

PEGG Capital AG

A Gateway to Private Equity

4 February 2010

Shares in Issue: 18m basic

27m fully diluted

EPIC Code: PGU

Sector: Equity Investment Instruments

Market: Frankfurt Stock Exchange
Projected commencement of trading
15 February 2010

Website: www.peggeu.com



Broker:



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Description: PEGG Capital AG invests in unlisted ICT, technology and technology related resource companies

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PEGG EU is a corporate advisory group trading predominantly in the UK and Europe and also in the USA. The company's investment vehicle, PEGG Capital AG, is to list on the Unofficial Regulated Market of the Frankfurt Stock Exchange in the first quarter of this year.

PEGG Capital AG's business model is to invest in ICT, technology or technology related resource companies that have the potential to be profitable and cash flow positive within 12 months of investment.

It currently has holdings in five companies – Azurn EU Limited, Data Insurance International Limited ("DII"), Ty-Man Limited, iCEphone Limited and Addictive International Limited. An agreement with GEM Investment Advisers and GEM Global Yield Fund Limited ("GEM") will provide the funds whereby PEGG Capital AG can invest in new opportunities.

The model is unusual in that 50% of PEGG Capital AG's investee company earnings are to be returned to shareholders in the form of dividends and the balance of earnings will then be available to be reinvested in new opportunities.

PEGG Capital AG has the backing of a strong management team – its Chairman is Simon Blagden, the Non-Executive Chairman of Fujitsu Telecommunications Europe. Other senior team and board members have extensive corporate experience, technology expertise and business contacts.

PEGG EU's original founders have to date made an investment of circa £5.6m in PEGG Capital AG's current five investee companies. This has taken the form of both cash and equity for services rendered.

We have based our valuation of PEGG Capital AG on the performance of its two most advanced investee companies – Azurn EU Limited and Data Insurance International Limited. PEGG Capital AG's management believe that these two companies have the potential to deliver significant revenue and profitability in their first year of operations. This is, in fact, one of PEGG Capital AG's criteria for investment.

In valuing PEGG Capital AG we have taken a more conservative approach. While we believe that the company has a team in place capable of executing on its plans we are also aware that, more often than not, delivery can take longer than initially envisaged.

On the basis of the information supplied to us we believe that a valuation for PEGG Capital AG of 140p to 185p (€1.6 - €2.1) per ordinary share can be supported.

In our view an investment in PEGG Capital AG is an investment in the abilities of its management team and in many cases it is the "people" who make a company. We believe that this will certainly be true in the case of PEGG Capital AG.

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STRENGTHS

- PEGG Capital AG has a strong management team and Board of Directors who have an extensive network of contacts within major organisations including Fujitsu, BT, Vodafone and Freemans Grattan Holdings, a member of German based The Otto Group. The company's network of contacts is expected to generate leads to a number of investment opportunities.
- Upon listing PEGG Capital AG, PEGG EU's investment vehicle, will have interests in five companies, Azurn EU Limited, Data Insurance International Limited ("DI"), Ty-Man Limited, iCEphone Limited and Addictive International Limited.
- PEGG Capital AG will invest only in ICT, technology or technology related resource companies where there is evidence that the investee company can be profitable and cash flow positive within 12 months of investment.
- While PEGG Capital AG is domiciled in Germany its assets are held by PEGG Holdings IoM Limited which is 100% owned by PEGG Capital AG, hence the company enjoys favourable tax treatment.
- The company has entered into an agreement with Gem Investment Advisers ("GEM") whereby GEM will provide a €20m line of equity credit.

WEAKNESSES

- PEGG Capital AG's investee companies are not as yet generating significant revenue and their ability to be profitable and cash flow positive within 12 months has yet to be proven.
- The company has only recently been founded and does not have a proven track record as yet.
- Under the terms of its agreement with PEGG EU, GEM is required to purchase equity in PEGG Capital AG at a 10% discount to the company's VWAP over a given 15 day period.

OPPORTUNITIES

- PEGG Capital AG will only acquire stakes in investee companies at a conservative valuation of 3x forecast earnings. It is envisaged the companies' exit values will be considerably higher.
- The company's line of equity credit with GEM provides PEGG Capital AG with access to immediate investment opportunities.
- Should PEGG Capital AG's investee companies realise management's projected revenues and profits the potential upside to investors will be significant.

