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hardman&co

Nexus Investments' Scale-Up Fund

Nexus Investment Management Limited

Summary

The fund's investment strategy is to invest in a diverse portfolio of EIS-qualifying investments in data, digital, education or health areas.

	Positives	Issues
Why invest	► **Strategy:** To fund companies that have existing products and support them in scaling up.	► **Track record:** No exits to date, but the unrealised figures show some promise.
The investment manager	► **Team:** The team has a broad experience in corporate finance, tax and accounting, as well as investment.	► **Small team:** The team is small, and is dependent on a couple of key people.

Nuts & bolts

- **Duration:** The fund is expected to have an eight-year lifespan, with closings as required.
- **Diversification**: The manager expects to provide 8 to 10 EIS investments in the fund, with the possibility of growing to up to 15.
- **Valuation:** Reviewed twice a year, with updates on progress being sent more frequently.

Specific issues

- **Fees:** A mixture of direct fees and those charged to the investee companies.
- **Performance fee:** Charged on a portfolio basis at 20% for returns over £1.

Risks

- **Target returns:** There is no explicit target return, but the strategy suggests a high-risk investment strategy.
- **Companies:** Supplying risk capital to early-stage technology companies at the start of commercialisation. There will be a spread of company returns, as the successful investments will do very well, but those that fail may do so completely.

Analyst

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Adviser information

Scheme assets:	£0m
Scheme target:	£10m
EIS assets raised:	£7m
Total FUM:	NA
Fund launch date:	2018

Contact details

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www.scaleupfund.co.uk , www.nivl.co.uk

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Factsheet

Nexus Investments' Scale-Up Fund	
Product name	Evergreen Investment Scale-Up Fund
Product manager	Nexus Investment Management Limited
Product advisor	Nexus Investment Management Limited
Tax eligibility	EIS (SEIS in limited circumstances)
Target return	Not given
Target income	None
Type of product	Discretionary portfolio service
Term	8 years
Sectors	Data, Digital, Education, Health
Diversification:	
Number of companies	8-10+
(Expected) Gini coefficient	0.10-0.13

Fees	**Amount**	**Paid by**
Initial fees:		
Initial subscription fee	3%	Investor
Transaction fee	3%-5%	Investee company (depends on deal size)
Annual fees:		
Annual management fee	2% + VAT	Investor – see page 10 for more details
Directors' fees/monitoring fees	£12,000	Investee company
Other expenses	Up to £25,000 or 0.2% for fund	Investor
Exit fees:		
Performance fee	20%	Investor – portfolio basis, aggregate returns over £1

Advisor fee facilitation	Yes
Advisor fee amounts	As agreed with investor
HMRC Approved?	No
Advance Assurance	Yes, for each investment
Reporting	Reports every six months
Minimum investment	£25,000
Current funds raised	In excess of £200,000 at launch
Fundraising target	£10m
Closing date(s)	Regular closings
Expected exit method	Expected mostly via trade or other sale

Source: Nexus Investment Management, Hardman & Co Research

Fund aims

Nexus Investments' Scale-Up Fund (NISUF) is a discretionary portfolio service, which will build a portfolio of EIS investments in unquoted companies in the target areas. No target return is given. Returns will be focused on capital gains, and investors are unlikely to receive any dividends. The fund is expected to have an eight-year lifespan, with closings as required.

Summary of risk areas

Note: There are generic risks from investing in EIS or unquoted companies, in addition to the specific ones commented on below. Comments on relative risk refer to other EIS investments and not to wider investments.

Investments

Portfolio risk

Each investment will be providing risk capital to an unquoted early-stage company in need of scale-up capital. Nexus aims to have at least 8-10 EIS companies in the portfolio, although this may go as high as 15. Although sector diversification is limited, stock-specific risk should dominate market risk.

No target return is given, though the strategy suggests high-risk individual investments.

