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Tax Efficient Review

Enterprise Investment Scheme
Breeding Capital

RISK WARNINGS

RISK WARNINGS AND DISCLAIMERS

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GENERAL RISK WARNINGS

Your attention is drawn to the following risk warnings which identify some of the risks associated with the investments which are mentioned in the Review:

Fluctuations in Value of-Investments

The value of investments and the income from them can go down as well as up and you may not get back the amount invested.

Suitability

The investments may not be suitable for all investors and you should only invest if you understand the nature of and risks inherent in such investments and, if in doubt, you should seek professional advice before effecting any such investment.

Past performance

Past performance is not a guide to future performance.

Legislation

Changes in legislation may adversely affect the value of the investments.

Taxation

The levels and the bases of the reliefs from taxation may change in the future. You should seek your own professional advice on the taxation consequences of any investment.

ADDITIONAL RISK WARNINGS

Enterprise Investment Schemes

1. EIS companies are unquoted
2. The value of EIS Shares can fluctuate and Investors may not get back their investment;
3. There is no market for EIS Shares and Shareholders may not be able to realise their shareholding unless the EIS company is sold or floated on a recognised Stock Exchange. Dividends may not be paid.
4. Potential Investors should consider that past performance of the EIS Manager is no indication of future performance and there can be no guarantees that the EIS Company will meet its objectives.
5. Investment in unquoted companies can offer good investment returns, but, by its uncertain nature involves a much higher degree of risk than investment in a quoted portfolio.
6. Whilst it is the intention of the EIS Directors that the EIS company will be managed so as to qualify as an EIS, there can be no guarantee that it will maintain such status. A failure to qualify could result in the Company losing the tax reliefs previously obtained, resulting in adverse tax consequences for Investors, including a requirement to repay the 20 per cent. income tax relief.
7. Levels and bases of, and relief from, taxation are subject to change. Such changes could be retrospective.
8. EIS qualifying companies have gross assets of not more than £15 million prior to investment. Such companies generally have a high risk profile. Investors are advised to seek independent advice as to the suitability of investing in EIS companies.
9. Fees charged by the EIS. Usually there is an initial cost of around 5%-10% to cover issuing the prospectus and paying a commission to introducers. This is paid out of the initial investment paid by the investor and the effect is that the EIS company receives around 90%-95%. Thereafter annual running costs of about 3%-3.5% are incurred by the EIS and met out of EIS income. On top of these, the EIS management usually have a performance incentive which pays a proportion of the return made usually after meeting some hurdle. A typical incentive might be that the management receives 40% of any uplift in net asset value over a 7% per annum hurdle.