THREATS

- Many early stage technology companies do not generate the revenues and profits expected by management within the time frame originally envisaged.
- The potential of the companies in which PEGG Capital AG has invested has not as yet been realised.
- There is the potential for anticipated contracts not to be entered into following customer trials.

Private Equity Gateway Group EU (“PEGG EU”)

PEGG EU is a corporate advisory and capital funding group delivering on projects across the UK, Europe and in the USA. The company is domiciled in the Isle of Man where the environment is generally supportive of technology and innovation and where the company receives favourable tax treatment. To date it has acquired equity stakes in seven companies, through a combination of direct investment and in return for investment advisory and capital restructuring services rendered. It is 100% owned by the four founding members of PEGG EU.

PEGG Capital AG, the investment vehicle of PEGG EU, is to list on the Unofficial Regulated Market of the Frankfurt Stock Exchange in the first quarter of 2010 for the purposes of investing into ICT, technology and technology related resource companies. The listing will provide investors with an opportunity to invest in high return technology companies without being locked into an investment for an extended period of time.

“PEGG Capital AG is to list on the Unofficial Regulated Market of the Frankfurt Stock Exchange for the purposes of investing into ICT and technology related resource companies”

Management Team

The key members of PEGG Capital AG’s management team are:

Simon Blagden, MBE: Group Executive Chairman

Mr Blagden has extensive experience in the telecommunications and IT industries. Most recently he was the Managing Director of Spescom Limited, a Johannesburg Stock Exchange listed IT company. Before this he held the position of International CEO for The Quante Group, an organisation with operations in over 50 countries worldwide. The Group was sold to 3M in 2000 under Mr Blagden’s leadership. Mr Blagden was appointed a Member of the Order of the British Empire in 1997 for services to industry. He also holds the position of Non-Executive Chairman, Fujitsu Telecommunications Europe.

David Daniel: Group Managing Director, Vice Chairman PEGG Capital AG

PEGG originated in Australasia and Mr Daniel was responsible for expanding the model into Europe. During his eight years with PEGG he has primarily been responsible for capital raising and structuring and for corporate strategy formation. Mr Daniel is on the Board of several of PEGG’s investee companies. Prior to founding PEGG Mr Daniel was the Chief Executive Officer of web solutions company, Web Alive.

Simon Hirtenstein: Managing Director, PEGG Capital AG

In addition to his role of Managing Director, PEGG Capital AG Mr Hirtenstein is a senior partner and Director of PEGG EU. He has extensive international banking and management consulting experience and has worked with a number of leading organisations, including Barclays, BT and EDS. Immediately prior to joining PEGG EU Mr Hirtenstein was employed by Barclays Wealth where he was responsible for developing Barclays funds management business in the Isle of Man.

Craig Astill: Executive Director

Mr Astill who is based in Melbourne, Australia, oversees PEGG Capital AG’s interests and relationships in Australasia. He has a background in international trade, finance, manufacturing and marketing.

Andy Roe: Executive Director

Mr Roe, a member of PEGG Capital AG’s investment committee, has held a number of CEO and COO roles in organisations including Littlewoods, Next Group PLC and Freemans Grattan Holdings. He has extensive experience at Board level and has been involved in three successful turnaround situations.

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Non-Executive Directors

PEGG Capital AG's Non-executive Directors are Mr Andy Nicholson and Mr Alfred Kane.

Mr Nicholson is the Managing Director of BT Global Services, Financial Markets. He is a member of PEGG Capital AG's investment committee and is actively involved in the assessment of potential investment opportunities.

Mr Kane, the Chairman of PEGG Capital AG's investment committee, was most recently the CEO in Residence at Baker Capital Corporation, a US \$1.5b private equity fund. He is a Director on the boards of Vodafone Ireland, GIIIC and a number of other technology companies. He is a past President of both Dublin and Manchester Chambers of Commerce and has over 25 years operational experience at CEO and Director level.

Company Strategy

The knowledge, experience and networks of PEGG EU's senior management team and PEGG Capital AG's Board are expected to enable the company to bring the products of PEGG Capital AG's investee companies to market more quickly than might normally be the case. Senior team members have contacts at board and senior executive level in a number of corporates and this, combined with the team's knowledge of vendor selection processes has and is expected to continue to speed up the route to market.

