coller ip

Valuation Report

Software in Sinetic AV Ltd

IPV/SINET/001

October 2015

Confidential

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EXECUTIVE SUMMARY

In this report we provide an independent valuation of IP, in the form of software held or developed by Sinetic AV, for the purpose of informing a potential investment by eaga Trust in Sinetic.

We regard a future income approach to the valuation, using a Relief from Royalty approach, as being appropriate to these circumstances and the Purpose here. On the basis of our analysis and our experience, taking into account the limitations of information available to us, the level of risks identified and the assumptions explicitly made and stated in this report, we arrive at a conservative valuation of the software in the range (to reflect uncertainties) of £60k-£79k, with a central value of £69k.

INTRODUCTION

Coller IP has been commissioned by Eaga Partnership Trustee Limited and Eaga Partnership Trustee Two Limited (together comprising the “eaga Trust”) to provide an independent valuation of Intellectual Property in the form of specific software assets held by Sinetic AV Ltd (“Sinetic”), for the purpose of informing a potential investment by eaga Trust in Sinetic (the “Purpose”).

Scope of work

As per our proposal dated 25 September 2015, the scope of this work is to provide a valuation report of the software. In completing the valuation we shall:

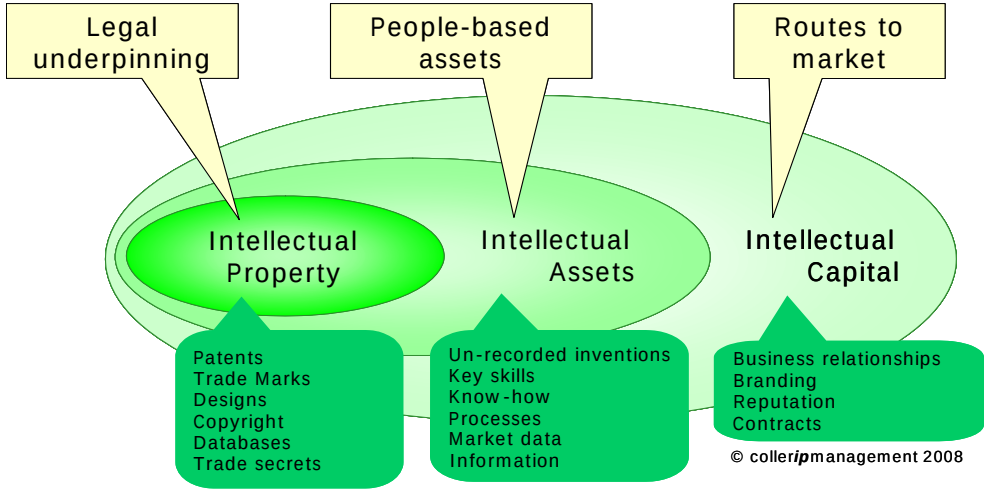
- identify and list the relevant intangible assets;
- provide an indicative value range of the assets;
- confirm the assumptions made in reaching the indicative value; and
- produce a full report clearly articulating the value, the methodology, the risks and the assumptions.

This report is supplied in full satisfaction of the proposed deliverables.

COLLER IP

Coller IP takes a holistic and structured approach to the commercial importance of intangible assets, looking beyond the formal IP to wider elements of intangible assets that are valuable in business.

We find it helpful to consider intangible assets as providing support for business success via an appropriate combination of **legal underpinning** to commercial business opportunities, **people-based assets** for effective business operations and availability of appropriate **routes to market**. For a business to be sustainable, our experience is that all three elements of intangible assets, as shown in the diagram below, are important.



In carrying out this type of work, we seek to identify specific Intangible Assets that drive significant value and/or are effective in managing risk within the business under review and seek to understand how these are appropriately managed.

Coller IP has many years' experience of intangible asset audits, competitor IP analysis, due diligence and valuation work for a range of purposes, ranging from board-level strategy, investor positioning and licence negotiation, to corporate structuring. We bring a proprietary combination of technical, legal and commercial (TLC) skills to this type of work.

COMPANY OVERVIEW

Business History/structure:

Sinetic AV Ltd was incorporated in October 2012 as Smudge Inc. Arts Ltd to carry out the software design and commercialisation of an innovative technology developed by the founder, Aaron Smiles. The business was formed following research conducted during postgraduate study indicated the commercial and technical desirability of a more gestural approach to the way people interact with computers to generated music. After rebranding to Sinetic AV, the company has begun initial development of its core technology and has created a business plan.

The software in question includes the actual software code developed as well as supporting development and research which is owned by Sinetic. In addition the company has made a UK patent application to further protect its intellectual capital.

