantial proportion of the invested capital back to the NWDA where it will be made available for a legacy investment fund to help business across the North West in future years.

In 2006 the NWBIS were the winners of the Insider Dealmakers Fund of the Year award, in 2007 the fund won the Investor Allstars Equity Gap Fund of the Year, an award for which they have again been shortlisted, thanks to the experience, expertise and knowledge of the investment team.

Chandos Fund

The Chandos Fund invests in fast growing businesses requiring up to £8 million of equity across all sectors targeting buy-outs, buy-ins, development capital, pre IPO funding and equity release opportunities.

In January, the Chandos Fund celebrated its first birthday following a year of successful fundraising and investing. There has been a continuation of this activity, we have featured a couple of recent investments over the next few pages.

Sector Events

Following the Telecommunications sector events held in November, three more highly successful networking events have been held in recent months, covering the Medical and Healthcare, Software and IT, and Retail sectors.

These evenings have proven to be a great opportunity for YFM's CEO and Non Executive Director contacts to meet new people and discuss current issues in their sector. We plan to hold follow-up events in each sector later in the year and, periodically, to produce a sector newsletter that allows group members to share their news and views.

Awards News

We are pleased to announce that YFM Private Equity funds have been shortlisted for the following awards at the Investor Allstars event to be held 24 September 2008.

- **VCT of the Year:**
British Smaller Companies VCT plc
- **Equity Gap Fund of the Year:** NWBIS

YFM Private Equity was also a runner up in the Acquisition Finance Business Excellence awards:
Small/Medium Equity Gap Fund of the Year 2008

YFM invests up to £8 million in fast growing companies, whether it is development capital, MBO, MBI or expansion funding.

Dealing directly with a small team of experienced investors we look for excellent management teams who are innovative, have a quality product or service and the know-how to further grow their business.

All sectors are considered, with over 40 investment managers nationwide we have the expertise and experience to complete more deals a year than any other equity provider.

We develop long standing relationships with our portfolio working with them as their requirements change and grow, offering more than just the financial backing but access to our network of contacts and understanding of how to help business owners realise their ambitions.

CASE STUDY 1

FUNDS: British Smaller Companies VCT, Chandos Fund, The Capital Fund **DEAL SIZE:** £1.7 million



James Gregory and David Gee

Darwin Rhodes

Funds managed by YFM Private Equity and YFM Venture Finance (YFM) increased their investment in Darwin Rhodes Group, a fast growing global specialist in professional financial services and insurance recruitment, by £1.7m.

With YFM as a shareholder, Darwin Rhodes will have access to significant follow-on funding to achieve their expansion plans. Darwin Rhodes is actively seeking to expand into new geographical areas and new product specialisms through both organic and acquisitive growth in the UK and key international markets.

Originally backed by YFM Venture Finance the company's progression and track record led to this second round of funding. The structure of the funding displays the in-house capacity to provide a wide range of investment as three YFM funds were involved, shaping our continued relationship with the client.

"The additional capital from YFM will be used to expand Darwin Rhodes' unique model, organically and through acquisition, to other industries and geographies. We have a track record of successful expansion during all stages of the economic cycle and our board and investors are confident that Darwin Rhodes Group will continue to build on this success over the coming years."

James Gregory, Darwin Rhodes Group

CASE STUDY 2

FUNDS: British Smaller Companies VCT, Chandos Fund
DEAL SIZE: £6.2 million



Fishawack

YFM Private Equity provided £2.55 million to support the £6.2 million MBO of Fishawack, a specialist medical communications business headquartered in Knutsford and Abingdon.

Fishawack has a strong reputation for providing original and highly professional marketing communications services to its clients, which include Sanofi-Aventis, Roche, GSK, Bayer-Schering and Shire.

"This is a very exciting development for us. Fishawack is a strong brand with a growing reputation for excellence. Following the MBO, we are well placed to deliver on our ambitious growth and development plans. YFM has been supportive and straightforward throughout the buyout process and are an ideal partner for us as we look to grow."

Tim Mustill, MD of Fishawack

CASE STUDY 3

FUND: North West Business Investment Scheme
DEAL SIZE: £13 million

KDC

North West Business Investment Scheme provided £1 million in mezzanine finance for the MBO of KDC Contractors.

Formed in 1985 KDC has demonstrated rapid recent growth and forecasts a turnover in excess of £20m in the next 12 months.

The business specialises in the decommissioning, demolition and remediation of hazardous sites in the nuclear, petrochemical and pharmaceutical sectors. There is a huge drive in the UK to clean up hazardous sites. The Nuclear Decommissioning Agency has an estimated £72bn clean up programme and there are major environmental pressures on the petrochemical and pharmaceutical industries to make clean large plants, many of which are now redundant. KDC has the specialist skills and accreditations to operate in these hazardous environments and is set to benefit from the increasing government spend as well as the legislative and environmental pressures in these sectors.

YFM Private Equity worked to challenging deadlines to provide this funding and our small and experienced team of professionals were able to respond quickly and positively.

"We were impressed by the quality and experience of the KDC team which displayed professionalism and a high level of sector knowledge."

Deborah Heyes, Investment Director,
 YFM Private Equity Limited



CASE STUDY 4



Sarian Systems - 8x return - Acquired by Digi Inc

www.sarian.co.uk

Sector: **Telecommunications**
 Time Held: **8 years**
 Deal type: **Development Capital**
 Location: **Ilkley**

In 2000, YFM funds invested in the Yorkshire based two man team whose initial product was to be an ISDN telecoms router. This product was aimed at, amongst others, the petrol forecourt markets and helped to reduce the cost and increase the speed of authorising credit card transactions.