“Senior team members contacts and knowledge of vendor selection processes is expected to speed up the route to market”

PEGG Investment Mandate

In order to be considered as an investment candidate several criteria are required to be met:

- Companies must be ICT, technology or resource/energy technology related.
- IP must be strong, protectable and globally scalable.
- There must be evidence that profitability and cash flow will be positive within 12 months of investment.
- Commercial contracts need to either be in place or be rapidly executable.
- PEGG Capital AG must have operational influence through Board or managerial control – typically two to three Board seats.
- PEGG Capital AG's initial investment must be able to be made on a price to earnings ratio of less than 3x on a one year forward earnings forecast.
- The exit strategy for each investment must be clearly defined and agreed. It is envisaged that exits will take place through IPO and targeted trade sales as appropriate.

Current Investee Companies

Following its listing PEGG Capital AG will have equity interests in five companies:

Data Insurance International Limited (DII Limited) – 35% owned

DII Limited is a global provider of data re-instatement insurance, allowing business critical data to be saved and protected in a security system designed so that insurance companies can indemnify and protect it under international standards for safe keeping, protection, storage and reinstatement of data. Where a client loses its data the insurance policy pays the cost of re-installing the data on the clients IT system or compensates financial losses to the level of the indemnity provided. DII currently has trading operations in Australia, New Zealand and the UK.

Ty-Man Limited – 8% owned

Ty-Man is a manufacturer of wireless, waterproof, underwater radio and MP3 headset devices. A distribution agreement has recently been entered into with a major global sports distributor and indicative orders of 10,000 units have been received.

iCEphone Limited – 26% owned

iCE (in case of emergency) products were originally designed for use in emergency situations. The iCEaid software package provides step by step emergency first aid prior to medical treatment being administered. The software package automatically records the first aid that has been given and compiles a report to pass on to emergency services. The iCEphone itself is suitable for gaming, use as a personal notebook or as a standard mobile application. To date circa 65,000 indicative orders for the iCEphone have been received. The Philippines Government has also indicated interest in the company's iCEPIC™ ruggedized e-Dogtag units. These units have the potential to deliver a database of health records for use in both military and domestic applications.

Azurn EU Limited - 90% owned

Azurn EU Limited has the exclusive distribution rights to ASX listed Azurn International Limited's technology implementation across the UK and Europe. Azurn is a global provider of business collaboration applications that enable full unified communications (voice, video, data, co-browsing, document and application sharing) to occur simultaneously in real time. The applications are centred on Azurn's MERLIN hardware platform, a simple to use collaboration platform that enables large groups and/or web customers and contact centres to interact globally in real time across all media and communication types. Contracts have been signed with Freemans Grattan Holdings (FGH), one of German based The Otto Group's 123 companies. The functionality of the technology has also been assessed by BT Labs and the potential benefits that the technology can provide are being reviewed by British Telecom Global Services.

“Azurn is a global provider of business collaboration applications that enable full unified communications to occur in real time”

Addictive Interactive Limited – 10% owned

Addictive Interactive Limited specialises in creative technologies including social networking, brand marketing, graphic design, online research and database development. The company has developed its own social networking infrastructure and scalable site solutions specifically for brands, virtually an online shopping mall. The value add from and for brands advertising through these sites will be their ability to cross promote sales across brands and simultaneously to be able to capture and measure return on investment on brands' social networking spend.

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Company Financials

No financial accounts for PEGG EU, PEGG Capital AG or any of its investee companies have been sighted. As no funds are being raised in PEGG Capital AG's Frankfurt listing the company has not been required to prepare a prospectus.

The initial price at which PEGG EU entered into each of its investments is listed below:

Company	Percent	Value on
	Acquired	Acquisition
Data Insurance International Ltd*	35.0%	£3,500,000
Ty-Man Limited	8.0%	£214,345
iCEphone Limited**	26.0%	£800,000
Azurn EU Limited	90.0%	£135,000
Addictive Interactive Limited**	10.0%	£1,000,000
Entry Value		£5,649,345

*In certain cases PEGG EU has received equity in exchange for services rendered.

**Heads of agreement signed. Settlements to be completed Q1 2010 post listing.

Management have supplied detailed financial forecasts for its two primary investments, Azurn EU Limited and Data Insurance International Limited.