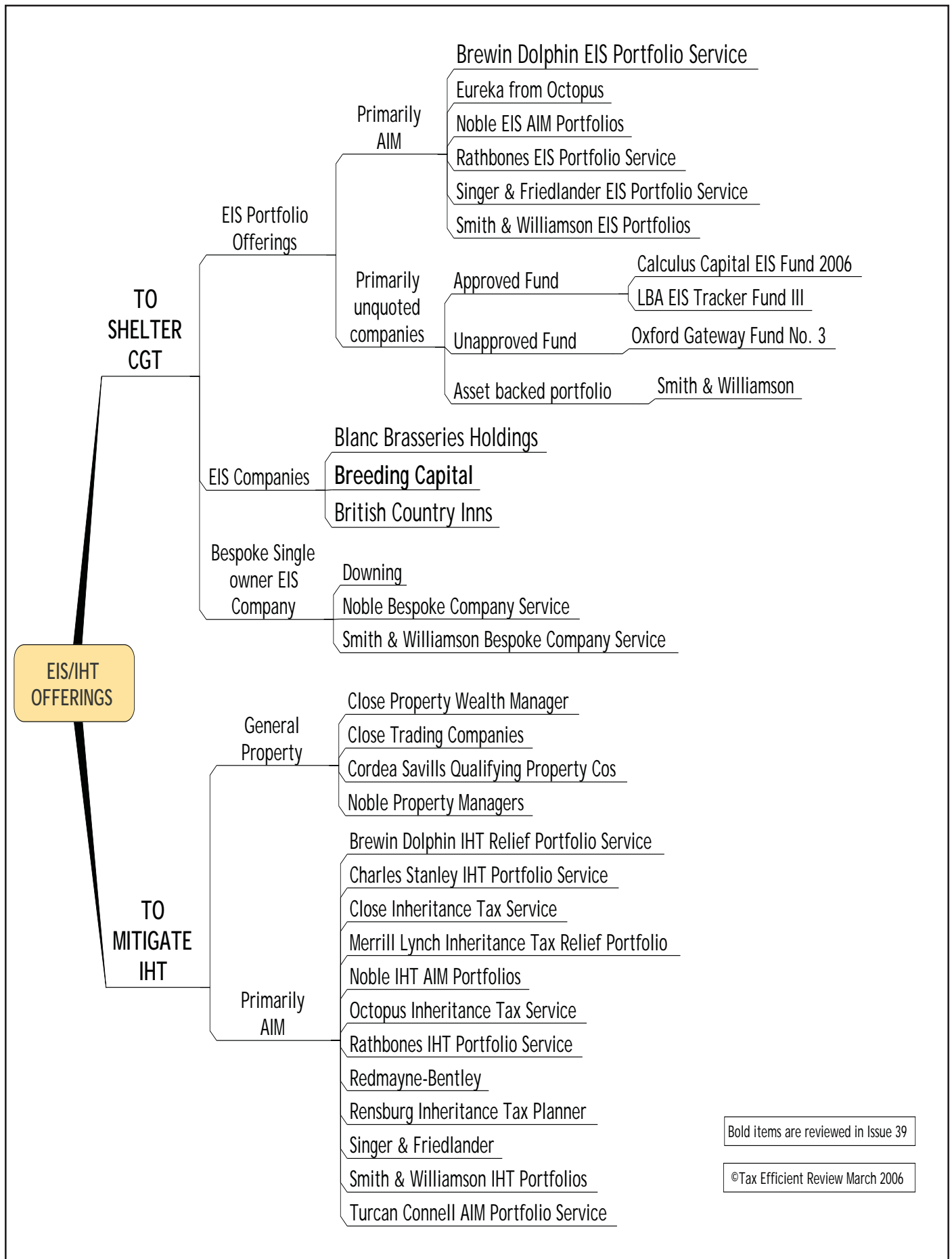
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Bold items are reviewed in Issue 39

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ENTERPRISE INVESTMENT SCHEME

Breeding Capital	Business	Invest in quality bloodstock assets
	Size	£5m through two offerings
	Company financial adviser	NW Brown Corporate Finance Limited
	Minimum investment	First offer: £10,000; Second Offer £35,000
	Minimum subscription	£2.25 million, which has already passed
	Closing Date	Tax year 05/06: 31 March 2006, 06/07: 28th April 2006
	Commission	3%

Strategy This EIS is looking to raise a total of £5m to invest in breeding bloodstock for the flat racing industry. There are two parallel offerings, both using different exemptions under the new European Prospectus Directive that came into effect in July 2005. The First offer, which will raise up to £1.6m, has raised £1.3m to date and has a minimum investment per investor of £10,000. The Second Offer is seeking £3.4m, of which £1.4m has already been raised and operates under the exemption for offerings with minimum investment level in excess of 50,000 Euros (£35,000).

The EIS will acquire and trade a portfolio of bloodstock assets, a trade that is EIS qualifying as well as providing asset backing from assets that should be readily realisable.

The business sequence will be:

Step 1. Acquire broodmares in foal. Average price £500,000 Normally around 25% of the acquisition price will be ascribed to the foal. Keep costs per day (payable to the stud used, most probably Watership Down Stud) around £25 per day.

Step 2. Foals are born and sold each year as yearlings. Keep costs around £23 per day per yearling.

Step 3. Cycle starts again as broodmares are mated/"covered" shortly after foaling by a stallion at a "nomination" fee (this time paid by the EIS) with the quantum of the fee related to the quality of the stallion. Estimates by the EIS management are that "nomination" fees will average £50,000, representing very high end stallions. We understand that there are only twenty five stallions in the world commanding a fee in excess of £50,000. Gestation period is 11 months. Step 3. In 2010, it is expected that the mares, foals and yearlings will all be sold and the EIS wound up.

