

Tax Shelter Report – Issue 252 – October 2012

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This issue:

STOR Power plc

EIS Review

STOR Power plc

STOR plc (Company) will trade in providing short term operating reserve (STOR) to the National Grid.

The Company will be managed by a board of directors recruited from Invicta Capital Limited and ESCO NRG Limited, who worked together on a solar EIS earlier this year.

Maximum size is £5 million. Minimum investor subscription is £50,000.

Initial closing date is 31st December 2012 unless extended.

EIS pre-clearance has been obtained from HMRC.

Conclusion

Trading in STOR provision potentially offers visible earnings secured against a counterparty of good credit, being the National Grid. Technology risk, in the main, should be low since diesel generators, comprising of an engine and alternator, are a reliable and robust technology. Connection points to the National Grid, we understand, are in abundance. In general, construction risk should be low by comparison with other energy trades, because the diesel generators arrive ready to go as a containerised solution.

STOR provision is a relatively young business model in the UK and is a new venture for Directors whose energy interests are detailed below (see *Directors and Associated Parties*). The central risk appears to be in winning tenders from the National Grid at the right price (below we describe the Company's tender strategy). Directors aim to manage this risk by submitting a range of tender prices and terms. While the maximum tender period is currently for 24 months, longer-term contracts may become available within the next two years, we understand, to meet a potential future shortfall in the UK's energy generating capacity (the Manager cites Ofgem's "Electricity Assessment Report" of

5th October 2012, which predicts that, within four years, the UK's energy generating capacity will be insufficient).

Consequently, Directors believe now is opportune to invest while the National Grid hopes to encourage entrants to the sector (see below) through attractive terms; accordingly, the Company forecasts relatively high returns on capital, which rise strongly if a fourth year exit is secured.

In summary, the Company may appeal to sophisticated investors in energy investment, who understand the implications of investing in STOR and can gauge the risk of tenders and their implication on the future sale of the assets. Investors who have an energy portfolio might wish to boost diversification through the inclusion of a focused STOR business, and gain exposure to relatively high potential rewards from a sharply focused energy venture.

Strategy

Overview

To safeguard against unexpected dips in the electricity supply, the National Grid contracts privately owned electricity generators (*generating sets*) to provide on request pre-set quantities of electricity. Such eventualities might result from a power station failure or unexpected demand spikes (a televised news bulletin attracting an extra million viewers, for example).

Pre-agreed parameters are set with National Grid; minimum requirements for STOR are as follows:

- Minimum contracted mega watt (MW) capability is 3MW
- Contracted MW must be achievable no later than 240 minutes after instruction from National Grid
- Contracted MW must be deliverable for no less than 2 hours.

To provide the National Grid with STOR the Company will:

- Purchase diesel Generating Sets that are appropriate for meeting STOR requirements;

STOR service providers generally provide electricity produced in the cheapest way, currently being by the burning of fossilised fuel, such as diesel.

- Submit tenders to National Grid
- Maintain and operate Generating Sets.

STOR can provide participants with two types of payment: where a service provider makes its generators available, it receives an availability payment based on a notional MW per hour; the National Grid will also pay for called upon electricity, again on a MW/hour basis.

The service provider can elect to link prices to standard indexation methodology, to be specified at outset.

The Directors expect the demand for STOR to increase for the following reasons, which they describe in greater detail in the information memorandum:

- Electricity generating capacity should reduce when ageing nuclear power stations and coal fired plants, are decommissioned over the coming years and replacements are not apparent, leaving a potential energy deficit
- Ever increasing renewable energy generation will result in fluctuations in electricity.

Diesel Generating Sets

The diesel Generating Sets will be located in brown field sites in the south of England. Appropriate sites have been sourced during the Directors' due diligence where the necessary grid connections are available.

The Directors intend to acquire engines from reliable and well-known diesel engine manufacturers, such as Cummins, Mitsubishi and Caterpillar, and alternators likely to be sourced from Mecc-Alte.

Each diesel generating set will be delivered as a containerized solution including fuel storage, remote start facilities and remote diagnostic functions to detect, for example, when fuel is running low, when oil changes are required etc. Generating Sets will be installed under a turnkey contract.

The Generating Sets run on *red* diesel, being the non-taxed home diesel for heating (a red dye is

added to differentiate it from vehicular fuel). The Generating Sets should burn 200 litres of red diesel per hour per 1MW set when running at three-quarters capacity.

At full subscription, the Company will buy seven Generating Sets, producing 3MW each, giving the Company a tradable energy sum of 21MW. The turnkey cost of the acquisition and installation of each generating set is forecast at around £634,000.