Azurn EU Limited

On 7 September Azurn International Limited (ASX listed) announced that Azurn EU Limited had entered into an agreement with Freemans Grattan for the provision of Azurn's Merlin and K2K technologies. An initial contract for a minimum amount of 1,000,000 minutes usage was agreed, to be converted to a rolling 12 month contract upon completion of the initial deployment, expected to take around 2 months. As a result of internal restructuring issues within Freemans Grattan (early in 2009 the company announced that 1,000 jobs were to be cut including the closure of a warehouse in Peterborough, an office in London and a call centre in Bradford) the initial deployment of Azurn's technology has taken longer than expected. The technology is, however, expected to go live in the imminent future. Following a successful implementation at Freemans Grattan it is envisaged that the technology will be able to be sold into the wider Otto Group.

"In November 2009 British Telecom agreed to trial Azurn's technology, a process which is currently underway in the US"

In November 2009 British Telecom also agreed to trial Azurn's technology, a process which is currently underway in the US.

Management is confident that the technology will be deployed rapidly and has an agreement with Azurn International for Merlin usage targets of 100,000,000 minutes, 500,000,000 minutes and 1,000,000,000 minutes over the next three years.

Given that Azurn EU Limited is at an early revenue generating stage and that it is not the company's intention to retain its investment holdings for a period of any more than 12-18 months we have limited our assessment of the likely earnings of the company to a one year horizon.

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We have assumed that:

- The initial 1,000,000 minutes contracted for by Freemans Grattan will be deployed over a period of six months.
- 5% of customers dialling into the call centre will connect to a call centre agent using Azurn's technology.
- Upon trialling the technology both the wider Otto Group and BT will begin to deploy Azurn in 2010.
- The company will be successful in converting circa 25% of its remaining pipeline of potential customers – we have seen evidence that both the company itself and potential distributors have active interest from a number of prospects.

The model allows for direct sales costs, technical support, general administration expenses and royalties to be paid to Azurn International. As Azurn EU is a reseller of Azurn International's products no provision has been made for capital investment. With the company domiciled in the Isle of Mann no provision has been made for taxation. Based on the above information our forecast of Azurn's likely performance in its first year of operations is set out below:

Azurn EU Limited	H1	H2	FY
	2010	2010	2010
No of Call Minutes	1,102,608	16,345,680	17,448,288
Gross Revenue	£441,043	£6,538,272	£6,979,315
Net Profit After Tax	(100,526)	£3,734,637	£3,634,111
NPAT margin	n/a	57.1%	52.0%

Given Azurn EU Limited's agreement with Azurn International for a targeted 100,000,000 minutes in its first year of operations, this is a more conservative assessment than that expected by PEGG EU's management.

DII – Data Insurance International Limited

DII sells both desktop/laptop policies and server data insurance policies, the majority of which are expected to be sold into the UK market in 2010.

PEGG EU's management have estimated that DII's target market in 2010 consists of circa 2.1m small to medium enterprises in the UK market and an estimated 800,000 small to medium enterprises in Australia and New Zealand. A small number of policies, around 250, have already been sold into the New Zealand market.

In its first year of operations management anticipates that DII will capture circa 1.0% of its UK target market and circa 0.6% of its Australasian market. This equates to a total of 50,000 policies in the UK and 5,000 policies in Australasia.

Policy holders will be targeted through two channels. First, through data centres which DII has certified as compliant and which will be able to issue indemnity policies to their own clients. The company estimates that each data centre will store data for around 250,000 separate clients. Secondly, policies will be sold through intermediary channels, and the company is already in discussions with both insurance brokers Lloyds and Willis Group Holdings.

“DII's initial target market consists of circa 2.1m SMEs in the UK market and 800,000 SMEs in Australia and New Zealand”

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Management's modelling allows for direct sales costs including a provision of 25% commission payable to external parties on all sales, underwriting costs and royalty costs of 10% payable to Data Insurance Holdings (DIH), the Australasian parent body for DII. In addition to general administration expenses an allowance of £380,000 for further IT development and support has been made.

