HARDMAN & CO.
TAX ENHANCED

NOVA COFOUNDERY SEIS & EIS FUND

Nova Managers Limited/Sapia Partners LLP

	Positives	Issues
Why invest	▶ **Strategy:** To invest in a portfolio of newly formed companies, with strong support provided before and after investment.	▶ **Volume of investments:** While Nova has tested it ability to scale its sourcing, a full fundraise will require a faster rate of investment than achieved so far.
The investment advisor	▶ **Team:** The experienced management group has spent 10 years honing its methodology, supported by a large team of specialists.	▶ **Past performance:** While the team has produced an impressive IRR on an unrealised basis, there have only been two exits to date.

Nuts & bolts

- **Offer period:** The fund is evergreen, with deployments in April and October.
- **Diversification:** Mixture of SEIS and EIS investments. The aim is to invest in 10 companies with higher weights in the EIS investments.
- **Valuation:** Investors will receive four valuations a year. Industry guidelines will be used.

Specific issues

- **Fees:** All fees apart from the performance fee are charged directly to companies.
- **Performance fee:** 20% on gains over a return of 150% of total capital invested.

Risks

- **Risk mitigation:** Nova's focus is on using the support it provides to mitigate the investment risk of investing in new start-ups. There is some evidence this is effective.
- **Target return:** Overall, as is normal for (S)EIS funds, the strategy is high risk, with the three-year return target of £2.18 (including tax relief), though this is effectively understated due to the expected five-to-seven year holding time for investments. Individual investments will have a higher target, offset by a proportion of failures.

	Advisor information	Advisor contact details
Analyst		

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- *Scheme assets:* £nil
- *Scheme target:* £8m p.a.
- *EIS assets:* £N/A
- *Total FUM:* £5.8m
- *Fund launch date:* 2019

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Factsheet

Nova Cofoundery SEIS & EIS Fund	
Product name	Nova Cofoundery SEIS & EIS Fund
Product manager	Sapia Partners LLP
Investment advisor	Nova Managers Limited
Tax eligibility	Mix of SEIS and EIS
Target return	£2.18 after 3 years, including tax relief
Target income	None
Type of product	SEIS and EIS fund
Term	5-7 years
Sectors	Technology and technology-enabled
Diversification:	
Number of companies	10
(Expected) Gini coefficient	0.10-0.11

Fees	Amount	Paid by
Initial fees:		
Corporate advisory and arrangement costs	Up to 5% (excl. VAT)	Investee company
Investor marketing fee	Up to 5% (excl. VAT)	Investee company
Dealing fee	0.25%	Investee company
Direct investor fee	2.5% (inc. VAT)	Investor – see *Fees*
Annual fees:		
Administration fee	2.0% (excl. VAT**)	Investee company
Custody fee	0.35% (excl. VAT)	Investee company
Exit fees:		
Performance fee	20%	Investor share of proceeds after return of 150% of original capital
Dealing fee	0.25%	Investor
Advisor fee facilitation		Yes
Advisor fee amounts		As agreed with investor
HMRC Approved fund?		No
Advance Assurance from HMRC		Usually
Reporting		Quarterly
Minimum investment		£10,000
Current funds raised		£nil
Fundraising target		£8m per year
Closing date(s)		Not set
Expected exit method		Trade sale, further capital funding, IPO or other exit opportunity

Source: Nova Managers Limited, Hardman & Co research

Fund aims

Nova Cofoundery SEIS & EIS Fund is a fund that aims to invest in 10 companies that are eligible for SEIS or EIS relief. The target return for each investee company is a three-year return of £2.18 after tax relief for each £1 invested (although investments are expected to be held for 5-7 years). Returns will be focussed on capital gains and investors are unlikely to receive any dividends. The aim is for the assets to be invested as soon as possible after receipt.

There are two parties involved in running the fund:

- **Nova Managers Limited**: the Investment Advisor to the fund, which will source and support all investments.
- **Sapia Partners LLP**: the regulated entity, which will be the Investment Manager of the fund.

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

The target is for investors to receive shares in 10 companies, with 80% of companies and two thirds of the value being brand-new companies (SEIS) and the balance EIS. Businesses will be technology-enabled, with some sector diversification, although this depends on the opportunities that arise. Given the very early stage of the investments, we would expect idiosyncratic risk to dominate market or economic risk.