The company is currently pursuing a number of investment opportunities which would enable the necessary development of the technology and products. The business plan projects moderate investment in the immediate future, and unlocking larger investments in the medium-term future, which would allow a two year period of further development of the technology and building of commercial partnerships. After that the business would enter the market through a number of established partners (including value-added resellers). The most active markets for the products have been identified by Sinetic as USA, UK and Germany.

OVERVIEW OF THE KEY INTANGIBLE ASSETS

This section of the report provides an overview of what we consider to be the significant intangible assets and IP related to the technology.

Software

Research for the product has been carried out for a number of years via postgraduate study and grants. The culmination of this research has led to development of the software beginning with the core functionality required for the products. Through software contractors, roughly £6000 has been invested in producing the current prototype of the software, with a further £60k having been invested in research, design, prototyping, patenting and commercialisation research.

This valuation is focussing only on the software assets, including any code, designs and research integral to the current prototype. In particular, although we take account of the supporting patent application and the patenting strategy as a whole, no patent assets are included within the assets valued.

VALUATION OF THE KEY INTANGIBLE ASSETS

In this section, we provide our valuation opinion on the software assets owned by Sinetic and identified above. This section will detail:

- the information relied upon;
- the assumptions made;
- caveats for understanding this report;
- the basis and approach suitable for the Assets; and
- the calculations and figures from our valuation.

Evidence and Information Provided

The information provided by Sinetic to Coller IP, and which forms the evidence base for this valuation, is listed below:

- Business plan, dated August 2015
- Statutory Accounts for Sinetic AV Ltd for the two years from July 2012 to June 2014
- "Pessimistic" Financial projections for five years
- "Realistic" Financial projections for five years
- "Optimistic" Financial projections for five years
- Record of cash investments
- Market insight report (The 2014 NAMM Global Report)
- Patent Application form for GB1419740.4, dated November 2014
- Patent Application Specification Documents P166555.GB.01, dated May 2015 (confidential)
- Companies House Documents for Sinetic AV Ltd

Basis, Assumptions and Caveats

Our understanding of the assets being valued is based on the information provided by the Client, described under the 'Evidence and Information Provided' section of this report. In particular we have made the following assumptions in relation to the Sinetic business and the use of the assets in that business, upon which our valuation relies, and which have been confirmed as appropriate by Sinetic and the eaga Trust:

- The software is one of the most significant intangible assets owned by the company;
- That patent protection will be extended to cover the geographical markets key to the business plan; and
- There remain a significant number of technical, legal and commercial risks to fulfilling the business plan.

In arriving at an assessment of value, we aim to determine a Fair Market Value, that is, a value that would be arrived at as a fair price between a seller and a buyer acting freely in a market. We have taken account only of the information made available to us by the Client, information available from public sources (as appropriate), and publicly available comparator information (as appropriate) on IP-related royalty rates. Where specific information material to value is not available, our valuation is dependent on explicit assumptions, which are stated in this report.

Our opinion is provided solely for the benefit of the Client for the Purpose stated above; we give no warranty for use of this opinion for any other purpose or by any other party.

Our valuation opinion is valid as of the time of our report and will be based on the information available to us at that time. Material changes in circumstances subsequent to that time may change the validity of that opinion at a future date. We note that in reaching our opinion we will make no detailed assessment of the validity or current legal status of the IP, other than where explicitly stated in our report.

Our valuation is given as an opinion in good faith based on our interpretation of the evidence available, our experience and our informed view of relevant risks. Other IP valuers may reach a different opinion from the same evidence. We note also the dependence of our valuation on the business projections provided by the Client; the reliability of these in practice will be determined by future events and the economic environment at the time and may be subject to unforeseen change, which may in turn impact on the reliability of the valuation made at this time.

We note also that we are valuing intangible assets that are dependent, at least in part, on the Client business remaining a going concern. In the event of a material change in the circumstances of the business, the value of these assets may or may not be realisable.

Basis for Valuation

In approaching the valuation of IP, three approaches are generally accepted as relevant: a **historic cost** approach which considers the investment made in developing the relevant IP; a **market value** approach, which seeks to identify free-market transactions that may be considered as comparators; and a **future income** approach, which seeks to estimate the present value of future economic returns that are attributable to the IP.

Historic Costs approach

Here we make an estimate of the costs of development of the IP to date. We note that the cost of developing intangible assets is not generally a good indicator of their future value, so we do not regard this approach as being appropriate in this case to provide our primary formal opinion. However, in some cases it can be useful in setting a benchmark cost and providing some protection from competitors who would have to invest a similar amount of resource to replicate the product or service offering. In this case, where we are dealing with software, we consider the cost to replace it does provide a relevant benchmark and perspective.