We have taken a conservative approach to our forecasts assuming firstly that corporates and individuals may take some time to be comfortable with the idea of data insurance, preferring to manage their own data back-up requirements and secondly, that the insurance industry may be slow to adapt to new ideas. When AIG first introduced its data insurance policies it took some two years for the company to build up to 1,500 clients.

Our forecasts allow for sales only through the data centres and do not include any sales made through potential partnerships with insurers Willis Group or Lloyds. 16,667 policy sales (over 90% of total sales) are expected to be made in the UK commencing in the second half of 2010, cf management's expectation of 50,000 sales.

Based on the above information our forecast of DII's likely performance in its first year of operations is set out below:

DII Limited	H1	H2	FY
	2010	2010	2010
No of D&L Policies	-	7,647	7,647
No of Server Policies	-	10,650	10,650
Gross Revenue	-	£11,764,556	£11,764,556
Net Profit After Tax	-	£982,595	£982,595
NPAT Margin	-	8.4%	8.4%

Dividend Returns

PEGG Capital AG's income will be generated from its investments, through both dividends and capital gains. A minimum of 50% of PEGG Capital AG's investee company earnings will be returned to PEGG Capital AG shareholders in the form of dividend payments. The remaining funds generated will then be available for investment in new opportunities.

"A minimum of 50% of investee company earnings will be returned to shareholders in the form of dividend payments"

Funding for the Future - GEM Mandate

PEGG EU has entered into an agreement with Gem Investment Advisers Inc and GEM Global Yield Fund Limited ("GEM") whereby GEM will supply PEGG with a line of equity credit. This credit line is to take the form of newly issued ordinary shares up to a maximum value of €20m as and if required by PEGG in tranches. Under the terms of its agreement with PEGG EU GEM is required to purchase equity in PEGG Capital AG at a discount of 10% to the daily volume weighted average price ("VWAP") over a given 15 day period should PEGG EU so require.

Following PEGG Capital AG's listing PEGG EU will release a yet to be determined number of ordinary shares for sale in order that the VWAP requirements of its agreement with GEM are met. Monies received from GEM will then be invested into PEGG Capital AG's investee companies.

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Valuation

On the basis of the entry price PEGG EU's founders have paid for the assets held in PEGG Capital AG the company would be valued at £5.6m. This figure does not, however, include any allowance for the work undertaken by PEGG EU's management team in transforming the various companies in which it has invested or for the introductions brought to its investee companies. Nor does it take the form of physical capital, with in certain cases PEGG EU having been given equity in return for services rendered.

Because of this we have taken the approach of valuing PEGG Capital AG on the basis of the first year's earnings of its two most advanced investee companies, the financial forecasts of which have previously been discussed.

A review of listed early stage technology companies does not provide a good guide as to likely forward price to earnings ratios as the typical early stage company does not tend to have positive earnings in its first few years of operations. A review of the average forward price to earnings ratio of early stage listed technology companies where earnings are positive suggests a wide ratio range, some examples of which are listed below:

Company	Share Price	Forecast Earnings	Forward P/E Ratio
Imaginatik	6.25	0.20	31.2
Endace	246.50	14.15	17.4
Eckoh	5.12	0.36	14.2
Portrait Software	20.50	0.75	27.3
Norkom Group	134.00	7.70	17.4

In each of these cases, however, the companies have proven business models which are revenue generating. Any multiple for a company such as PEGG Capital AG where significant revenue is yet to be generated must be discounted heavily to reflect this, and in our view a price to earnings ratio of 6.5x - 8.5x is more appropriate. While this figure is higher than the 3x that PEGG Capital AG is itself willing to pay for its own investments, we do not believe the uplift is unreasonable, in light of the investment of management's time, expertise and contacts.

Applying this multiple to our estimate of PEGG Capital AG's earnings yields a valuation range of £23.3m - £31.1m. To this we have added the minimum value of PEGG Capital AG's remaining investments, circa £2.0m, to yield a company valuation of £25.3m to £33.1m. With 18m shares in issue we believe that a value of 140p - 185p (€1.6 - €2.1) per share can be supported.

PEGG Capital AG's investments are all early stage and the company's business model has not yet been proven. In our view an investment in PEGG Capital AG is ultimately an investment in the abilities of PEGG Capital AG's management team.

“With 18m shares in issue we believe that a value of 140p – 185p (€1.6 - €2.1) per share can be supported”

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