Amati Global Investors

QUARTERLY NEWSLETTER

Issue 4

September 2016

Investment in smaller companies can be higher risk than investment in well-established blue chip companies. Funds investing significantly in smaller companies can be subject to more volatility due to the limited marketability of the underlying asset. Please refer to the risk warning on page 4.

INVESTING IN THE NATURAL RESOURCES SECTOR

PAUL JOURDAN

The London Stock Exchange has long been a provider of capital to a wide range of natural resources companies operating across a variety of geographies, and Amati's smaller companies fund has made many investments in this sector over the years. Whenever we invest in such companies we always want to know a good deal about the details of their engagement with the people of the area in which they operate. We take the view that a strong health and safety record, transparency and investment in local communities are not optional extras for such companies. However, this approach still leaves some important questions unanswered. Where countries are run by dictators, or where there are widespread human rights abuses? What are the ethics of investing in the exploitation of natural resources? If some countries are to be ruled out, where should we draw the line and why?

During August, Prof Leif Wenar spoke at the Edinburgh International Book Festival held every year outside our office in Charlotte Square, and discussed his new book, "Blood Oil: Tyrants, Violence, and the Rules that Run the World". I went to listen to his talk with modest expectations, but realised that this work, which took 10 years to write, contains an impressively well-reasoned, structured and thoughtful approach to answering exactly the questions above. Wenar starts out by arguing that this topic is of much greater significance than we might think. This is because the trade in commodities, particularly oil, is the most significant factor in maintaining the power of many of the most cruel and autocratic regimes, explaining why they persist for so long, becoming more and more entrenched as they do so. Our willingness to buy these goods from any regime which is powerful enough to seize control of the area of origin underpins much of the terrorism and war that troubles our world today. We have a legal system dating back centuries, under which, in Wenar's phrase: "Might makes Right".

Wenar suggests that the passing of Clean Trade Acts in the free countries of the world, which would restrict the purchasing of natural resources from the most extreme and violent regimes, is as important a project now as the Abolition of Slavery was in the early 19th Century. It's hard to argue with the logic, and it provides valuable food for thought in shaping our own investment approach.

"AIM provides a wealth of under-researched opportunities, but the work required to uncover them is significant. Dr Paul Jourdan and the Amati team have the experience and level-headed approach needed to succeed in this market."

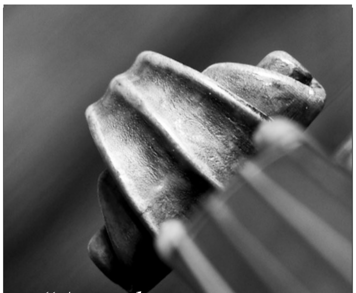
Richard Troue, Head of Investment Analysis
Hargreaves Lansdown

AMATI FUND RETURNS AND FUM

Source: Amati Global Investors as at 31 August 2016

	Fund Return (since launch#/takeon##)	Benchmark Return	Funds under Management
TB Amati UK Smaller Companies Fund (B)	400.56%##	152.26%**	£33.5m
Amati VCT	40.06%#	-20.58%*	£39.9m
Amati VCT 2	63.20%##	18.63%*	£38.4m
Amati AIM IHT Portfolio Service	43.63%#	4.19%*	£2.3m

Benchmarks: *FTSE AIM All-Share Total Return Index
**Numis Smaller Companies plus AIM Excluding Investment Companies
TB Amati UK Smaller Companies Fund takeon 31 August 2000 / Amati VCT launch 24 March 2005
Amati VCT 2 takeon 25 March 2010 / Amati AIM IHT Portfolio Service launch 29 August 2014



"Amati has a strong team with a clear focus on risk mitigation and a pioneering approach to VCT management"

Martin Churchill
Editor, Tax Efficient Review

An investment in a VCT carries higher risk than other forms of investment. An investment in the Amati VCTs is suitable only for investors who are capable of evaluating the risk and merits of such investment and who have sufficient resources to bear any loss which might result from such investment. Investors should check their eligibility for income tax relief with a professional adviser. The information presented here is intended as a summary only of information contained in the Offer Document and is not a substitute for reading the Offer Document.