Sourcing and external oversight

Although the fund is a new venture, Nexus has been making venture investments in EIS-eligible companies for four years. It has established sources of deals, and the recent rate of investment is similar to what is required for the fund. The majority of the Investment Committee are external, with only the Nexus members involved in the selection process prior to their consideration.

Ongoing support and monitoring

Nexus places a strong emphasis on support after investment, with good testimonials in its marketing materials. Board positions are seen as desirable, although a monitoring role may be taken instead, with regular contact and the provision of strategic input being seen as key. The intention is to have the (new) Investment Committee add to that capability.

Exits

Nexus has a limited track record to date and expects that most exits will be via trade sales. The return profile of individual investments is likely to be skewed, with successful investments probably giving very good returns, while those that do not will give little or nothing back.

Manager

Team

Nexus has a small dedicated internal team, which has a strong background in corporate finance, tax and accounting. It has been grown over the last year and has the capacity to deal with the fund as proposed. Further funds may require additions to the capacity of the team.

Track record

Since 2014, Nexus has made 59 investments into 20 companies. With no exits to date, the track record is limited, but follow-on fundings completed so far suggest that the investments have made progress.

Regulation

Product

Advance Assurance is sought for each investment.

Manager

The manager of the fund is Nexus Investment Management Limited. It is FCA registered (number 796814), with appropriate fund management permissions. Submissions to Companies House appear to be up to date.

Risk analysis/commentary

Overall, although NISUF is a new fund, Nexus has an experienced team in place that has been committed to the area for some time. The team is not large but seems adequate for the proposed rate of investments. With the company entering EIS only four years ago, the track record lacks depth, particularly for exits, but its unrealised returns so far show promise.

Investors do need to be aware that they will be investing risk capital into early-stage companies. The Nexus team have experience in supporting these companies, with the addition of the members of the Investment Committee likely to extend that capability further. Although it does not have a deep pool of capital, its willingness to work, and experience of working, with other investors suggests a network that can support follow-on investments.

Diversification is an important consideration for any investor – while the companies that succeed are likely to produce exceedingly good returns, those who do not may return little or nothing. Diversification within the fund is limited, although comparable with, or better than, many other EIS funds. NISUF should be considered in the context of an investor's entire portfolio.

Investment process

Nexus Investment Management (NIVM) and Nexus Investment Ventures (NIVL) are both part of the Nexus Group. The group has several diverse businesses in education and healthcare, including being the manager of Primary Health Properties plc.

For all the Nexus investments to date, members of the team have co-invested alongside the external investors. The team has agreed to commit a minimum of £200,000 of investment to the new fund, and will continue to invest alongside fund investors.

Deeper dig into process

The portfolio of NISUF will consist of companies from four sectors: Data, Digital, Education and Health. The latter two, in particular, link into the areas in which the Nexus Group is active, but the first two are potentially very wide and could encompass a variety of businesses. The choice has been prompted by looking at areas that should be relevant for the next 20 years. Given the prospective time horizon for holding investments, this is a sensible criterion.

In terms of company development, Nexus looks for the ability to demonstrate traction in the market, which seems to be the most common sweet spot for EIS investors. They also look for a continued ability to compete, whether through product leadership in the area or some sort of IP.

There are three key criteria that Nexus applies when looking at potential investments:

- **People**: Nexus is particularly looking for 'mission-driven' founders – the team expresses a very strong preference for that over managers that have been brought in to run a business. The ideal criteria are a high-calibre academic, someone with experience in the sector in a major company, or someone who has previously built and sold a business.
- **Business plan**: The ideal plan is something that is both exciting and deliverable, with Nexus commenting that it sees plenty of plans that are not realistic. The business needs to be scalable, most likely into new markets or by adding new distribution. Nexus looks for the company to have the capacity to develop into a £20m-£50m business, which corresponds with the range in which successful small businesses are most often sold.
- **Industry-specific insight**: This is the specific application of a macro trend that may be supportive to the business. Nexus cites the example of an ice cream maker whose product does not contain sugar – something that is clearly supported by current food trends.

