22 March 2019

HARDMAN & CO.
TAX ENHANCED

EIS FUND REPORT

EMVC EVERGREEN EIS FUND

EMV Capital Ltd/Sapphire Capital Partners LLP

	Positives	Issues
Why Invest	► **Strategy:** Exposure to a portfolio of technology companies that focus on hardware and hardware-enabling software and applications.	► **Past performance:** The Fund is new and has no past performance, although we note that the team has one exit from other investments.
The Investment Advisor	► **Team:** The EMVC team has significant experience of building new businesses and making Angel/Venture Capital investments.	► **Team size:** The EMVC team is relatively small, although recruitment is under way to expand capacity.

Nuts & Bolts

- **Offer period:** The Fund is evergreen, with investors sharing in the deal flow subsequent to investment, although there may be a close before the 2018/19 tax year ends.
- **Diversification:** The aim is for each investor to have exposure to four to six companies.
- **Valuation:** There will be little or no change in the valuation, except at further fundraises, and investors will receive regular updates on progress.

Specific Issues

- **Fees:** Mixture of direct fees, and charged via the investee companies.
- **Performance fee:** 20% on gains above £1.10 per £1 invested on a per company basis.

Risks

- **Target returns:** The target return of tripling invested capital over six to eight years suggests a higher-risk strategy within the EIS area and is appropriate for the strategy, although investors should note the slightly longer term than some other funds target.
- **Companies:** Individual investments will be high-risk, with the return profile likely to be skewed. Those that do well will give a larger-than-target return, but the failures may return little or nothing.

	Advisor information	Advisor contact details

Analyst

Brian Moretta
0207 194 7622
bm@hardmanandco.com

Advisor information

- *Scheme assets:* £0.25m
- *Scheme target:* £2m-£5m p.a.
- *EIS assets:* £0m
- *Total FUM:* £15.9m
- *Fund launch date:* 2018

Advisor contact details

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Factsheet

EMVC Evergreen EIS Fund	
Product name	EMVC Evergreen EIS Fund
Product manager	Sapphire Capital Partners LLP
Product consultant	EMV Capital Limited
Tax eligibility	EIS
Target return	£3 for every £1 invested after 6-8 years
Target income	None
Type of product	Discretionary portfolio service
Term	6-8 years
Sectors	Technology
Diversification:	
Number of companies	4-6
(Expected) Gini coefficient	0.167-0.25

Fees	Amount	Paid by
Initial fees:		
Entry fee	0.75% (excl. VAT)	Investor
Initial fee	3.0%-5.0% (excl. VAT)	Investee company
Annual fees:		
Management fee	1.05% (excl. VAT) per year for 5 years	Investor – see report for details
Annual fee	1.0%-2.0% (excl. VAT) per year for first 3 years	Investee company
Exit fees:		
Performance fee	20%	Investor share of proceeds over £1.10 per £1.00 invested on a per company basis

Advisor fee facilitation	Yes
Advisor fee amounts	As agreed with investor
HMRC Approved fund	No
Advance Assurance from HMRC	Yes
Reporting	Quarterly
Expected exit method	IPO, trade sale, secondary sale or other exit opportunity
Fundraising:	
Minimum investment	£25,000
Current funds raised	£0.25m
Fundraising target	£10m in current financial year
Closing date(s)	No specific closing dates, although likely to be one before end of 2018/19 tax year

Source: Sapphire Capital Partners LLP, Hardman & Co Research

Fund aims

EMVC Evergreen EIS Fund is a discretionary portfolio service that will give each investor exposure to four to six technology companies. The target return is £3 for each £1 invested. Returns will be focused on capital gains, and investors are unlikely to receive any dividends. The Fund, as the name indicates, is evergreen.

There are two groups that have a role in managing the Fund:

- **Investment Manager:** Sapphire Capital Partners LLP, which does fund management and compliance.
- **Investment Advisor:** EMV Capital Limited, which sources and manages the projects.

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 into a technology company. The target is for investors to receive shares in four to six companies. The focus means that there will be limited sector diversification, but each investment will be expected to perform independently of the others.

The target return of 3x invested capital over six to eight years suggests a higher-risk strategy.

Sourcing and external oversight

Sourcing will take place through a combination of direct approaches and the infrastructure and network that EMVC has built up. Notably, this includes major corporates, some of which EMVC has co-invested with previously and from which it is now getting referrals.