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AIM Valuations

Douglas Lawson

The Inheritance tax planning is all about saving tax. Assets that qualify for Business Property Relief (BPR) are exempt from inheritance tax, potentially saving the deceased's beneficiaries a 40% tax bill. For this reason, the starting point for considering a specific BPR qualifying asset must be: "is my (realistic) maximum loss on this investment less than 40%".

One such BPR qualifying asset is unquoted shares, including those listed on the Alternative Investment Market (AIM) of the London Stock Exchange. Portfolios of AIM shares have been an increasingly popular destination for inheritance tax planning. It is difficult to know how much money has gone into AIM IHT portfolios due to the lack of disclosure from some providers of the service but the best estimate we can find is from Intelligent Partnership, which puts the number at £750million.

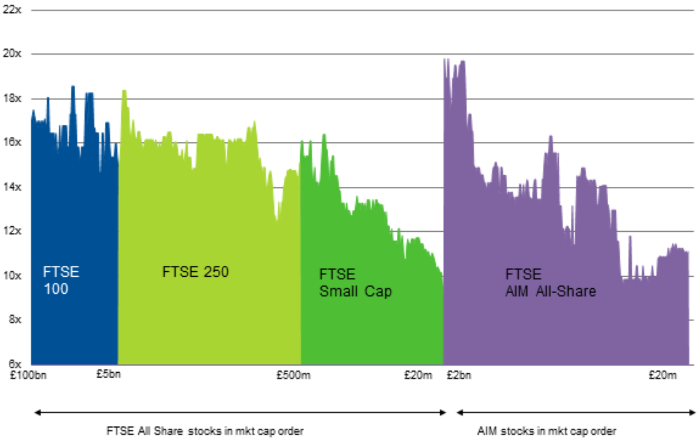
If the starting point is avoiding losses, rather than making profits, it is logical to assume that investment managers will seek out the least risky shares listed on AIM. Most would interpret 'least risky' as the largest, most liquid shares on AIM. The largest share on AIM is ASOS, the online clothing retailer, which is capitalised at £3 billion and trades an average of £27 million of stock every day (source: Fidessa at 3 June 2016). Even if every AIM IHT manager held a 5% position in ASOS, the combined holding would be worth £37m (5% x £750 of AIM IHT assets under management) and could be traded (theoretically) in under two days. On this basis, ASOS certainly ticks that size and liquidity box.

Below ASOS, the AIM top 10 was made up of the following stocks at 3 June 2016: GW Pharma (a biotech specialising in cannabinoids across a range of therapeutic areas); ABCAM (the online sale of antibodies); Hutchison China Meditech (a diversified, Chinese healthcare business); Dart Group (operator of the Jet2 airline and holiday business); James Halstead (a manufacturer of flooring products); Fever Tree (a producer of premium tonics and other drinks mixers); Breedon Aggregates (a supplier of asphalt and concrete); Plus500 (an online platform for trading contracts for difference); and Burford Capital (a litigation funding business). This is an interesting list of stocks, all of which we believe qualify for BPR. Two of these stocks (GW Pharma and Hutchison China) are loss-making but the other eight stocks trade on a mean forward Price/Earnings ratio of 27.5x (source: Capital IQ at 3 June 2016).

To prove that these are not anomalies, we extend this list to encompass the next 10 largest AIM stocks (that quality for BPR)* and we find that (exclude one outlying stock) the aggregate rating falls slightly, but only to 27.0x. By most measures, this is an expensive Price/Earnings ratio.

In certain circumstances, a high rating can be justified by the very high growth prospects of a business. Fever Tree, for instance, has a Price/Earnings ratio of 43x but 2016 earnings per share (EPS) is expected to be 44% higher than 2015. However, several of these stocks with high ratings have low growth prospects. James Halstead is rated at 24.6x but EPS growth is expected to 5.9% (source: Capital IQ). Under normal circumstances, this would be considered expensive, even for a company with the undoubtedly high qualities of James Halstead.