The Company will hire a third party specialist to maintain and operate the generating sets.

Remote software will diagnose each generating set's performance, sending an alert to the operator when running short of fuel, for example.

Tender Strategy

Three times a year, National Grid invites energy providers to tender for STOR contracts.

To tender, the National Grid and the service provider must have entered into a STOR framework agreement, which gives details of the STOR provider's generators, their location and MW capacity availability. There is a minimum capacity requirement of 3MW to enter into a direct STOR framework agreement. Once the parties are contracted under the framework agreement, National Grid will invite the STOR provider to tender. The tender selection process has been designed to buy for the public reserve electricity at the best price.

Tenders can propose commitments up to a maximum of two years but Directors expect contract terms to be lengthened soon, in line with the rises for STOR services referred to above.

The STOR provider can be contracted to provide a *Committed Service* or a *Flexible Service*. Under committed contract, the STOR provider must make the service available across all designated time periods. Conversely, the flexible contract, as it suggests, asks for limited availability.

A STOR generating set can only be tendered once per season (i.e. it can be tendered a maximum of three times a year).

Some providers of STOR tender to supply more electricity than they can produce themselves,

contracting third parties to plug any deficit. Normally, they will, as the framework name suggests, aggregate production from generating sets under the 3MW threshold. The Company does not expect to trade under an aggregate framework contract, but recognises it as a contingency if the Company's tenders are not accepted.

The Company will only tender for committed service, which we understand generally offers the highest available payments.

The Company will submit seven tenders for the seven generating sets of the Company (assuming total subscription of £5 million). Each tender will offer 3MW availability at different prices with the aim of supplying STOR at the mid price. This strategy will be varied and repeated across the three tender seasons.

Should any tender not be accepted, the Company will make the capacity available to the *Aggregators*, as described above.

Intended Exit

In the fourth year of trade, the Directors will look to sell the assets of the Company. The Directors believe that a financial buyer, seeking a long-term income stream, may be attracted to the revenue stream from National Grid or alternatively a trade sale to an aggregator of STOR services may be achievable. Any sale of the assets would transfer management of the tender process to one of a variety of market providers. An exit for shareholders may, also, be achieved by the Company refinancing to buy back its own shares.

Risks and their Mitigation

As generating sets will be driven by red diesel, the Company is exposed to the world's oil price. If oil prices rise strongly, will the Company's margins be squeezed?

The Manager responds: *Any potential exposure to an increase in diesel pricing will be factored into the utilisation tender price. This will significantly reduce the exposure for short-term contracts. If the expected longer-term contracts are reinstated in the market, the cost of forward hedging diesel pricing will be factored into the utilisation price.*

How can investors be reassured that the best generating sets on the market will be chosen?

The Manager responds: *Diesel generators are a well proven and robust asset class with many years of historical data to back up manufacturers' performance claims. The Directors' experience in performing detailed due diligence provides a solid foundation to assess and select the most appropriate diesel generators for the Company.*

If the Company fails to win tenders, how can Directors be sure that the *Aggregators* will assume their capacity?

The Manager responds: *High quality STOR assets are sought after not just by National Grid, but further by market aggregators who are keen to fill phantom tenders (i.e. a tender made by an aggregator and accepted by National Grid, but where no underlying STOR asset is contracted to provide the service). The Directors remain in constant dialogue with a number of key market aggregators who maintain their desire to utilise dormant STOR assets.*

What will happen if the generating sets fail to perform as expected?

The Manager responds: *Diesel generators generally come with a two year warranty. In some cases, longer warranty terms can be negotiated and the Directors will seek out longer warranty terms where possible.*

If the tenders are for two years maximum, how will the Company attract a buyer for its assets?

The Manager responds: *Following tender round 18, due to be held in Q3 2012, National Grid has advised it will be reviewing future contract terms with a view to providing greater market stability. The industry expects this will involve increasing contract terms, thus providing greater certainty for any future buyer of the assets.*

Directors and Associated Parties

Key Personnel

Invicta's chairman and managing director, Mohammed Yusef and Niall Bamford, will sit on the Company's board.

The third director, Steven Rademaker, will be appointed from the energy service company, ESCO NRG Limited.

The directors of Invicta have experience in developing both UK and Africa-based energy infrastructure assets and collectively have a wide network of contacts and relationships within the energy market.

Invicta Capital – Promoter and provider of business/administration service

Invicta is a corporate finance house specialising in financing predominantly media projects, and latterly energy and property, founded in 2001.