Ongoing support and monitoring

EMVC looks to put in place an accelerator-type plan for each company, looking to determine the areas in which the investee company needs support. There is a particular push towards good financial controls and internationalisation of sales. EMVC hopes to take an ongoing role in providing follow-on funding for the companies that require it.

Each investee company will have a director or board observer representing the Fund and with a regular flow of management information to EMVC.

Exits

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

Manager/Advisor

Team

EMVC has been making venture capital investments since 2014. The team is adequate to manage the Fund, although it is small for EMVC's growth plans, and it is currently recruiting. The senior members of the team have significant experience in building businesses, managing investments and corporate finance.

Track record

As it has been launched recently, the Fund does not have any track record, although the management team behind it is experienced in the technology sector. EMVC has facilitated venture capital investments into nine companies to date, five of which were eligible for EIS, with one exit (although some rounds in two companies were alongside EIS investors).

Regulation

Product

Advance Assurance will be sought from HMRC for each company investment.

Manager

The Investment Manager is Sapphire Capital Partners LLP. It is FCA registered (number 565716), with fund management permissions. Submissions to Companies House appear to be up to date.

EMV Capital Limited is FCA registered (number 820038) as an appointed representative.

Risk analysis/commentary

Although the Fund is new in the EIS space, the principals bring experience of both building new businesses and venture capital investing. EMVC's track record shows an ability to raise and deploy capital, although there have only been a small number of investments to date, and several of these were not EIS-eligible. The Fund does appear to have a well-constructed investment process, with some features that are comparable to much more established managers. It has also shown an ability to work with/alongside large corporates, which could supply additional technology validation, support or finance options.

The focus on hardware and hardware-enabling software is slightly unusual, and does bring some distinct characteristics. In particular, there may be more need for follow-on investments and a longer time to maturity than some other technology investments. However, this may bring some diversification benefits to an investor who already has exposure to other technology areas.

As is usual in this industry, expected returns will be skewed, with only a proportion of companies doing very well. It is likely that there will be some complete failures to offset the successes. Individual investments, as is normal in the technology area, may be high- risk.

The expected diversification within the product is limited. Individual investments should perform independently of each other, though. Investors should consider this product in the context of their whole portfolio.

Investment process

Deeper dig into process

The EMVC Evergreen EIS Fund will look to invest in technology companies focused on several sectors. The sectors of interest are clearly set out in the Information Memorandum, and are as follows:

- energy and energy efficiency;
- industrial technology;
- resource efficiency and the circular economy and
- smart cities and connected transport.

Within these sectors, EMVC has preferences for certain technology areas: robotics, AI, power electronics and controls, internet of things, material science and industrial chemistry, and advanced engineering. Since June 2018, about 40% of the opportunities that have progressed to a diligence stage have been in robotics and automation, with the others spread across a variety of areas.

EMVC highlights that it is interested in hardware or hardware-enabling software. This is different from many technology EIS funds, and, in particular, it will not invest in pure software.

This has a couple of consequences for investors. Firstly, future capital requirements may be larger than some other sectors, and follow-on fundraisings are more likely to be required, with potential dilution if investors are unable to join in. EMVC looks to mitigate this in the investments it chooses, but most successful investments will require follow-ons.

Secondly, the time required to maturity is potentially longer than some other investments, with EMVC guiding six to eight years.

The hardware and hardware-enabling software focus also means that investee companies will be more focused on business markets than consumer ones. EMVC wants to see an identifiable market with substantial commercial potential. It also wants demonstrable interest from a large corporate, whether as a potential customer or a partner/investor.

Members of the EMVC team have a background in IP management, and this means that EMVC has a sophisticated approach to proprietary technology. The latter is seen as very desirable, although, for EMVC, it is often not as simple as just having some patents. The team looks for an appropriate strategy to be in place and views the approach of company management towards this as a measure of their development as entrepreneurs.

EMVC also places importance on the management team, with an emphasis on making sure they have the relevant expertise and experience. In addition, it is looking for a willingness to work with, and take advice from, the Investment Advisor – post-investment support is important, and management that cannot accept advice will not be suitable.

Sourcing deals

It is anticipated that deals will come from a mixture of direct applications and through the network that EMVC has built up over the last five years. When EMVC first opened its doors, there were a lot of direct approaches, most of which were pretty low-quality. As it has developed its capacity, it has made connections that have led to much higher- quality referrals.