The return target seems reasonable for what is a higher risk strategy, although this is in line with other SEIS investments.

Sourcing and external oversight

Nova has a well-established sourcing process, with an emphasis on digital media. Its focus on entrepreneurs who are just starting up a company is unique in SEIS funds with little competition from other investors. Nova has tested its ability to boost potential deal-flow by increasing its advertising and appears to have plenty of capacity to source sufficient investments for the fund.

Sapia Partners LLP (Sapia) validates all investment decisions made by Nova. Within Nova, candidates are pre-qualified by a mentoring team before being assessed by the separate Investment Committee.

Ongoing support and monitoring

The Nova proposition is unique in the (S)EIS market. The support has some features of an incubator, such as mentoring, support for finance or business space assistance, but also has a staff of technology specialists that can be deployed into a company, reducing recruitment risks at the earliest stages. Nova 's parent takes a board seat in investee companies, with Nova having the right to do so too.

Exits

The intention is that exits will come through trade sales or other normal exit routes such as IPOs.

Manager

Team

Although it is a new entrant into the (S)EIS market, Nova has a large infrastructure to nurture and support new businesses. Senior management has experience of being founders and developing other start-ups. Nova has a staff of over 170, which includes business mentors and technology specialists for subcontracting to investee companies.

Track record

Nova and, prior to its founding, Andy Davidson (Nova CEO) have made 66 investments to date, 54 of which were before 2018. To date, there have only been two successful exits, and 24 write-offs. On an unrealised basis, the portfolio IRR is 32.5%, with the investments since Nova started showing better progress compared with the earlier ones.

Regulation

Product

Advance Assurance will usually be sought from HMRC for each company investment, but is not a requirement for Nova to proceed.

Advisor/Manager

The Fund Manager is Sapia Partners LLP. It is FCA registered (number 550103) with fund management and custodian permissions. Submissions to Companies House appear to be up to date. The Advisor, Nova Managers Limited, is an appointed representative of Sapia.

Risk analysis/commentary

Although Nova is a new fund manager in (S)EIS terms, the team has had 10 years of investing in and supporting new start-ups. This time has been used effectively, with some evidence that its methodology is working better now than it was at the outset. The proposition of supplying capital, staffing and other support together seems attractive to the right class of founder.

Overall, this gives a proposition that investors looking for exposure to early stage companies might find attractive. Although co-investing is increasingly common, the other elements of Nova's strategy are distinct from other early-stage funds. The only element of concern in the track record is the lack of exits to date; however, Nova management is clearly aware of this.

While Nova has a methodology to reduce the risk of investing in new companies, as is normal for SEIS, each investment remains high risk. Those that do well should produce good returns, but a good proportion will not and will return little or nothing. Company diversification is typical for technology-focussed funds. Although idiosyncratic risk will dominate, investors need to consider their whole portfolio when assessing whether they have adequate diversification.

Investment process

Deeper dig into process

Over the past 10 years, the Nova team has developed a unique proposition for founders, looking to support them from the start of their entrepreneurial journey. Nova has been investing in many of these companies and this new fund will be co-investing alongside.

The fund will be investing in technology-enabled businesses, with Nova looking for several criteria:

- Demonstrable and significant market potential
- A solution to a problem that will create new market segments or displace others
- Technology-enabled or other innovative approach
- A clear and realistic path to delivery of a minimum viable product or prototype
- Strategy for developing and protecting intellectual property
- Passionate, energetic and experienced founders
- Exit strategy with a 4-5 years horizon
- SEIS eligibility

While these criteria are not unique within (S)EIS funds, the way that Nova executes on them is. Nova has built up a team of more than 170 people, who support and develop new businesses alongside the founder(s).

Most founders start with Nova at the same time as their business starts, usually arriving with a problem or idea and a desire to set up a business to solve it. From the outset, there is a strong mentoring process for all entrepreneurs. This includes goal setting and, if further support is to be received, these goals need to be met. Nova has a substantial team of three pre-investment and twelve post-investment mentors.