The latter point is directing Nexus towards certain areas. While it is open to a wide range of health areas, the team is particularly interested in healthy food and drink companies, where these are scalable.

Although the Nexus Group would seem to have natural strengths in education and health, the majority of investments to date have been in the data and, particularly, digital sectors. In practice, the exposure to each sector will be largely determined by the actual deal flow, although Nexus indicates that investors will get at least one investment in each of the four sectors.

Sourcing deals

Given that Nexus is a relatively new manager within EIS, it has a very well developed and specified network for sourcing potential investments. In the health and education areas, the Nexus Group brings a lot of connections. The group publishes HealthInvestor and EducationInvestor, leading magazines in each area, and also organises events. In addition, there is a corporate finance business within Nexus focusing on the health area (and procedures in place to manage any potential conflicts of interest).

It also has an established network through the legal and accounting professions. Several of the senior members of the team and the Nexus Group qualified within Magic Circle law firms or big accountancy practices and retain good connections. Nexus estimates that it receives around 50 referrals a year through these sources – though not a high proportion of the total of 200-300, these tend to be better quality.

The existing portfolio is also increasingly important, whether through staff within the investee companies, board members or other shareholders. Referrals from these sources can also be seen as strong references for the support Nexus has supplied since investing.

Most of the existing portfolio will also require follow-on funding, and it seems likely that the fund will invest in some of these. This is not a given, as some companies may no longer be EIS-eligible or the expectations of existing investors may not match those for new EIS shareholders. Although diligence has already been done on the companies, each new investment will be approved by the Investment Committee, as there is potential for conflicts of interest due to Nexus staff already being existing shareholders in these companies.

The pace of sourcing has increased since Nexus started to make early-stage investments in 2014. Having sourced seven new investment in 2016 and four in 2017, together with the potential for follow-on rounds into the existing portfolio, sourcing the target 8-10 companies over two years should be achievable. If the deal flow continues to increase, then a higher number could be sourced.

Decision-making

Nexus has put together a decision-making process for the fund, which is a little different from what it has done before. This has been through contact with other firms, and the process follows the good practices that are seen elsewhere.

All incoming prospective investments are subject to an initial review by the Investment Associates in conjunction with the Associate Director. At this stage, the emphasis is on whether the company fits within the remit of the fund, primarily using the criteria outlined above. The decisions are reviewed by the Managing Director and Associate Director. One of the aims is to work through the prospects as quickly as possible, to allow resources to be devoted to the more critical parts of the process.

Companies that move to the next stage are subject to further diligence. This starts with meetings with the management, with the assessment of them being a key part of the process. This is followed by more detailed diligence. During the latter part of this process, the Group Managing Director adds his experience to the due diligence.

While the intention is to only invest in businesses that Nexus understands, several of the areas sometimes require assessment of, or diligence on, technology. External experts have been drawn on in the past. This is an area in which the Nexus Group can be helpful: with a team of over 70 professionals with strong links in healthcare and education, the group can be helpful in sourcing appropriate experts.

Once the diligence is complete, an investment paper is prepared for the Investment Committee. The members will know of the pipeline roughly two to three weeks before a meeting, giving them a chance to check with their own network before reviewing the proposal in detail.

As NISUF is new, the Investment Committee has not met yet. Nexus is putting a process in place to optimise the committee's involvement, and intends for it to be able to add value to investments as well.

The overall figures that Nexus gives suggest four to six investments a year from over 200 initial approaches. The acceptance rate of 1 in 40 is comparable with other managers in the area.

Governance and monitoring

Advance Assurance will be received from HMRC on all investments prior to completion.

The custodian for NISUF is Woodside Corporate Services. Cash will be held by the latter on behalf of the underlying investors at Metro Bank.

The intention is to give investors exposure to 8-10 companies, although there may be more – up to a maximum of 15. It is unlikely that investors will get equal weightings in each investment. The aim is to give investors a blend of earlier scaling and later scaling investments, which will give a spread of risk vs. reward across the portfolio.

