BLACKFINCH VENTURES EIS PORTFOLIOS

Blackfinch Investments Limited

	Positives	Issues
Why Invest	**Strategy:** Exposure to a portfolio of technology companies that have achieved product-market fit and are starting to scale up.	**Track record:** As a new fund from a new team within Blackfinch, there is no track record.
The Investment Manager	**Team:** There is a diverse range of experience in the team, with a clear strategy and well-designed processes.	**Team size:** The investment team is small, although the angel network is very active and, overall, is adequate for current activity levels.

Nuts & Bolts

- **Duration:** The Fund is evergreen, with investors participating in transactions on an ongoing basis after investment.
- **Diversification:** The manager expects to provide at least 10 investments to each investor.
- **Valuation:** Usually changes at next financing or on writedown.

Specific Issues

- **Fees:** Combination of direct fees and company charges.
- **Performance fee:** Charged at 20% on aggregate returns over 130% of amount invested in companies on a per company basis.

Risks

- **Target returns:** The target IRR of 3x capital 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 ones will do very well, but those who fail may do so completely.

	Manager information	Contact details

Analyst

Brian Moretta

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Manager information

- ***Scheme assets:*** *£7m*
- ***Scheme target:*** *£20m p.a.*
- ***EIS assets:*** *£50.1m*
- ***Total FUM:*** *£323m*
- ***Scheme launch date:*** *2018*

Contact details

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Factsheet

Blackfinch Ventures EIS Portfolios	
Product name	Blackfinch Ventures EIS Portfolios
Product manager	Blackfinch Investments Limited
Tax eligibility	EIS
Target return	3x capital
Target income	None
Type of product	Discretionary portfolio service
Term	Evergreen
Sectors	Technology
Diversification:	
Number of companies	10+
(Expected) Gini coefficient	0.1

Fees	Amount	Paid by
Initial fees:		
Portfolio establishment fee	3.0% (incl. VAT)	Investor
Closing fee	1.0%	Investee company
External legal fees	ca.£10,000	Investee company
Annual fees:		
Management fee	2% (plus VAT)	Investee company – capped at 4 years
Board fee	£12,000	Investee company
Exit fees:		
Performance fee	20%	Investor – per company basis, 130% threshold

Advisor fee facilitation	Yes
Advisor fee amounts	As agreed with investor
HMRC Approved?	No
Advance Assurance	Yes, for each investment
Reporting	Annual
Minimum investment	£10,000 (advised), £50,000 (non-advised))
Current funds raised	£7m
Fundraising target	£20m p.a.
Closing date(s)	n.a.
Expected exit method	Mostly trade sale

Source: Blackfinch, Hardman & Co Research

Fund aims

Blackfinch Ventures EIS Portfolios is a discretionary portfolio service, which will provide a portfolio of investments in unquoted technology companies. The target return is an average of 3x capital. Returns will be focused on capital gains, and investors are unlikely to receive any dividends. The Fund is evergreen.

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 technology company. Blackfinch aims to have at least 10 companies in each portfolio, with position sizes between 5% and 20%. Although sector diversification is limited, stock-specific risk should dominate market risk.

The target multiple of 3x capital suggests a high risk, and seems appropriate for the strategy.

Sourcing and external oversight

Although Blackfinch is a new operation, much work has been done on establishing sourcing, with technology being cleverly used. The run-rate for potential investments looks adequate, although has not yet been sustained for more than a few months. The Investment Committee contains some experienced, external private equity professionals.

Ongoing support and monitoring

Blackfinch dedicates part of its investment team to supporting and monitoring companies after investment. As well as taking observer rights, an UltraNED is appointed to the board of each investee company. While the Blackfinch team seems to have good understanding of what it intends to do, it is still too early to assess how well this will work in practice.

Exits

With no exits so far, there is no data yet. As is normal for the sector, the primary focus is expected to be trade sales.

Manager

Team

The Blackfinch Ventures team is small, but brings a range of experiences. The head of the team, Dr Reuben Wilcock, has very strong entrepreneurial experience, and is probably a key man. The rest of the team has significant quoted markets experience. Blackfinch does have plans to grow the ventures business, and will recruit as it scales.