The chart below is compiled by Liberum Capital and illustrates the distortion of valuations within AIM. *Source: Liberum, IMA as at 31 May 2016.*



The chart shows that the FTSE 100 trades in a Price/Earnings ratio range of 16-18x, tapering to 14-16x in the FTSE 250 and upper end of the FTSE Small Cap, before falling to a 10-12x range by the bottom of the Small Cap Index. With AIM, there is a very prominent spike at the top of the market at around 20x earnings before the market falls to a range of 12-16x. Closer to the bottom of AIM, the rating settles in the 10-12x range.

Few would consider the stocks at the bottom of AIM to be suitable for an AIM IHT Portfolio but there appears to be a sweet spot of stocks below the spike that offer a significant discount. A discount to reflect reduced liquidity would be expected but the variance that has opened up appears extreme.

The conclusion to be drawn from this is that a large proportion of investment into AIM companies for inheritance tax planning has gone into a comparatively small number of stocks at the top of the AIM market. This has had the predictable effect of squeezing up valuations as AIM IHT inflows chase a relatively fixed number of stocks. There are undoubtedly good quality companies in this area but valuations at the levels discussed, without growth rates to support the Price/Earnings ratings, should be treated with caution.

*EMIS, Clinigen, Mulberry, BooHoo, PureCircle, 4D Pharma, Nichols, RWS, CVS, First Derivatives

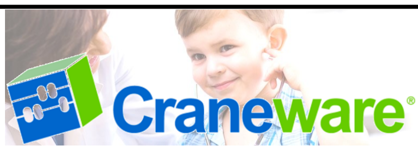
Portfolio Companies Spotlight

Amati has been invested in **Accesso** since 2010 - the business has undergone a significant transformation under Tom Burnet, the CEO who was appointed in the same year. Formerly known as Lo-Q, the company specialised in renting handheld devices called Q-Bots to visitors to theme parks. These devices allow users to select a theme park ride in order to be added to a virtual queue. Instead of waiting in a physical line, the guest can fill their time more productively and enjoyably in the park before being notified that their queue time has elapsed and walking straight on to their chosen ride. This product has proved popular with customers such as Six Flags and Legoland, due to the benefits of an additional revenue stream for the park (Accesso shares revenues from the rental of the devices with the theme park customer) and the unlocking of 'secondary spend', meaning increased revenues from food and beverage locations. Accesso's range of products has been enhanced through the acquisitions of three technology businesses,

also serving the theme park market. The first was called Accesso (hence the group name change from Lo-Q to Accesso), a hosted online ticketing solution. This was followed by the acquisition of Siriusware, which provides ticketing, ecommerce and point-of-sale (POS) software for a variety of venues, including ski resorts. The final acquisition was Showare, which specialises in ticketing for smaller venues such as sports arenas and theatres. Since 2010, revenues have grown from £20 million to £71 million and EBITDA (earnings before interest, tax, depreciation and amortisation) from £2.4 million to £7.8 million. Accesso is held in Amati VCT 2, TB Amati UK Smaller Companies Fund and the Amati AIM IHT Portfolio Service.

There has been much debate about how much the changes to the VCT legislation last November would impact opportunities to make VCT qualifying investments on AIM. Our view has always been that after an initial hiatus deals would start to emerge again that we would want to invest in. The first half of the year saw only one new investment for the VCTs (medical diagnostics company Genedrive), and it is encouraging that early in the second half we have made another, with more to come in the pipeline. This latest investment was in **LoopUp**, a company headquartered in London, with offices in the US, Hong Kong and Barbados, employing 96 people currently. LoopUp is focussed solely on providing conference call facilities in such a way as to eliminate the numerous common

frustrations and time-wasting experiences that are often associated with them. In their words, they deliver "a premium remote meeting experience for mainstream business users along with the quality, security, and reliability expected by global blue-chip enterprises". The value of the product is attested by the fact that 1,850 enterprise customers have signed up. We liked the fact that this business has a strong track record of growth over a good number of years, and that it has invested heavily and cleverly in really differentiating its product. Once you've tried conference calls with LoopUp, you really won't want to go back to PowWowNow or the like!
LoopUp is held in Amati VCT and Amati VCT 2.