The Nova team extends far beyond mentors, with development capabilities and skills in a wide range of areas, such as different programming languages, web development, AI, as well as business skills. As a company develops, members of the Nova team are seconded to it on a project basis.

The company pays for these secondments via a fee to Nova, although the fee is charged on the basis of cost plus a very small margin. In the first year of a company's operation, most of the money raised will be spent this way. After that, Nova will look to extract its team members from the business as they are replaced with more permanent staff.

Nova has premises in Liverpool and has started planning to open in London too. It can offer free co-working facilities, but these are not obligatory. Despite this, mentoring contact is frequent with phone calls usually taking place daily and face-to-face meetings at least once a fortnight.

Nova's core philosophy is based on lean start-up methodology, augmented by focussing on helping companies avoid the five most common mistakes that are made (sourced from 100firsthits.com). Nova described some of its mentoring as indoctrinating founders into its way of working, with those who don't fit not progressing further.

1. **Building something nobody wants**: One of the first goals that a mentor sets a new founder is to form a user panel, a group of 10-15 people who understand the problem that the entrepreneur is trying to solve. The role of user feedback in start-ups is now well understood, if not always widely appreciated and essential to getting a product right. Often, members of such a panel become customers too.

2. **Hiring poorly**: By using staff supplied by Nova, founders know they are getting reliable staff. It also reduces HR issues as such people are usually available quickly. From a Nova/fund perspective, the capabilities of the seconded staff are usually very well known, allowing a more accurate assessment of sources/blockages of progress.

3. **Failing to execute sales and marketing**: Nova perceives the main risk here to be the premature scaling of a company. It can be tempting for a start-up to attempt to scale once it has created an MVP, rather than waiting until the product is right. Another mistake is to scale before it has a repeatable sales process in place. Nova's mentoring aims to help companies avoid these mistakes.

4. **Not having the right cofounders**: New teams of cofounders have often not worked together before, which can be challenging in the high-pressure situation of a start-up. With Nova as the cofounder, the pressure to get a team of cofounders is alleviated. Nova recognises that its set-up is better suited to the solo entrepreneur or a pair of founders than a fully formed team, which might already have many of the skills that the Nova staff bring.

5. **Chasing the investors, not the customers**: It is easy for founders to spend more time seeking investment than working on the business. Nova provides a clear path for funding, subject to making progress, for the first couple of years. It can also assist with introductions beyond that, but founders will then have to work harder in this area. Nova sees this as a price of success, but companies that reach this stage should have expanded their capabilities enough to allow founders to seek investment.

Although the research is US-based, these are issues for start-ups anywhere. Interestingly, Nova quotes the research as giving a 92% failure rate for new start-ups. In Nova's experience to date, it has reduced this to 54%, suggesting that its methods are bringing value.

Sourcing deals

Nova's sourcing requirements are somewhat different from most other (S)EIS managers. The ideal candidate is an entrepreneur who has a business idea, wants to execute on it but hasn't yet made a meaningful start. This is in contrast with other managers, who generally want an existing company and some signs of progress.

Lead generation follows a variety of channels, with an emphasis on digital advertising and e-media. Nova also runs hackathons and has found these to be very successful. As well as the prospect of funding, Nova's initial service to entrepreneurs is free mentoring. Although it has sourced some limited funding for this, Nova simply views the mentoring as a cost of sale.

The volume of leads generated is strongly correlated with Nova's investment. In 2018 Nova tested this, generating 300 new leads in some months with no reduction in quality. A normal level of activity would be less than half that number, but it is reassuring that the flow could be increased if required.

Not every lead will be mentored. At this stage Nova is looking for problem origination as much as anything else. It is also looking for an indication that the problem can be solved, and that the person bringing the problem is the right person to do it.

For every 300 leads that Nova generates, it estimates that about 50 will receive mentoring, which in turn will ultimately lead to ca.12 initial SEIS investments. The target for each tranche of the fund is to have 10 investments, with more than three quarters being SEIS. This would suggest that Nova should be able to source sufficient investments for the fund, something its investment record over the past couple of years supports.

Geographically, Nova is agnostic about where it invests, but notes that it has a stronger network in the north-west of England and tends to get more high-quality referrals from that region. The net effect is that the fund is likely to have a proportionately higher number of investments from that region than from the rest of the UK.