While the focus of the fund is on making EIS-eligible investments, there may be some SEIS-eligible companies too. In the past, this has arisen where Nexus looked to make an EIS investment, but the company had not fully used its SEIS allowance.

Reports giving updates to investors will be sent to investors at least twice a year, although there may be more frequent newsletters. Investors will also receive the annual report and accounts for NISUF. Valuations will be updated twice a year, as of 31 March and 30 September. The valuations will follow IPEV guidelines. This means that recent investments will mostly be held at cost, with subsequent transactions being used where available.

In addition to the written reporting, Nexus intends to run capital days for investors where they can meet the managements of investee companies and get direct updates on progress.

Nexus will look to take a board position in investee companies, although it expects that in some cases this will be a monitoring role, especially where a board already has appropriate directors. To date, a member of the Nexus team (to date only Matthew O'Kane) has taken a full board or advisory board position in a majority of the investee companies. There are several others where a board member has been added from within the Nexus network.

Like most EIS managers, Nexus recognises that support for the investee companies goes beyond simply monitoring. Nexus views this as a particular strength of theirs, and the team's practices do seem to be in line with those of other good-quality, growth investors. Nexus has also had referrals for potential investments based on the quality of its support, another sign that it is adding value.

To date, Nexus has focused on supplying strategic input. Particular areas have included advice about investor relations, corporate finance (this being a particular feature of the team's background), accounting and tax. Input is also supplied on future fundraisings – in terms of both how to structure and introductions to a wider pool of funders.

So far, Nexus has either co-invested with, or had investee companies receive follow-on funding from, other tax-enhanced managers. With most of the investee companies likely to require follow-on funding, the ability to find investments that attract money from other sources and be able to work with them is important.

Exits

With an eight-year expected lifespan for the fund, it is clear that Nexus is investing for the longer term. It is possible that exits will not be achieved in all companies in that timescale. The co-investment by the fund's managers suggests that any companies still held at that time will continue to receive support from them.

With no exits yet achieved from its historical investments, the Nexus team can only express expectations. As is normal for these investment areas, trade sale should be the most common exit route for successful companies, although other options will be considered. Nexus states that it is exit-focused from the time of investment, although it is too early to judge how successful this is.

It is perhaps worth mentioning again the links that the Nexus Group has in education and health, in particular. This may give additional support for finding exits in these areas, although it is not clear if this will be significant.

Track record

Although the fund is a new venture, Nexus has been investing into EIS companies since 2014 on behalf of the NIVL team, Nexus and connected investors. To date, the team has made 59 investments into 20 companies, an aggregate of £7.0m. All the investments were EIS-eligible, although one was ultimately in the form of a convertible (which is not EIS-eligible).

Hardman & Co has been supplied with performance data as of 31 May 2018. As of that date, no exits had been achieved. This is not unusual for a portfolio with this investment profile and maturity. Hardman & Co understands that offers have been received for two companies, but both were declined.

Of the 20 companies, one has been written down to zero, nine are valued at the entry price and 10 have had subsequent share sales at higher valuations. The profile in the Information Memorandum (IM) shows that, on average, the older investments have larger gains. In aggregate, the valuation move is 1.55x.

Overall, there are signs of promise, but the results to date do not give enough data to draw strong conclusions.

Fees

The fees for NISUF are set out in the table on page 3. Most of these are reasonably straightforward, with a combination of direct investor and investee company charges, although investors should note the points highlighted below. It should also be noted that the members of NIVL will effectively be co-investing and will receive corresponding investment returns.

There may be additional charges for withdrawals of uninvested cash or duplicate EIS3 certificates.

Initial fee

The transaction fee will reflect the size of the investment, with larger investments paying a smaller percentage.

Annual fees

The initial deduction will be 10p in each pound, leaving 90p available for investment and tax reliefs. This will cover the Initial Subscription Fee and approximately three years of Annual Management Fees. The balance of any management fee will be paid from subsequent realisations.