Market value approach

A market-value based approach relies on the ability to identify transactions similar in character for similar types of asset. Such an approach is familiar in real estate and art markets. The combination of very much broader (and relatively unique) nature of intangible assets and the current absence of significant liquid markets for such assets strongly limits the ability to use this approach, and we have not sought to apply this as a primary approach to valuation.

Future Income Model

We consider a 'Future Income' approach to be the most appropriate under these circumstances. This approach is based on making an estimate of the current value of future cash that can be attributed to the Intangible Assets, taking proper account of risk. We regard this approach as being the most appropriate here to provide a valuation opinion and later sections describe how we have applied this approach in this case.

Future Income Model

The Future Income approach is based on making a quantitative estimate of the current value of future year-by-year cash that can be attributed to the Intangible Assets, taking proper account of risk and the cost of capital through a Discounted Cash Flow (DCF) calculation.

In this case, we have assessed the value of the assets, appropriately discounted for risk, using a 'relief from royalty' future income model, which is appropriate under these circumstances. This is based on an estimate of the future cash flows attributable to applying a notional royalty rate to the sales of the products and services. This is equivalent to the royalty that the company would have to pay to a third party if it did not own the IP and had to pay royalty fees under a licence agreement, hence the name for this approach.

For this purpose, we need to establish a revenue stream and apply a notional royalty rate to the revenues to provide a basis for valuation.

Revenue Stream

We have based the future revenue and profit projections for Sinetic on the "pessimistic" forecasts provided by Sinetic which are described as "full risk" and allow for a downturn in the market and a reduced profit margin. We therefore start from the most conservative view of the opportunity expressed by Sinetic. In its projections, we note that Sinetic is anticipating a price point for its software just below that of its nearest identified competitor in the market. This appears to us to be a realistic approach. However due to the very early stage of the business and the number of challenges which remain to be overcome to drive the business to a revenue earning position, we have applied our own additional conservative discounting to these projections.

We have included explicit risk factor discounting to account for various significant risks facing the business, mainly technical, legal and commercial in nature. We assign a success factor to each area of risk depending upon the importance of that area to the business and the challenges in that area, with a lower percentage reflecting a greater risk and further discount. We have applied a 40% commercial factor, reflecting the risks in achieving the additional investments needed and delivering the planned value-added partnerships on schedule and on acceptable terms. We have applied a 50% technical factor, reflecting the difficult technical goals and innovation required, but also accounting for the progress to date achieved in this area. We have applied a legal risk of 60%, reflecting the limited role of legal uncertainty in protection of the software and the indirect relationship of between the patent risks and the software asset. The product of these success factors gives the overall risk factor, in this case 12% at this point in time. The risk factor is then applied to the projections in future years to discount the value of the future cash streams in light of the challenges faced in reaching them.

DCF discount rates

In a DCF calculation, a key input is the discount rate applied to represent the cost of capital and the general business risk. This starts from an assessment of risk-free capital (normally based on government bonds/gilts) and then has additions to account for risk (reflecting the higher costs of borrowing or financing according to risk). For a large listed stable business with well-established trading performance, this would typically be about 10-12% depending on market sector and volatility factors. As risk is perceived to increase, higher rates apply.

At the extremes, the risks in a start-up company with no established trading are very high, and the DCF rate can be considered to be equivalent to the expectations of a typical early stage investor, looking for an over 10x return on investment within a 4 year period, to offset the expectation that a few (perhaps as low as 1 in 10) such early stage investments will succeed. If reflecting this risk solely in DCF rate terms, this rate of return requirement would be equivalent to a DCF rate of as high as 80%, but this does place little value on growth in the medium to long term. In practice, a combination of discounting projected performance explicitly at the top line and implicitly with a lower DCF rate is often appropriate, especially for early stage companies that have established a level of performance.

In this case the risks justify a combination of DCF discounting and explicit topline risk factor discounting, as detailed above, in the revenue stream section.

As we have accounted explicitly for many of the business risks already, we have adopted a medium-risk DCF as appropriate to take account of this additional discounting but to maintain a generally conservative view of the business projections. We have used a medium-risk DCF rate of 20% in our calculations.