The range of the network has much in common with many other VC firms, and includes Universities, accelerators and friendly VC firms. One source that gets greater emphasis by EMVC than some others is corporate referrals. In several of the deals it has done to date, it has co-invested alongside large companies, including ABB, Mitsubishi, Philips Lighting and Evonik Industries. Some of these are now referring possible investments to EMVC, sometimes with the potential for co-investing. Interestingly, it is also receiving referrals from corporates with which it has not yet worked actively, suggesting that it is getting a good reputation in these circles.

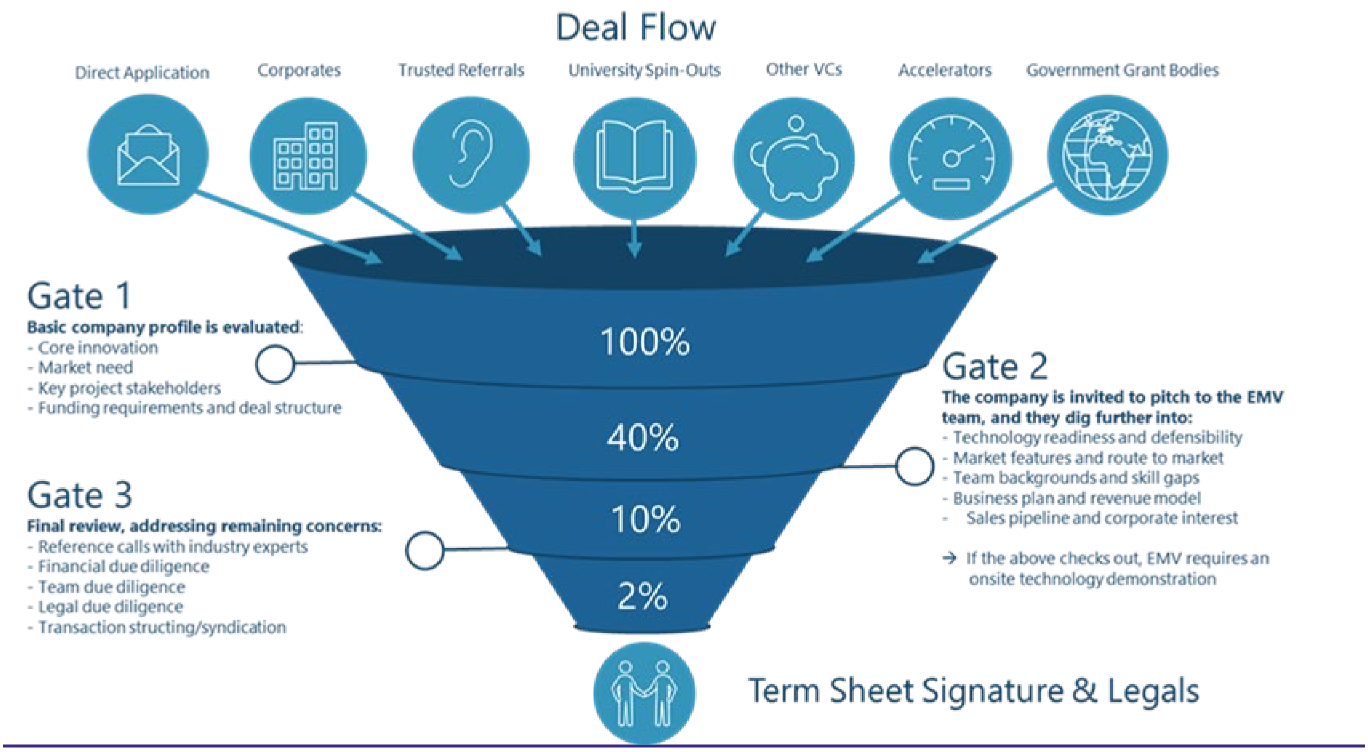
As well as the EIS Fund, EMVC will continue to source deals for its existing network of investors. Hardman & Co understands that the Fund will get priority on any potential investments, although there may be the possibility of co-investing. Where potential investments are not EIS-eligible, clearly no conflict will arise. EMVC is also looking to raise a parallel fund from overseas investors. This will usually invest at a slightly later stage than the EIS fund, but may also co-invest alongside it.

Overall, EMVC has looked at more than 180 potential investments from June 2018 to March 2019 to date. Given its estimated acceptance rates, it should be able to source the four to six investments targeted for each investor in the Fund within a year.

Decision-making

EMVC has produced a diagram summarising its decision-making process, shown below.