The Annual Management Fee itself is payable for five years, leaving no management fee for the latter part of the fund existence.

The IM allows companies to be charged a Director's fee and a monitoring fee. In practice, where Nexus appoint a director there will be a single fee agreed to cover the director's time and input at board meetings, and monitoring work. Where there is no director from Nexus, a monitoring fee will still be agreed and will likely be lower than the Director's fee.

There are some additional fees covering expenses. These are given as the greater of £25,000 or 0.2% of subscriptions. With the fund target size being £10m, it seems the former will apply.

Exit fees

The performance fee is charged on a portfolio basis, being 20% of gains above the net investment.

Fundraising targets

NISUF has a limited lifespan, with tranches closing depending on the speed at which funds are raised and progress with potential investments. The target for the first close is 28 September 2018. The intention is for capital to be invested within two years of the start of the fund, although this is not guaranteed. Investments may be spread across multiple tax years. The target is for £10m to be raised.

We note that, for the investments to date, over 75 individuals have co-invested. This suggests that, although this is the first fund from Nexus, it already has fundraising capability. NISUF has a minimum size of £1m. With £200,000 committed by the Nexus team members and established fundraising capability, it is unlikely that this minimum will not be reached.

The minimum subscription is £25,000 (although the manager may accept lower amounts at its discretion), with higher amounts in multiples of £25,000.

Investment Manager

Company

Nexus Investment Management (NIML) and Nexus Investment Ventures (NIVL) are both part of the Nexus Group. As well as the NIML and NIVL companies, it has businesses in several other areas. The highest profile area is the management of Primary Health Properties, a £1.4bn UK REIT that invests in primary healthcare premises. It was also the manager of another, smaller, fund – which was sold in May 2017.

The other businesses include a corporate finance advisory firm, a publishing company focused on health and education investors, which also runs related events, and a hospitality advisory service and app.

People

Harry Hyman – Group Managing Director, Nexus Group

A Chartered Accountant, he founded the Nexus Group and Primary Health Properties in 1994, and has been MD of both since then. Prior to that, he spent 11 years at Baltic plc, where he was Finance Director and Deputy MD.

Matthew O'Kane – Managing Director, Nexus Investments

A Chartered Accountant, he first worked in the tax area at PwC. Subsequent roles include Senior Tax Manager at Deloitte, and investment and tax roles at Ingenious Media and Bridgepoint (on secondment), before joining Nexus in late 2013.

Douglas Lidgitt – Associate Director

Also a Chartered Accountant, his career prior to Nexus has been spent mostly in corporate finance. At BDO, he focused on transaction due diligence. This was followed by four years as an M&A Manager at EY.

Paul Downes – Investment Committee

He brings lengthy experience in private equity. He previously worked for European Acquisition Capital and Silver Point Capital. He subsequently became a partner at Hutton Collins and Chairman of E-Synergy.

Stephen Lawrence – Investment Committee

After senior roles at Arthur D Little and Mason Communications, he became CEO of Logicalis, a subsidiary of Datatec, then Whitehead Mann Group. In 2004, he took on the same role at Protocol Education, where he is now Chairman.

Alan Newman – Investment Committee

He has had a series of senior roles in media, education and technology. Employers include Pearson Education, MAI (now United Business Media), KPMG and EY. He spent almost 10 years as CFO of YouGov, before returning to Newlawns Limited as MD.

Russell Trenter – Investment Committee

Following roles in retail companies, his career moved towards senior roles in healthcare companies, including Oasis Healthcare, Sala Healthcare and, currently, Alliance Medical. Has completed four company exits and over 100 other deals.

The Investment Committee consists of the above, apart from Douglas Lidgitt. The members of the committee seem to bring a variety of backgrounds and areas of experience.

