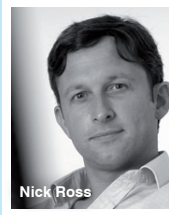


Clever, really clever

- An interview with Nick Ross, Acuity Capital

When you think about it, there is no surprise that a “son” of VC industry founding father, Electra Partners – namely Acuity Capital – should be the firm that has timed its entry into the green investment sector with such precision and planning, with an offering that will tempt many, being all of environmentally friendly, in the energy sector, offering asset backing and last, but by no means least promising a 10% tax free yield.



Nick Ross

Acuity Capital is an interesting firm. It is not one of the noisier VCT fund managers in the market, but is one of the oldest having launched its first fund, whilst under the umbrella of Electra in 2001. A dig around its website reveals lots of information not only about

the companies in which it invests, but also about itself and its philosophy. It sets itself high standards, not least its belief that private investors should have access to investment products and services that are often only available to institutional clients.

“we believe in levelling the playing field for private investors” Acuity Capital website

From the website it is clear that the Acuity team believes in the use of brain power, not financial brawn. The firm’s website abounds with phrases such as “exploit structural inefficiencies” and “highly disciplined private equity approach.” (I suspect that they whilst they have not quoted the expression “sweat assets hard”, that is exactly what they do.) The more I read, the more I was intrigued. Those of you who already know me will understand that this immediately sent me off to find out about the people behind the brand.

Lo and behold I already knew one of them, Mike Kennedy, from his previous life at YFM Group and I had of course, heard of Hugh Mumford one of the Managing Partners of Electra Private Equity, but I did not know the main man, Nick Ross, Acuity’s co-founder and managing partner. So I made the approach, bagged the interview and got the inside track!

“adding alternative assets to a conventional investment portfolio can lower overall portfolio risk” Acuity Capital website

The excitement typically generated around VCTs in the public domain is usually focused on the tax breaks, particularly the upfront ones that private investors receive. Further noise will be made around the risk, or lack thereof, in the investment portfolio the fund manager is going to build. Not enough is usually made about issues such as dividends, the need to have an extremely well thought out, focused investment strategy or the need for market understanding of the sectors in which investee companies will be trading. It is common to see VCs lowering these risks by conventional methods; but it is far less common to see them making a really concerted play on a specific sub-sector of an industry.

Perhaps to buck the trend or just because it is who it is, this is exactly what Acuity is now doing with the first of its Environmental VCTs. It has picked a large, legislatively protected, but high growth sub sector in the environmental space. Specifically it will now be investing in “organic waste recycling into energy via anaerobic digestion plants serving local authority and corporate customers”. Quite a mouthful but all will be revealed below...

We found out a lot about Nick when we interviewed him. For one he is a hockey enthusiast, so team playing is his lifeblood. I wouldn’t say that Nick is self-effacing – that would be too extreme - but he clearly does not want to crowd out his colleagues, with his own personality. In various contexts, he made comments about having the right team in place. He spoke of the importance of “healthy discussion” in the investment process, especially between the operational team and the three independent members of the investment committee. And this philosophy clearly extends to commercial deals. Acuity has been smart to nab Envar, waste management subsidiary of 50 year old ADAS as its Preferred Operating Partner for the 8-12 plants it plans to invest in. Teamwork, with Acuity doing the financial engineering and Envar undertaking the operational role, will be vital for this model to work. But don’t be misled, Nick is just following the precedent of Nectar Taverns which he backed [in a similar way] very successfully a few years ago.

When it comes to investing, it is clear that Nick is driven by investment returns, especially those that can be quantified. He sees the numbers on two levels, the underlying financial performance of the businesses backed and the returns that can be delivered to investors. This has been said by many, but delivered by few and Nick’s handle on both, does

give me confidence that he knows what he is talking about.

On an operational level he spoke of an existing pipeline of 18 sites under consideration, of which 3 already have planning permission; 8-12 sites to be backed in total, each with 10 year local authority contracts with fixed price, plus penalty charges contracts; a 12 month build and commissioning process for each site; and a plan to invest the VCT’s funds fully within 2 years.

At the investor level he told me about the offer of a 10% tax free dividend to investors from the start of year three onwards; capital repayments to the fund from year 5 onwards [out of which additional dividends could be paid to the investors]; and last but not least the commitment that if the fund has not returned 100p per share to investors by the 7th AGM, then Acuity will put a wind up vote to the shareholders as a mechanism to return capital to the investors. If he achieves even most of this, there will be some very happy investors around, and if the ultimate vote of confidence will be that his shareholders at that 7th AGM vote to give the VCT an indefinite life!

Interestingly Nick did not brag about the income that might be achieved from generating biogas. Perhaps, there is less certainty around the numbers, but it would not surprise me if Nick’s reticence is more about the size of the opportunity, than the lack thereof.

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Risk and investment go hand in hand. I happen to know a bit about anaerobic digestion from hanging out with a few environmentalists, so I quizzed Nick about some of the detail behind his plants. We chatted about issues such as the challenges surrounding mix of waste that is to be recycled. Nick knew his stuff – crucially the trick will be in wording the local authority contract to ensure that the financial effects of the operational risks stay with the local authority and not with the plant operator. Nick is fortunate, that there is a lot of industry experience in overcoming such challenges. There are great precedents in Germany where anaerobic waste-to-energy plants have been commonplace for years.

Unless the EU backs away from its Landfill Directive, or the UK Government does a complete about turn (unlikely when the New World Order is green), only local authorities going bankrupt will stop the march towards uptake of these plants. [And once proven in local government, inevitably the private sector, e.g. food manufacturers will also start adopting them].

It's a nice little environmental niche that does the world good, whilst offering investors a high risk yield on what is effectively a low-risk asset-backed opportunity. The VCT tax wrapper status is justified because the investments themselves are going to be challenging start-ups, in a relatively new sector, with more technology and operational challenges than the average punter would ever believe. No wonder Acuity is chasing it so seriously.

Although waste to energy is the new big thing in VC investing, we also asked Nick about other issues which are always on the tip of people's tongues when they chat about VCTs.

Like so many he remains frustrated by the lack of a secondary market in VCT shares and he notes that

the only real M&A in the industry has been occasional consolidations of funds by a fund manager. He, like so many, waits for a new predator to emerge and start the takeover ball rolling.

[2009-2011 will, according to Nick be vintage years to invest, not least because of depressed asset prices], but only the best fund managers will find them as they will be about looking forward not backwards. This makes it all the more important to back the right fund managers who know how to ride the investment wave.

In Nick's view, the long term Venture Capital fund manager does not head off permanently down a single sector investment track; instead he keeps fingers in many pies, thus explaining why Acuity will continue to operate its existing, more generalist VCTs and its AIM Portfolio Service. He has a point - who knows whether the next big thing will be in medical technology or even education. After all before Lord Browne took the helm at BP had anyone envisaged that the concept of energy Beyond Petroleum would ever be taken seriously enough to become an asset class of its own and deserving of investment by the general public, via the Venture Capital Community?

Nick maintained that he and his team are fund managers, but I wonder?

I suspect that whilst he is not a buccaneer, he is at heart rather a bright entrepreneur, with cash in his pocket, thus making him the most interesting sort of Venture Capitalist of all.

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For further information about our services contact
Chris Lane
clane@kingsonsmith.co.uk
or
Mark Fisher
mfisher@kingsonsmith.co.uk