Summary of decision-making process



Source: EMV Capital

The first stage is an initial assessment by a junior member of the team. At this stage, it focuses on four issues: i) what the company does and what innovation is there; ii) how it will do it and what the business model is; iii) who the key stakeholders are, including any corporate support; and iv) the broad financials, such how much is being raised and what the valuation is. At this point, a short document is considered by the Investment Committee.

The second stage is a longer process, and may have some mini-gates within it. The stage starts with a structured conversation with the company management. To avoid this consuming too much resource, normally a template is used for asking questions, with the aim of keeping the conversation short. This will include a principal, as well as the junior member of the team.

Assuming the conversation is satisfactory, EMVC then starts to examine supporting documents. As the diagram indicates, this covers areas such as the technology, any IP surrounding that, the potential market, company finances and staffing. At this stage, a third-party reference will be taken on the technology.

This stage will involve the completion of EMVC's Score Card. This is a structured rating process. Over 50 items are scored on a mixture of subjective and objective measures, with comments added where necessary. These are grouped into seven categories, which allows an easy (visual) summary of the broad stages of development of the company.

EMVC stresses that decisions are not based solely on these scores. It believes this helps to keep its views objective and avoid 'falling in love' with a company. It is a well-structured part of its process, and better than what many larger companies have produced.

The Score Card is also a helpful part of its process when an investment does not immediately move on through the 'Gate'. EMVC keeps in touch with several companies that it believes could eventually be suitable for investment, but not at the time of first contact. The Score Card allows EMVC to monitor progress in a structured way.

Assuming these investigations are satisfactory, EMVC then requires an on-site validation of the technology. This may be by a member of the team, or may involve a specialist when a more technical (typically less visual) assessment is required. This will be followed by a draft term sheet – it is important to get a broad agreement on this before progressing to the third stage.

The third stage is primarily one of due diligence: legal and financial checks are made, and references are taken, on both the team and on the technology. The Fund Manager, Sapphire, is involved at this stage. The decision to invest is taken by the Investment Committee, with a majority decision required.

The historical final selection rate of 2% is in line with many others in the industry. EMVC notes that, recently, this rate has improved, probably due to the improved referrals it is getting from its network. This higher rate will need to be maintained for EMVC to hit its target number of investments.

As indicated in the sources above, EMVC is keen to co-invest with other parties, particularly industry sources. It sees an advantage in its ability to bring stronger technology assessment capabilities, supply a possible route to market and potentially provide options for further funding or exits. In the deals it has done to date with industry partners, the latter have been happy to have a financially orientated partner. This is validated by the supply of potential deals that these industrial partners are now directing to EMVC.

It is expected that investments will be between £200,000 and £1m, for which the Fund will typically get a 15%-25% stake.

The aim is to give investors exposure to at least four companies. Whether this number is exceeded will be affected by the size of the fundraising and the needs of the companies. There will be no specific diversification by sector, as this will be a function of the opportunities that arise, although, given the nature of the projects, each should perform independently of the other.

Governance and post-investment monitoring

Advance assurance will be received from HMRC on all investments prior to committing funds.

All client assets, including cash and shares, are held by the Custodian, Mainspring Fund Services. Mainspring will also carry out the Fund's administration and use an online portal to supply client documentation.

Investors will receive reports on their investments quarterly, with an annual review that will give more detail. As unquoted investments, we would not expect there to be significant changes in share values, unless there is a follow-on investment.

The Fund will expect to have a board position on each investee company, or have board observer status. This role will most likely be taken by one of EMVC's senior executives, a Venture Partner, or from its network.

EMVC look to play an active role in supporting investee companies after investment. The starting point for this is what it describes as an accelerator-type plan. This is tailored to each company, looking to the specific areas with which a company needs help.

The most common requirement for existing investments has been help with talent identification. This is usually for senior roles, including non-executives, and sales. EMVC expects this to be similar going forward, as most companies will not be well developed and at the early stages of commercialisation.

One area of support that EMVC tends to push for is the right capability in financial reporting. This may include ensuring that a CFO or financial controller is appointed. EMVC also encourages early internationalisation of markets.

Other areas of support include connecting the company within the relevant industry, helping with a review of the company IP, and what is required to protect that (a particular strength of the EMVC team). For early-stage companies, support will also include preparation for the next funding round.

It is anticipated that the support required will broadly decrease over time. EMVC cites Qbot, an existing investment where the intensity of support is lower than it was originally. This is also reflected in the fees payable by the investee company, which may cease after three years (although the exact timing may vary on a company-by-company basis).