Within the technology-enabled criteria, there is anticipated to be a wide range of underlying businesses. There is no focus on any particular sector, and the investor's breadth of exposure will depend on the opportunities that arise during the period their funds are invested.

Decision making

The input into the decision-making process starts at the mentoring stage described above. Over the course of the various meetings, the mentor will gain an understanding of the entrepreneur and the progress they are making. In advance of each pitch day, the mentoring team is asked to recommend the strongest candidates for funding. This aim is to ensure that pitches for funding are only made once the entrepreneur is ready.

There is an implict secondary assessment via the staff placements. The Nova staff have some discretion about which projects they work on. So, if a company is struggling to get Nova staff interested, then it is unlikely to be suitable for investment.

Pitch days take place once a month, with a quorum of Nova's Investment Committee (IC) in attendance. The aim is to keep the assessment relatively simple, focussing more on generic start-up issues rather than specific domain risk. The IC scores each pitch on the prescribed criteria to decide if the candidate will progress further.

Where a founder is rejected at this stage, there is a strong emphasis on giving clear and prompt feedback. Roughly half of the pitches are rejected at this stage, but the intention is to make it clear what the founder needs to do so they can come back and make a successful pitch.

If a pitch is successful, then Nova produces a paper for the IC that is compliant with the Information Memorandum. This is then passed to Sapia, which examines the paper and confirms within a week whether the investment can be made.

There is a short due diligence process. Nova views the ability of the entrepreneur to execute during the mentoring period as a key part of the diligence. It is complemented by other diligence, such as background and some market checks. With no company existing yet, many of the usual diligence requirements are not needed here.

Once investment is agreed, Nova provides legal and financial support. This includes setting up the company using standard documents, opening a bank account, setting the company up on Xero for accounting purposes and assigning someone in the accounting team to act as financial controller.

For SEIS investments, the cash is paid out in two tranches. The total investment is expected to be £150,000. Initially, £50,000 is transferred into the company's account. The balance of £100,000 is paid after four months, and only if the company has reached, or in some cases got close to, the performance targets that have been agreed with Nova.

Ownership is on standard terms, with the founder(s) getting 50% of the new company, 25% being owned by Nova and 25% by SEIS investors. Nova invests on the same terms as fund investors, but no fees are charged on the former's investment.

EIS investments have somewhat different parameters. Although these are follow-on investments into existing companies, the assessment process follows more conventional lines, albeit with the advantage of not only having been invested in the business for a year, but also having full access to all the management information. EIS rounds are usually about £350,000 - £450,000, with ownership proportions variable and dependent on progress to date.

The expectation is that two thirds of the money will be deployed into SEIS investments and one third into EIS. The larger size of the latter means that, by number, around three quarters of companies will be SEIS.

The mentoring period is expected to last a minimum of a month, although the expectation is that many will require support for longer. Once a pitch is successful, the process should be relatively quick compared with managers who are dealing with established companies.

Deployment will take place in batches each April and October. Nova builds up potential deal flow over the preceding months. We note that a successful fundraise of the £8m that is targeted will require a greater deal dealflow than Nova have invested in to date. It is reassuring that they have tested the ability to scale the input, but the ability to invest at that rate is not proven yet.

Governance and post-investment monitoring

All investment will apply for Advance assurance. Usually be received from HMRC for each investment prior to completion, but it is not always received promptly and so is not a requirement for the investment to proceed.

The values of investments are reviewed quarterly and reports are sent to investors' online accounts in January, April, July and October. The April report will be an annual statement.

Valuations are carried out using IPEVC guidelines. For most companies, this will mean revaluations when there is a significant sale of shares to another investor. Companies that reach profitability will be valued at a discount to comparable listed companies.

It is worth noting that Nova is a bit quicker to write down values for companies that are not making progress. Usually, this will be a 50% write-down after one year and 100% after two years. Given the early stage, it is not unusual for the rate of progress to change and for subsequent positive revaluations to take place.

Galactic HQ (Nova's parent) takes a director positions on each investee company board, with the fund having the right to appoint another and the founder taking a third position. Formally, this gives Nova control of each board. Nova notes that for most companies this is rather academic, with there being very few board meetings as these are subsumed under the regular interaction described under the investment process above.