EIS running costs are expected to include a max 2.5% charged by the EIS management, a fee paid to the bloodstock consultants Michael Youngs and Charles Gordon Watson of around 0.4% per annum and all the individual costs of "covering" and stabling the various assets acquired or produced (in the case of foals) by the EIS. Keep costs per horse are around £9,000 per annum and mortality insurance is around 3% per annum.

Mares are treated as stock, and will be held at the lower of stock and market value. Management believes that their investment strategy will protect the residual value of the mares.

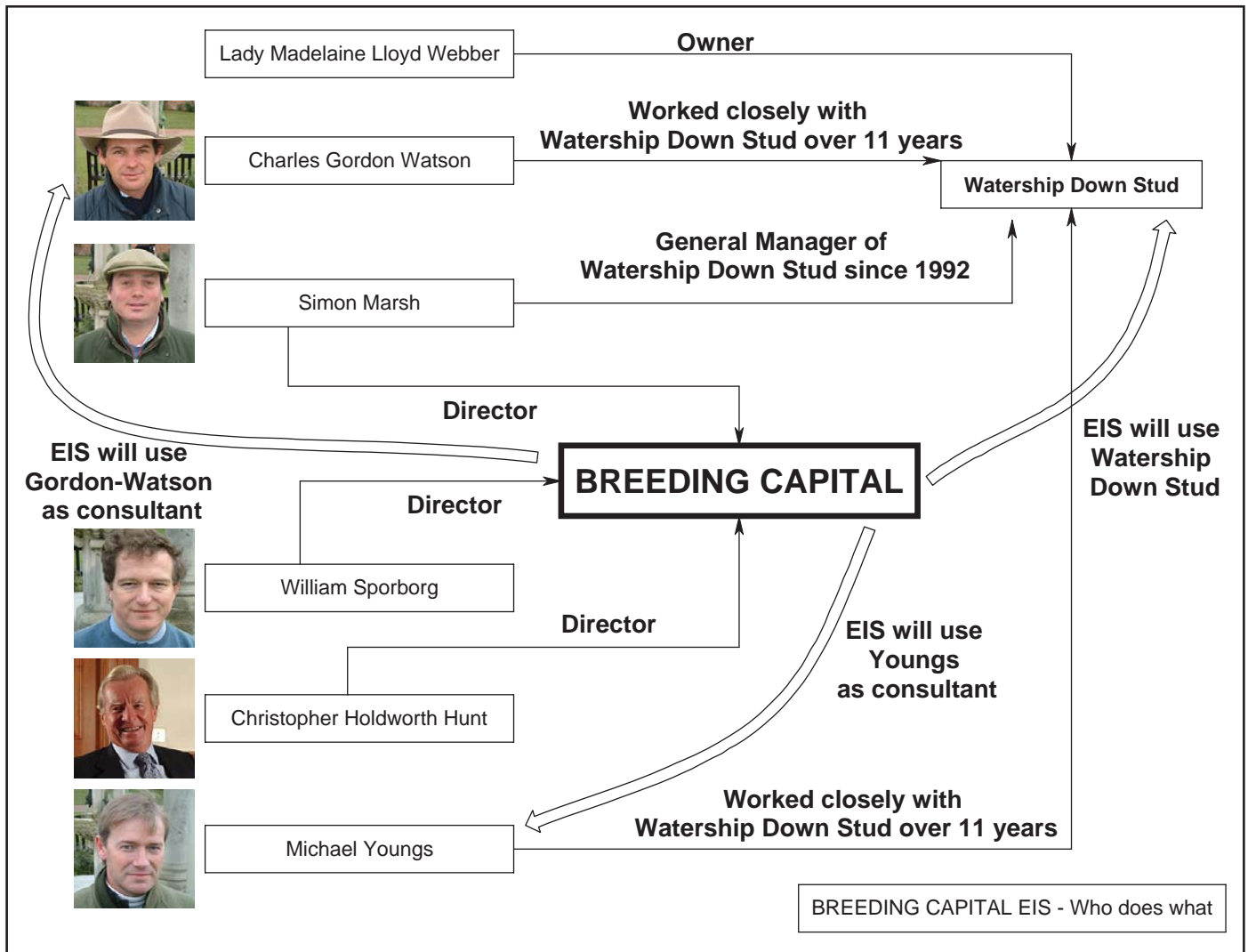
Profit is expected to arise from selling yearlings profitably – over the last eleven years the management team has sold yearlings at an average of 8.5 times nomination fee, as against an industry norm of 3.0 (and mares at the winding-up of the EIS) usually at auction