EMVC expects an EIS funding round to finance a company for around 18-24 months. While, ideally, this will take the investee company to being self-funding, the areas in which the Fund will invest mean that it is expected that some of the investee companies will have greater follow-on funding requirements than those in some other EIS funds.

The expectation is that existing investors will be given the opportunity to participate in any follow-ons. These, of course, may or may not be EIS-eligible. EMVC hopes to be able to take a leading role in sourcing follow-on funding, but there is no guarantee that it will be able to do so. EMVC is currently raising a new fund, which will be able to help fund follow-ons. Investors may be diluted if they do not participate in these follow-ons.

Exits

Most exits are expected to occur through trade sales, although other options, including flotations and secondary sales to other financial investors, are not ruled out, if appropriate.

EMVC management would like to be able to provide an earlier exit option by facilitating secondary sales as part of follow-on funding rounds where it is sourcing the funding. To date, EMVC has managed to produce one exit this way. Hardman & Co notes that, although positive, others who have tried to get regular secondary sales have not managed to do so on a sustained basis yet. If this happens, investors should note that it is likely to take place on a matched bargain basis, and they may wish to have any transaction price independently validated.

Track record

The Fund is a new venture and does not have any past performance. EMVC , and its predecessor EcoMachines Ventures, have deployed £17.5m into nine companies since April 2014. All bar one were funded from non-EIS money, although five were EIS-eligible. Unlike EIS investments, the funds were deployed into a mixture of equity and convertibles with a small amount of debt. Half of the investments from EcoMachines are still entirely managed by it, while EMVC has an ongoing role in the others.

To date, one of the smaller investments has exited at a gross 1.57x multiple (1.41x net of fees) over two years. Some of the remaining portfolio have seen follow-on investments, and the valuation using the most recent prices is showing a 24% uplift on cost (although we note that there are exchange rate effects too). Most of this is driven by a single investment, Qbot, which is natural in a small portfolio. There have been no failures yet.

Overall, the track record is very limited. Although the figures to date show signs of promise, EIS investors will not be able to place any real reliance on them yet.

Fees

The fees for the Fund are set out in the table on page 3 and are a mixture of fees payable directly by the investor and by the investee companies. These are straightforward, other than as noted below:

- **Management fee:** The first three years of this will be deducted from the initial payment, with subsequent payments drawn from exit returns on a deal-by-deal basis, subject to a return of at least £1.10 per £1 invested. The fee is payable for the first five years only.

- **Fee variability:** Although there is not a fixed fee, the intention is that fees broadly reflect the effort required. Where different rates are given, it should be expected that smaller investments will pay a higher fee rate, and vice versa.

- **Performance fee:** This is payable at a rate of 20% on gains over £1.10 for each £1 invested. This is calculated on a per company basis. This structure may lead to performance fees being paid when the Fund as a whole has not outperformed.

- **Other costs:** These are for when costs go beyond those normally expected, e.g. extra testing equipment for diligence, and substantial supporting/monitoring expenses, such as travel.

The fees and charges are quoted net of VAT. Where investee companies have sufficient VATable revenue, the VAT can be offset, but where a project is unsuccessful, that may not be the case.

Fundraising targets

The aim is to raise £2m to £5m each year. There are no fixed closing dates, with investors simply participating in the deal flow after the investment into the Fund is made. There may be a closing at the end of the 2018/19 tax year for investors who wish to be invested in this tax year. The number of investee companies is not very dependent on the amount raised.

The minimum subscription is £10,000 per investor.

Fund Manager and Advisor

Sapphire Capital Partners LLP is a fund manager within the Tax Enhanced services market. It provides a wide range of specific Tax Enhanced services. We note that the two partners each won EISA best individual rising star in 2015 and 2016.

The EMVC team has been investing in technology companies since 2014. Until last year, this was through EcoMachines Ventures, but a change of ownership has led to a new company being spun out. To date, it has mostly sourced funds through family wealth offices, and this is its first EIS fund. It is also looking to raise a fund from investors who are not EIS-eligible, who will invest primarily in later rounds than the EIS fund.

People

Dr Ilian Iliev – Founder and MD, EMV Capital Limited

A serial entrepreneur, he founded a business operating in the industrial power electric space in South Africa in 1997. He followed this working as a strategy consultant, and was a Board Advisor to Allen & Overy. In 2006, he co-founded CambridgeIP Ltd, which was sold to a major West Coast player in IP.