Craneware floated on AIM in 2007. It is an Edinburgh-based business, founded in 1999 to supply billing and auditing software to US hospitals. The software was designed to reduce mischarging in hospital revenues. Most hospitals in the US used manual processes to control the raising of bills, claims and invoices, leading to errors and lost revenues. Since its IPO, Craneware has developed a range of other applications and now offers its customers a range of 'Value Cycle' products. The Value Cycle describes the full life cycle of the patient journey and the oppotunity to optimise every case to achieve the best outcomes for the patient and the hospital at the best cost. In line with this, as well as Craneware's traditional modules such as charging, price capture, claims performance and compliance, the solution now address quality of care, patient satisfaction and engagement, clinical outcomes, operational efficiency and risk management. The company employs a Software-as-a-Service (SaaS) business model, which provides excellent revenue visibility and cash generation. It has used these cashflows to make a small number of select bolt-on acquisitions and to invest in the growth of the business. Revenues have grown from £11.5 million in 2007 to an anticipated £38.1m in 2016 (financial year end June). Over the same period, EBITDA has grown from £1.1 million to £11.2 million (consensus forecast at 22 August 2016). Craneware is held in Amati VCT and the Amati AIM IHT Portfolio Service.

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Amati Global Investors are managers for:

- Amati VCT
- Amati VCT 2
- TB Amati UK Smaller Companies Fund
- Amati AIM IHT Portfolio Service

Investment markets and conditions can change rapidly and as such the views expressed should not be taken as statements of fact nor should reliance be placed on these views when making investment decisions. Past performance is not a reliable indicator to future performance.

Upcoming Events:

- 24 November: London National Financial Planning Symposium, Wembley Stadium, London
- Details of forthcoming events will be posted on our events page

We would welcome your feedback/comments on any of the areas covered in this issue. Please either email the team on info@amatiglobal.com or call on 0131 503 9100. If you would like to receive our monthly fact sheets by email please send a request to info@amatiglobal.com.

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Money Observer Award

Amati are delighted to have won the Money Observer Award for Best Smaller UK Small/Mid Cap Fund of 2016. The award is in recognition of consistently superior risk-adjusted performance. (The award is over the 3 year period to end March 2016).

TB Amati was also a finalist in Investment Week's Fund Manager of the Year Award (UK Smaller Companies category), and Amati Global Investors is currently one of the finalists in Investment Week's Boutique Management Group of the Year.

As at 1 September 2016

Time Period	Ranking (out of 45 peer funds)
Year to Date	6
1 Year	2
2 Years	3
3 Years	4

Source: FE Trustnet, IA UK Smaller Companies Sector.

Risk Warnings

This newsletter does not constitute investment, tax, or legal advice, and nor does it constitute an offer, invitation or solicitation to invest in the products described. Amati will not provide any investment, tax, or legal advice, or make any personal recommendations as to the suitability or otherwise of these products. Before investing in our products we recommend that you contact your financial adviser.

These investment products place your capital at risk and you may not get back the full amount invested, even allowing for any tax breaks. The value of your investment may go down as well as up. Past performance is not a reliable indicator of future performance. Investors should be aware that any investment in equities is subject to risk, and that investment in smaller companies, in particular unquoted companies and those quoted on the Alternative Investment Market (AIM), carries an even higher risk than that of larger companies listed on the main market of the London Stock Exchange. This is due to the higher volatility and lack of liquidity often found in smaller company shares, as well as typically higher levels of business specific risks. Illiquidity means that buying and selling portfolio holdings may take some time, and in a worst case scenario portfolio companies could be delisted from AIM, making them very difficult to buy or sell, which in turn could affect the value of your investment. Current tax rules and the available tax reliefs offered on investments into AIM-quoted stocks may change at any time, and there is a considerable risk that if the legislation changed in respect of these tax reliefs, then those portfolio companies that no longer qualified for such reliefs would be subject to heavy selling pressure, potentially leading to significant investment losses.