When fully invested it is anticipated that the assets will be spread as follows:

65% in broodmares. It is intended that the majority of the funds raised under the Offers will be used to acquire high quality, young broodmares which will be mated/"covered" every year by high quality stallions. The young stock will be nurtured at studs with a proven track record prior to being consigned to the sales as foals or yearlings. The principal income for the EIS will be derived from the sale of such offspring. However these are expensive animals costing on average around £500,000. This means that even at full subscription the EIS will only acquire about seven broodmares which does not seem to provide much of a spread.

20% in foals and yearlings, acquired for resale and stallion shares. The EIS will also acquire young stock, acquired for resale, often called pinhooking. Pinhooking involves the purchase of either foals or yearlings, for subsequent resale, either as yearlings or two year

ENTERPRISE INVESTMENT SCHEME (CONT)



olds. A Stallion share entitles the bearer to utilise the services of the stallion to which the share relates, or to sell the benefit of those services, called a nomination. The value of a share reflects the likely future income streams, so it is valued by reference to the age and perceived future desirability of the relevant stallion.

15% in working capital and costs.

The Company may acquire other bloodstock related assets, such as fillies out of training for sale as in foal mares and racehorses for sale abroad, when the Directors believe that trading such assets will be accretive to Shareholder value.

It is the Directors' intention to board the majority of the bloodstock assets at Watership Down Stud. The Directors believe that Watership Down Stud's portfolio of properties and track record lends itself well to maximising the value of the underlying assets. One of the three directors of the EIS, Simon Marsh, is a co-founder and now General Manager of Watership Down Stud as well as being Bloodstock Director of the EIS. The Stud was founded by Lord and Lady Lloyd Webber in 1992. Set in the downs of the Hampshire countryside their vision was to build a stud that would produce top quality thoroughbreds that they would go on to race and breed from. Before her marriage, Lady Lloyd Webber was an International Three Day Eventer, representing Great Britain.

Track record

The key for this EIS to succeed will be the ability of the EIS to purchase mares at a good price, sell yearlings and foals at a price that both covers their running costs and makes a significant contribution and then sell at the end of four years the mares, in effect winding down the EIS. The Information Memorandum notes that Watership Down Stud has sold 139

ENTERPRISE INVESTMENT SCHEME (CONT)

yearlings in the last eleven years, grossing in excess of £27 million, at an average selling price of almost £200,000 each.

The board of directors comprises:

Christopher Holdsworth Hunt (63, Chairman), co-founder and previous managing director of KBC Peel Hunt Limited), William Sporborg (40, Managing Director, a qualified Chartered Accountant, has spent the last thirteen years investing in unquoted companies, ex point to point jockey, before retiring through injury in 1994) and Simon Marsh (43, Bloodstock Director, see below).

The management team will be crucial. However in reality this EIS has no full-time management team. It has a board of directors (see above) and buys in the services of two consultants. The management team comprises one of the directors (Simon Marsh) and the two outside consultants (see diagram on previous page).

Simon Marsh (43) is the Bloodstock Director of the EIS. He is also a co-founder of the Watership Down Stud. After working at a number of studs throughout Europe and the USA, Simon established Myriad Bloodstock & Communications Ltd, a bloodstock consultancy and publisher. In 1992, Simon became General Manager of Watership Down Stud. Under Simon's stewardship Watership Down Stud has consistently been one of the leading studs in the UK in terms of value of bloodstock sold, and holds the record of breeding and consigning the animal that has achieved the highest price ever in a European Sales ring – a yearling colt sold for £3.4 million in 2000. In addition to Watership Down Stud, Simon has a portfolio of international clients whose bloodstock interests he manages. He has extensive global relationships, particularly in the USA, where he has a strong relationship with Lanes End, Kentucky, one of the most prestigious and successful stud farms in the world.

The consultants are Charlie Gordon-Watson and Michael Youngs.