Ian Cooke – Venture Partner

Has worked in venture capital and business development in the engineering and environmental sectors, covering a variety of emerging markets in Asia and Africa. A former Director at the Carbon Trust, where he led its investment programme, he has also founded several new ventures.

Boyd Carson – Founder & Managing Partner, Sapphire Capital Partners LLP

Previously worked as a Director of PwC LLP corporate finance in New York. Boyd is a Fellow of the Institute of Chartered Accountants. He also acts as a director for several companies in the UK, and is the honorary treasurer of a leading cancer charity.

Vasiliki Carson – Partner, Sapphire Capital Partners LLP

Having started her career at JPMorgan Chase, Vasiliki moved to PwC LLP before joining Goldman Sachs, where she worked in both New York and Tokyo. She returned to PwC corporate finance, staying there until she left to become a partner in Sapphire Capital. She is a qualified accountant.

The Investment Committee comprises of Dr Ilian Iliev and Ian Cooke. The latter is not an employee of EMVC, but he will get carry in investments on which he works, and it is anticipated that he will spend the majority of his time on the Fund.

EMVC has a small number of staff but, at the time of writing, it is recruiting in anticipation of its growth. In addition to the staff, EMVC has several advisors in place. These will act more like Venture Partners, sourcing potential deals, assisting in due diligence and helping manage investments, where appropriate.

Appendix 1 – due diligence summary

Summary of core due diligence questions		
Manager		**Validated by**
Company	Sapphire Capital Partners LLP	
Founded	2009	Hardman & Co
Type	Limited Liability Partnership	Hardman & Co
Ownership	Two LLP designated members	Hardman & Co
FCA registration	565716	Hardman & Co
Solvency	Yes	Sapphire
EISA member	Yes	Hardman & Co
Advisoe		
Company	EMV Capital Limited	Information Memorandum
Founded	2018	Hardman & Co
Type	Private Limited Company	Hardman & Co
Ownership	Dr Ilian Iliev	Hardman & Co
CRN	11412783	Hardman & Co
FCA registration	820038	Hardman & Co
Solvency	N/A	
EISA member	Yes	Hardman & Co
Fund Custodian		
Company	Mainspring Nominees Limited	Information Memorandum
FCA registration	591814	Hardman & Co

Source: Hardman & Co Research

Regulation

The Fund Manager is Sapphire Capital Partners LLP. It has two LLP designated members: Mr Boyd Carson and Mrs Vasiliki Carson. It was created in 2009, and has its accounts made up to 31 December 2017. The company has confirmed its solvency, and has appropriate investment management permissions from the FCA.

As discussed under *Fund Manager and Advisor* above, EMV Capital is a new company and has not yet be required to submit accounts to Companies House. Its FCA registration is as an appointed representative.

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
Scheme investment	£500,000
VAT is reclaimable by investee companies.	

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

Calculations					
		Hardman & Co standard			Target
Gross return		-50%	0%	50%	119%
Amount (pre-tax relief)		£100,000	£100,000	£100,000	£100,000
Initial fees	**Rate**				
Entry fee	0.75% (excl. VAT)	£900	£900	£900	£900
Management fee (three years deducted)	1.05% (excl. VAT)	£3,780	£3,780	£3,780	£3,780
Total		**£4,680**	**£4,680**	**£4,680**	**£4,680**
Net investment		£96,220	£96,220	£96,220	£96,220
Company charges					
Initial fee	4.0%	£3,849	£3,849	£3,849	£3,849
Annual fee	1.5%	£1,443	£1,443	£1,443	£1,443
Total over 5 years		£8,179	£8,179	£8,179	£8,179
Gross fund after investment return		**£48,110**	**£96,220**	**£144,330**	**£210,722**
Exit fees					
Management fee (years 4 and 5)	1.05% (excl. VAT)	£0	£0	£2,520	£2,520
Performance	20% above £1.10	£0	£0	£6,866	£20,144
Net amount to investor		£48,110	£96,220	£134,944	£188,057
Gain (pre-tax relief)		-£51,890	-£3,780	£34,944	£88,057
Gain (post-tax relief)		-£23,024	£25,086	£63,810	£116,923
Total fees paid		£12,859	£12,859	£22,245	£35,523

Source: Hardman & Co Research
Note: Fund target has been reduced pro-rata for shorter term than target; for variable fees, the midpoint has been assumed
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