In March 2008 Sarian was sold to Digi, a US company in a \$30.5m sale, making YFM a 8 times return on their investment. The company had grown to become an international business operating in over 40 countries and has a workforce of 35 staff working directly for them.

One of the important aspects to the investment was the wide range of help and advice given by YFM on start up issues and in helping the Company set up a wider management team.

Sarian was the first Company to market with a GPRS router and subsequently developed the capability to operate over other faster wireless networks.

An approach during the summer of 2007 and previous exit planning led to the decision to undertake a formal process. Key advisor appointments were made through our recommendation and a small number of highly targeted potential acquirers approached. YFM were involved in all the major decisions including content of Information Memorandum, who was to be approached and crucially, timing.

Throughout the exit and indeed the whole period of investment YFM were there to listen to management and advise accordingly. YFM were able to help particularly due to their previous experience in selling UK businesses to quoted US businesses.

From an initial nominal investment the two original founders made £7.4m on exit, employed 35 people directly and Sarian is now an International company.

Sarian Systems appeared at number 3 in a list of top exits compiled by Library House for the first half of 2008.

"It has been a pleasure to work with YFM over the last 8 years, the relationship has not only been about the financial backing but the expertise and support which have helped make it possible for us to realise our ambitions."

Andy Hood, Managing and Technical Director, Sarian

CASE STUDY 5

Tekton - 3x return - Acquired by Sage plc

www.tekton-group.com

Sector: **Computer Software**
 Time held: **27 months**
 Deal type: **MBO**
 Location: **Manchester**

Tekton are experts in financial construction software and are a company with a long history in delivering highly reliable products and services in the IT business.

In 2005, YFM funds invested in the business to enable its ambitious management team to realise their strategy. With the funding they invested heavily in the company's products, infrastructure and sales force.

Small deals are notoriously difficult to invest in and from the start it was apparent that if the Group was to be attractive to a trade buyer it would have to become much larger. In 18 months three acquisitions took place, Evision, CIT and Site Stream.

12 months and one day after the original MBO, a secondary buy out took place in which both YFM and the team realised substantial capital gains. Whilst common in larger deals this type of transaction was, and still is, very unusual. Sage had been looking for a suitable product to further enhance its range providing clients such as quantity surveyors with software and support from the design through to contractor management stages of a project.

"With the help and support provided by YFM Group we achieved our growth objectives. The original investment and commitment to the company has been invaluable in enabling Tekton to position itself as the UK's fastest growing construction software specialist."
 Richard Beaton, MD of Tekton



Other news & dates for the diary

For the 5th Year running YFM Group, through its investment arms YFM Private Equity and YFM Venture Finance have completed more equity investments in the sub £5 million range than any other UK investor (Source: VCR in the 5 years to June 2008)

Results

- **BSTC VCT2** results announced August 2008
- **BSC VCT** Half year results will be announced in November 2008
- **BSTC VCT2** 4p dividend payable 26 September 2008

Forthcoming events

- **16TH SEPTEMBER - YFM TELECOMMUNICATIONS NETWORKING EVENT**
Venue - Browns Courtrooms, London
- **2ND OCTOBER - NWBIS NETWORKING EVENT**
Venue - Alberts Shed, Manchester
- **JAN/FEB 2009 - INVESTOR WORKSHOP**
Venue - TBC

A British Smaller Companies VCT (BSC VCT) investor



Mike Wroblewski first invested in the top performing BSC VCT in March 1998. He is an enthusiastic advocate for VCTs as a tax efficient product having at one point been paying 98% tax!

Mike studied at Lancaster Gate Law College in London and alongside his training was involved in establishing a Vehicle Rental Business. His business partner died suddenly and he was left with a difficult decision to make - whether to continue his training and lose the lease on his business, or run the business himself full time. He decided to run the business himself, with a view to returning to law school shortly. 30 years later, he still hasn't managed to finish his training!

In 1980 he sold the business and invested heavily in commercial and residential property. Mike bought a number of holdings from developers who were suffering due to the recession in the late 80's and 90's.

He is now the Managing Director and 100% shareholder of the successful Centurion Finance (Lincoln) Limited. His business acumen and past successes have led to him to be included in the latest edition of the Who's Who Guide - Britain's Business Elite June 2008. The revelation of his entry was a great surprise.

In the early 80's Mike was paying 98% tax and started looking for tax efficient investment vehicles. He tried property related Enterprise Zone Funds, many of which went bust, and he was no more fortunate with the Business Expansion Schemes which were the fore-runners to Venture Capital Trusts. He invested in British Smaller Companies VCT among others.

Mike says, "the early VCTs were a mixed bag, but as the years have gone by, the better performing ones have provided reliable income streams. As an avid supporter of VCTs, in total I now have around £500,000 invested across several VCTs, I like the nice, tax free income!"

His aim is to wipe out as much of the 40% tax as possible and then build up his income stream. With a realistic approach, he compares the VCT portfolios to lending money on vehicles - 1 in 10 will be written off in an accident and 1 in 10 will default on payments.

With not much control over his investment, Mike says it is important to find a quality Fund Manager who you can rely on. Mike bases the performance on Net Asset Value and the dividends received to date to give the true return. If it is a good performer, he leaves his money where it is and enjoys the tax free dividends. Many of his VCT investments, including British Smaller Companies have performed better than his ISAs and PEPs.

Mike on British Smaller Companies VCT plc:

"The fund manager undertakes very thorough due diligence which is reflected in the good track record of a good spread of investments from around the country. From an investor relations point of view, I appreciate the regular communication from BSC VCT, and particularly the workshops. Shareholders are given the opportunity to meet with the fund managers and Board members. I like the openness of the Managing Director and the impression of quality from the Chairman. British Smaller Companies VCT is managed by a smaller team and that becomes evident by the personal service that is offered."

Further information

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