ESCO NRG Limited (ESCO)

ESCO is an energy service company, developing, financing and managing small scale, UK renewable energy and low carbon projects.

Founded in early 2010 by Steven Rademaker, ESCO employs two full time and two part-time staff.

ESCO's projects have concentrated on solar PV installations. It was the first UK solar company, we understand, to finance a 100kWp roof mounted solar PV unit in October 2010. In 2011, in partnership with RenEnergy, ESCO installed solar PV units on 250 residential rooftops in East Anglia under EIS (the venture was cut short by changes to Feed in Tariff legislation and EIS).

ESCO's current project, outside STOR EIS, is to develop a 50MW portfolio of utility scale Solar PV assets.

ESCO monitors and operates a 3.5MW UK portfolio of UK domiciled commercial solar PV assets.

Company's Board

Mohammed Yusef – Chairman

A solicitor by training, Mohammed has a long career in banking, leasing and corporate finance. He has worked with a number of European and American companies including Lloyds Bank, Société Générale and Barclays. More recently Mohammed has been involved in large scale Africa-based energy projects. Mohammed founded Invicta in 2001.

Niall Bamford – Managing Director

Niall qualified as a chartered accountant in 1992. He began his career in financial services with Matrix Securities Ltd in the late 1990s, marketing and managing investments for private clients in property and media. For Invicta, where Niall has worked for over ten years, he manages a team responsible for £1.5 billion under management.

Steven Rademaker – Founder and Managing Director

Prior to founding ESCO in early 2010, Steven completed the world's first and only MBA in carbon management and renewable energy at the University of East Anglia. Prior to that Steven worked for Deutsche Bank for eight years in its structured capital markets business, where he was responsible for marketing new and existing product lines, managing and modelling the group's lease portfolio, and had responsibility for building tax risk models. Previously, Steven worked for Citibank for two years in foreign exchange and money markets, having joined from ANZ Bank, where he began his career in foreign exchange.

Manager Record

The following are salient points of Invicta and ESCO's respective records:

- Invicta has raised over £1.4 billion for projects in the media sector since 2001
- Recently, Invicta has expanded into property, acting as promoter and operator for the acquisition and redevelopment of an office building in central Birmingham on behalf of investors for £34.5 million in April 2012. A number of similar type transactions have been secured by Invicta for the forthcoming year.
- In 2011, Invicta successfully raised funds for an EIS company in partnership with ESCO NRG to install solar PV units on residential rooftops in East Anglia (see ESCO bio summary).

Investor service & Reporting

Invicta will be responsible for ensuring that bi-annual reports are delivered to investors on behalf of the Company in relation to the Company's performance.

All reporting to investors will be done via Invicta's secure investors' on-line account on behalf of the Company.

Clients will be notified by email when correspondence or information is uploaded to the website.

Both advisors and their clients will be given access to the website.

Financials

Costs

Charges levied on Investor Subscriptions

zero There are no costs levied on investor subscriptions

Charges levied on Investee Companies

Initial Charge	6.5%	Authorised advisers can receive commission of up to 2%, paid by Invicta from this initial charge. As the Company is a single purpose EIS company then payment of commission will not be affected by the forthcoming RDR changes.
Annual Management Charge	1.5%	Paid to Invicta, from which advisers can receive commission of 0.25%
Performance Payment		A 30% performance fee is payable to the manager on returns above a distribution of 100p to investors per 100p share.

General Notes on Charges that may apply to the Company

- Should fees be levied on the Company for corporate services, such as secretarial, marketing, board appointments, business consulting etc, rates may vary widely.
- Fees, whether applied to investor subscriptions or to the Company, potentially dilute investor equity.
- Fees may be subject to VAT but VAT should be reclaimable as the Company will be registered for VAT

Financial Forecasts

Directors' Forecast of Internal Rates of Return over 4 years/20 years

	Sale of assets at year four	20 year hold
A tax-free average return per annum, when grossed up to allow for the 30% EIS Tax Credit of:	21.1%	14.4%

which is equivalent to . . .

An equivalent return offered by an investment taxable at the marginal rate of 45% of:	38.4%	26.2%
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* Assumes a 4th year trade sale with a 9% discount rate.

Tax Certificate Time Line

Following the issue of shares in the Company, but no earlier than four months after commencement of the Company's trade, the Company will apply to HMRC for authorisation to issue tax relief certificates (Form EIS3) to investors. As soon as authorisation is received by the Company from HMRC, Form EIS3 will be distributed to investors. The Company's trade will commence on the sourcing of the diesel engine sets.

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