Royalty Rate

The royalty rate in a relief from royalty calculation is a key parameter which aims to attribute a fair value to IP for the asset's contribution to the revenue and profit stream. In our experience software products are often key assets of technology companies and so we would expect royalty rates

for software to range widely and may sit anywhere between a few percent and tens of percent, allowing for the specific nature of the business, the software in question, and costs of distribution of licences. We note that the business plan anticipates a profit to Sinetic benchmarked against a range of 30%-50% typical of a model for software distribution through a Value-Added Reseller partnership. We note here that the software is technically sophisticated and innovative, and will be one of the key assets of the company. These factors would usually indicate a high royalty rate would be appropriate (perhaps 10-20%), however we have taken into account that the software in question is at a prototype stage of development, does not include the full features of a final product and has not yet been tested in the market. Therefore we have conservatively applied a 5% royalty rate to the revenue stream for the Purpose here.

Terminal Value

Our discounted cash flow calculation takes into account ten years of projections; however in some cases IP may have a continuing commercial lifetime of over ten years. If the current patent application is granted, this will have a potential life of 20 years from the filing date. Where IP has a long commercial life, we would normally include a terminal value to represent the value of the IP beyond the projection period. However in this case our view is that it is inappropriate to assume the software will be relevant after a ten-year projection period. Software assets tend to become obsolete over time as the market moves and supporting operating system and hardware platforms and technologies change. Software strongly dependent on user interfaces, for example, may have a lifetime as short as five years, as they are most dependendt on platform changes. . In this case the software relates predominantly to a core calculating engine which will have a longer-term relevance for future products and developments, although it will not begin to be sold for another two years. In these circumstances, we regard a ten year projection period as appropriate, but we have not allowed for any value after that point and we regards this approach as conservative.

Relief from Royalty Calculation

The following section presents our calculations of value for the software, using the projections provided by Sinetic and the key parameters detailed above.

The table below contains the net present value (NPV) calculation for the current business allowing for a 20% corporation tax liability (applied to previous years' profits to reflect the timing of tax payments) using a risk discount factor of 12%, a royalty rate of5% and a DCF rate of 20%.

£k	30-Jun					Growth:			20%	0%	0%	0%	0%	0%	0%
FY:			**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
	Revenues					£0	£0	£4,450	£5,340	£5,340	£5,340	£5,340	£5,340	£5,340	£5,340
	Risk Factor Discount	12%													
	Adjusted Projected revenue					*£0*	*£0*	*£534*	*£641*	*£641*	*£641*	*£641*	*£641*	*£641*	*£641*
	Gross Profit					£0	£0	£2,720	£3,015	£2,524	£2,524	£2,524	£2,524	£2,524	£2,524
	Risk Factor Discount	12%													
	Adjusted Projected Profit					*£0*	*£0*	*£326*	*£362*	*£303*	*£303*	*£303*	*£303*	*£303*	*£303*
	Profit Margin							61%	56%	47%	47%	47%	47%	47%	47%
		Relief from Royalty													
		Rate	5.00%												
		Notional Royalties				£0	£0	£26,700	£32,040	£32,040	£32,040	£32,040	£32,040	£32,040	£32,040
			Less Corp tax	20%		£0	£0	£0	-£5,340	-£6,408	-£6,408	-£6,408	-£6,408	-£6,408	-£6,408
			Total			£0	£0	£26,700	£26,700	£25,632	£25,632	£25,632	£25,632	£25,632	£25,632
			Roy/Profit					8.2%	7.4%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%
			DCF			1	2	3	4	5	6	7	8	9	10
			20.0%		100%	83%	69%	58%	48%	40%	33%	28%	23%	19%	16%
		Discounted value				£0	£0	£15,451	£12,876	£10,301	£8,584	£7,153	£5,961	£4,968	£4,140
													Existing	NPV	£69,435
												Terminal growth:		TV	
														Total:	**£69,435**

From this calculation we obtain a NPV to 2025 of £69k (all figures are rounded to the nearest one thousand pounds).

Allowing for uncertainty variations in the royalty rate (4.5%-5.5%) and the DCF rate (18%-22%) we calculate a value for the assets in the range £60k-£79k, with a central value of £69k (all figures are rounded to the nearest thousand).

CONCLUSIONS AND OPINION

In this report we provide an independent valuation of IP, in the form of software, held or developed by Sinetic, for the purpose of informing a potential investment by eaga Trust in Sinetic.

We regard a future income approach to the valuation, using a Relief from Royalty approach, as being appropriate to these circumstances and the Purpose here. On the basis of our analysis and our experience, taking into account the limitations of information available to us, the level of risks identified and the assumptions explicitly made and stated in this report, we arrive at a conservative valuation of the software taken together in the range £60k-£79k, with a central value of £69k.