Appendix 1 – due diligence summary

Summary of core due diligence questions

Manager	**Nexus Investment Management Limited**	**Validated by**
Founded	2017	Hardman & Co
Type	Private limited company	Hardman & Co
Ownership	Nexus Central Management Services Ltd	Hardman & Co
FCA Registration	Yes – 796814	Hardman & Co
Solvency	Confirmed	Nexus
EISA member	Yes	Hardman & Co
PI arrangements	Yes	Nexus
Advisor	Nexus Investment Ventures Limited	Validated by
Founded	2011	Hardman & Co
Type	Private limited company	Hardman & Co
Ownership	Nexus Central Management Services Ltd	Hardman & Co
FCA Registration	No	Hardman & Co
Solvency	NA	
EISA member	No	Hardman & Co
PI arrangements	Yes	Nexus
Fund Custodian		
Company	Woodside Corporate Services Limited	Information Memorandum
FCA Registration	Yes – 467652	Hardman & Co

Source: Hardman & Co Research

NIVL was originally incorporated as Nexus Healthcare REIT Management, changing its name in February 2014.

Both NIML and NIVL are owned by Nexus Central Management Services Ltd, which, is turn, is owned by Nexus Tradeco Holdings Ltd. This is 100%-owned by Harry Hyman. As a new company, NIML is not required to publish accounts yet. Nexus has informed us that it is capitalised well in excess of the requirement. Its Companies House filings appear to be up to date.

NIML is FCA-registered with permissions to manage an unauthorised AIF. It can control, but not hold, client money.

We note that the Nexus Group, as the manager of a large REIT, has additional regulatory requirements, so should be well placed to support the fund management entities.

Appendix 2 – example fee calculations

This calculates the estimated total amount payable to the manager under certain assumptions.

Basic assumptions	
Term	5 years
Investor amount	£100,000
Company investment	£1,000,000
Fund size	£10,000,000

Source: Hardman & Co Research

Calculations					
		Hardman & Co standard			Target
Gross return		**-50%**	**0%**	**50%**	**125%**
Amount (pre-tax relief)		**£100,000**	**£100,000**	**£100,000**	**£100,000**
Initial fees	**Rate**				
Initial subscription fee	3.00%	£3,000	£3,000	£3,000	£3,000
Transaction fee (paid by company)	3%-5%	£3,600	£3,600	£3,600	£3,600
Total		£6,600	£6,600	£6,600	£6,600
Further fee deduction upfront	10% total	£7,000	£7,000	£7,000	£7,000
Net Investment		£90,000	£90,000	£90,000	£90,000
Annual fees					
From advance deduction					
Fund expenses	£25,000 for fund	£1,250	£1,250	£1,250	£1,250
Management fee	2.00%	£5,750	£5,750	£5,750	£5,750
From company					
Director/monitoring fee	£12,000 per company	£6,000	£6,000	£6,000	£6,000
Gross fund after investment return		£45,000	£93,297	£139,946	£185,924
Exit fees					
Balance of management fee	2.00% p.a.	£4,250	£4,250	£4,250	£4,250
Performance	20%	£0	£0	£6,038	£19,504
Net amount to investor		£40,750	£85,750	£124,600	£178,600
Gain (pre-tax relief)		-£59,250	-£14,250	£24,600	£78,600
Gain (post-tax relief)		-£32,250	£12,750	£51,600	£105,600
Total fees to manager		£23,850	£23,850	£30,000	£43,500

Source: Hardman & Co Research

Notes: Some fees may be payable for longer, but we have used five years, in line with our standard assumptions

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Status of Hardman & Co's research under MiFID II

Some professional investors, who are subject to the new MiFID II rules from 3rd January, may be unclear about the status of Hardman & Co research and, specifically, whether it can be accepted without a commercial arrangement. Hardman & Co's research is paid for by the companies and legal entities about which we write and, as such, falls within the scope of 'minor non-monetary benefits', as defined in the Markets in Financial Instruments Directive II.

In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public…'

The fact that we are commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.

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