As well as the formal governance structures, it is clear that Nova will have a deep relationship with the investee companies through staff deployment, ongoing mentoring and acting as a financial controller. For successful companies, these will reduce over time, but should remain significant for some time.

Exits

Nova expects exits to derive from the usual sources for companies in their field, which means mostly trade sales or replacement capital from VCs. A small number may IPO, but they are expected to be the exception.

Although Nova's method may reduce the proportion, there will still be a meaningful proportion of failures. Nova intend to apply for these to be struck off promptly to allow investors to claim loss relief as soon as possible.

Track record

Hardman & Co has been supplied with details of a combined investment track record to the end of 2018. This encompasses that of the CEO prior to the founding of Nova in 2014, and the latter thereafter. There are 17 investments from the earlier period (2008-2011) and 37 by Nova (2015 onwards). Nova made another dozen investments in late 2018, but these are not included due to the very short time since the investment.

Nova has had only a small number of positive exits, with two achieved to date, both of which achieved very good returns on capital and IRRs. Management believes it could get liquidity on another couple of investments, but has chosen to remain invested and these have continued to appreciate in value.

Of the 54 investments, 24 have been written down to zero. The earlier group of investments has 10 of these (59% of investments), with the balance in Nova (27% of investments). Another five have been written down, with the remaining 25 showing positive returns. This skewness is typical of investments in this area.

There is some evidence that Nova is achieving one of its targets of reducing the failure rate within companies. There is an improved three-year survival rate between the earlier and later investments, although a larger number of investments than each group are less than three years old.

Using latest valuations, the unrealised IRR for all investments is 32.5%. This is very credible, albeit with the caveat about the lack of realisations. Since Nova started investing, the IRR has been 58.7%, although this portfolio is less mature (but still has one of the successful exits).

We note that Nova itself (the service company, not the equity holding vehicle) is the most successful investment and is valued at over a third of the current total.

As with many SEIS managers, the Nova portfolio performance shows strong signs of promise. The underlying performance looks good, but the lack of realisations means the IRR figures to date need to be treated with care.

Fees

The fees for the Fund are set out in the table on page 3 and, other than the performance fee, are payable by the investee companies. As is normal for an SEIS fund, these are somewhat higher than for most EIS funds, although the threshold for the performance fee helps to offset this.

The fees are straightforward, other than as noted below:

- **Initial fees:** Although these are stated as being up to 5%, in practice, they are expected to be 5%.

- **Direct investors' fee:** The intention is to primarily market the fund to advised investors. Direct investors will pay an additional fee of 2.5% (including VAT).

- **Performance fee:** This starts when the investor has 150% of their capital returned, making it on a fund basis.

The fees and charges are quoted net of VAT. Where investee companies have sufficient VATable revenue, the VAT can be offset; however, most of the investments will be pre-revenue at outset and this will not be possible in the early years.

Fundraising targets

The target is to raise is £8m, with deployment each April and October. If the amount raised falls short of this, then other funding will be used, so the number of investee companies is likely to be independent on the amount raised.

The minimum subscription is £10,000 per investor.

Fund Manager

It is clear that the CEO has been the driving force behind developing Nova's philosophy and operational methods. This development was started several years before the creation of Nova, with the latter appearing to reap the benefits from earlier learning.

Nova itself has developed into a substantial operation, mostly operating under the brand *We Are Nova*. While the leadership team, as is usual, remains important, there does not seem to be excessive reliance on any one individual for the fund's success.

The team seems to be adequate for Nova's current scale of operations. As indicated under sourcing, Nova believes it can generate leads at a much faster rate than current levels. On this basis, Nova believes it could source 150 SEIS investments a year, although currently has the capacity to handle around a quarter of that. The ambition to grow is there, with the acknowledgement that the team needs to be scaled accordingly. Management is firm that it will only take on business that it can fund and manage, but investors should expect to see capacity growth in the future.

People

Andy Davidson – CEO

Having started as a software engineer, he has subsequently co-founded several technology businesses. He has been making investments since 2008 and founded We Are Nova in 2014.

Olivia Greenberg – Chief Growth Officer

Has extensive experience in operational and production roles in the media and digital sectors, most notably during 14 years with Amaze. Since 2010, she has worked as a business consultant and coach, joining Nova in 2015.