Charlie Gordon-Watson, 46, has been trading independently as a bloodstock agent since 1985 and is now consistently among the top five yearling buyers in the UK as well as major independent buyer in the USA and Europe. Charlie's achievements include acting as agent on the acquisition of eight Classic winners including the Epsom Derby Winner, Kris Kin and Kings Best, the winner of the 2000 Guineas at Newmarket, and now a successful sire. Charlie has purchased 24 individual Group 1 winners of 37 Group 1 races worldwide.

Michael Youngs, 45, is an independent bloodstock consultant. In 1994, following nine years as pedigree and matings consultant to Prince Khaled Abdullah's Juddmonte Farms, where he was involved with numerous classic and Eclipse award winners, Michael moved to Kentucky to work for four years at Three Chimneys Farm as their in-house pedigree adviser with responsibility for stallion bookings. Returning to England in 1998 to set up his own business, Michael now advises owners and breeders in Europe, the Americas, and the Far East. Michael is a frequent contributor to breeding publications, including Pacemaker.

Simon Marsh (see above), Charlie Gordon-Watson and Michael Youngs have worked together over the last eleven years and the Information Memorandum says that they are entirely responsible for the track record of Watership Down Stud – they acquired the mares, chose the stallions and sold the yearlings at public auction.

The consultants will be paid a yearly fee of 0.4% of funds raised and will share in the option pool, which will grant options to subscribe for Ordinary Shares in respect of up to 20 per cent of the Company's issued share capital from time to time to the Directors, the Management Team and the Promoters. Such options will be issued with an exercise price of not less than 100 pence per Ordinary Share.

What is not clear is how much time Marsh and the two outside consultants will spend on EIS business. Another key question is also how the three members of the team will handle any conflicts of interest when it comes to purchasing horses.

A potential conflict could arise when the independent consultants are seeking to purchase a mare for the EIS and have also been instructed by a private client of their consulting business to also seek out a mare. As the consultants receive an annual fee from the

ENTERPRISE INVESTMENT SCHEME (CONT)

EIS, then in our view they could seek to maximise their income by purchasing the mare for their client (earning a fee related to the purchase price) as a purchase on behalf of the EIS does not increase their income.

Charlie Gordon-Watson and Michael Youngs are consultants working for Breeding Capital – they are not exclusive to the EIS, nor is the EIS exclusively obligated to use them. They will provide a range of services to Breeding Capital including identifying, inspecting and valuing potential purchases, helping maximise returns from the assets through mating plans and exit strategies, developing the portfolio and generally promoting the Company's assets.

The managing director of the EIS tells us that "Through a combination of strong corporate governance, including a contractual agreement and the recently introduced Bloodstock Industry Code of Practice, the remuneration structure of an ongoing consultancy agreement and significant share options, the long standing relationships with the management team and the collective belief in the future of Breeding Capital, I am confident that we have in place a structure/ethos which will enable us to work effectively and minimise the conflicts".

We see this potential conflict of interest in an area (bloodstock trading) which is not particularly transparent to an outsider as the most difficult point about this investment.

Deal Flow There can be no shortage of mares on the market for a company with up to £5m to spend.

Costs Initial costs are fixed at 5%. Commission is 3% .

Annual directors fees are capped at 2.5% of the lower of funds raised or net assets (excluding VAT). Other running costs to be paid by the EIS include audit and legal fees.

It is the Directors' intention to grant options to subscribe for Ordinary Shares in respect of up to 20 per cent of the Company's issued share capital from time to time to the Directors, the Management Team and the Promoters. Such options will be issued with an exercise price of not less than 100 pence per Ordinary Share. The allocation and vesting of options will be determined by the Board from time to time.

We disapprove of this form of dilution that gives no priority return (above the tax break) for the shareholders for taking on the risk of investing in the EIS

Conclusion This EIS is looking to raise a total of £5m to invest in breeding bloodstock for the racing industry through two parallel offerings, and has already raised almost £3 million.

The EIS will acquire and trade a portfolio of bloodstock assets, a trade that is EIS qualifying as well as providing asset backing from assets that should be readily realisable.

A very interesting and potentially lucrative business, with a management team with a proven track record in exactly this segment of the market. Even though it is an industry that we find opaque and potentially rife with conflicts of interest, we take some comfort from the quality of the investor base and the Chairman.

Recommended.