Paul Morrissey – Chairman

In 1989, he founded the Tubedale Group, an international telecoms and software company, where he was MD for 19 years. Since then, he has taken on numerous board roles in technology related companies, including several Nova investments.

Akshay Bhatnagar – Chief Investment Officer

A chartered accountant who qualified at KPMG, since 2000, he has taken on various venture capital management and corporate finance roles. He joined We Are Nova in 2017, and is also the Finance Director.

The Investment Committee constitutes the four people listed above. At pitch days, it is normal for the three executive members to be present, with the Chairman deputising when one is unavailable.

As well as the above, Nova has two high-profile and very well-connected shareholders in Sir Terry Leahy (former CEO of Tesco) and Bill Currie (founder of William Currie Group). Although they have no specific role, they are clearly very strong connections to have.

Appendix 1 – due diligence summary

Summary of core due diligence questions		
Investment Manager		**Validated by**
Company	Sapia Partners LLP	
Founded	2010	Hardman & Co
Type	Limited liability partnership	Hardman & Co
Ownership	Sgg (Lc) UK Ltd (sole partner)	Hardman & Co
FCA Registration	550103	Hardman & Co
Solvency	Yes	
EISA member	Yes	Hardman & Co
Investment Adviser		
Company	Nova Managers Limited	
Founded	2018	Hardman & Co
Type	Private Limited Company	Hardman & Co
Ownership	Galactic HQ Limited	Hardman & Co
FCA Registration	526519 (AR of Sapia)	Hardman & Co
Solvency	Yes	Nova Managers
EISA member	No	Hardman & Co
Fund Custodian		
Company	Reyker Securities	Information Memorandum
FCA Registration	115308	Hardman & Co

Source: Hardman & Co research

Regulation

Sapia Partners LLP is a well-established manager of several EIS funds with different advisers. It has recently changed to having a single partner, which is in turn owned by SGG (FNG) Netherlands B.V. The latest accounts (31 March 2018) have capital of just over £253,000. Its FCA permissions are suitable for a fund manager.

Nova Managers Limited is an Appointed Representative of Sapia Partners. It has no particular permissions. As a new company, it has not produced any accounts yet. Its parent company is Galactic HQ Limited, which has six shareholders, including the CEO, Chairman and shareholders listed in the previous section. Its Companies House filings appear to be up to date, though we note the late submission of the 2018 accounts.

Note that Galactic HQ will hold the shares from Nova's co-investments.

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
Split SEIS: EIS	2/3: 1/3
VAT is reclaimed by investee companies	

Source: Hardman & Co research. Five years used for consistency with other reports.

Example fee calculations

		Hardman & Co standard			Target
Gross return		**-50%**	**0%**	**50%**	**150%**
Amount (pre-tax relief)		**£100,000**	**£100,000**	**£100,000**	**£100,000**
Initial fees	**Rate**				
Corporate advisory fee	5.00% (excl. VAT)	£5,000	£5,000	£5,000	£5,000
Investor marketing fee	5.00% (excl. VAT)	£5,000	£5,000	£5,000	£5,000
Dealing fee	0.25%	£250	£250	£250	£250
Total		£10,250	£10,250	£10,250	£10,250
Net investment		£100,000	£100,000	£100,000	£100,000
Company charges					
Administration fee	2.00%	£2,000	£2,000	£2,000	£2,000
Custody fee (annual)	0.35%	£350	£350	£350	£350
Total over 5 years		£11,750	£11,750	£11,750	£11,750
Gross fund after investment return		£50,000	£100,000	£150,000	£248,832
Exit fees					
Dealing fee	0.25%	£215	£250	£375	£622
Performance	20%	£0	£0	£0	£19,766
Net amount to investor		£50,000	£100,000	£150,000	£229,066
Gain (pre-tax relief)		-£50,000	£0	£50,000	£129,066
Gain (post-tax relief)		-£6,667	£43,333	£93,333	£172,399
Total fees paid		£22,125	£22,250	£22,375	£42,388

Source: Hardman & Co Research
Note: tax relief only allows for basic relief and makes no allowance for any loss relief or other benefits.

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