Track record

Although Blackfinch has been present in the EIS market for a number of years, the Ventures operation is new and, consequently, has no track record yet, other than a small number of investments.

Regulation

Product

Advance Assurance is sought for each investment.

Manager

The manager of the Fund is Blackfinch Investments Limited. It is FCA registered (number 153860) with appropriate permissions. Submissions to Companies House appear to be up to date.

Risk analysis/commentary

Although Blackfinch is a new entrant into this part of the EIS funds market, it has invested to put an appropriate investment process in place. As well as industry-standard procedures, this is backed up by a smart use of technology. The short history makes it hard to assess how effective these processes are in practice, but the initial impression is good.

Investors do need to be aware that they will be investing risk capital into early-stage technology companies. The use of the UltraNED means that a more specialist director is being added to investee companies, and this takes some of the pressure off the small scale of the existing Blackfinch team. The branding of this is very clever and should be good for the investee companies, although several other managers use a similar concept.

Blackfinch co-invests alongside EIS investors. Although the amounts are small relative to Blackfinch as a whole, it does add to the credibility of the processes being followed.

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. Diversification within the Portfolio is limited, although typical for products in this area. This EIS fund should be considered in the context of an investor's entire portfolio.

Investment process

Deeper dig into process

Blackfinch is looking to invest in technology-focused businesses, with an emphasis on companies where the technology is creating the value. There are two main criteria that Blackfinch uses:

- The first is looking for product-market fit, with evidence of market traction being required. Blackfinch has some flexibility around this, with, for example, successful trials being acceptable in lieu of revenue. Investments of companies at an earlier stage are likely to be complemented by some with demonstrable revenue.
- The second is looking for a strong management team. The decision-making process involves repeated contact with company management, much of which is recorded to allow other members of the team to review as necessary.

The are no sector preferences, with the only desire being to avoid companies in regulated industries. This means, for example, that there will not be many medtech investments.

The targeted stage of development is common among EIS funds, particularly those with a technology focus. While the formal criteria are limited, the team gives a good understanding of what it is looking for in a potential investment.

Sourcing deals

Although the team has a network that it uses for sourcing deals, Blackfinch also takes a very proactive approach to sourcing potential investments. In particular, it tracks accelerators and incubators, looking to approach interesting companies before they require funds and hoping to get preferential access as a consequence.

Use is also made of a research platform, which gives some visibility across the whole market. This tool is used to generate companies that may be proactively approached. Blackfinch also invites applications through its website, *LinkedIn* and other direct approaches, but notes that, as usual, these tend to be of lower quality.

While there is no intention to bring a geographical focus, Blackfinch is finding that its location in Gloucester means that it tends to be more attractive to those outside the South East, but it will invest across the whole country.

Blackfinch believes that it can generate 1,000-2,000 potential leads a year. Run rates since April are in line with this target, although have not been demonstrated over a sustained period yet. At that rate of generation, it seems likely that Blackfinch can source enough investments for the Fund.

Decision-making

Blackfinch has established a seven-stage investment process (although this includes post-investment monitoring). Although the Ventures team is new within Blackfinch, it is clear that significant time and investment have been spent on putting a process in place. Underpinning this is a technology platform that is used to manage all the stages of investment.

Each stage is subject to a pass, hold or progress decision. Holds are for companies that may be of interest, but need to make further progress before being suitable. Daily team meetings are held, at which the pipeline is discussed and decisions for the early stages made.

Prospects are subject to an initial filtering before being added to a long list. This filtering looks at whether the business has a tech focus, is in the right area for pre-money valuation and is EIS-eligible. Companies on the long list have a recorded video conference call with a member of the pipeline team to establish further information, which is collected under standard headings on the system.

Roughly half of the companies progress to a short list. At this stage, areas of concern are addressed, which typically revolve around either the product or sales/customer issues. These usually take the form of two to three recorded video discussions, which also allows Blackfinch to observe the interactions of the management team.

The pitch session seems to be at the heart of the Blackfinch process. Founders are instructed to give a 10-minute pitch, which will be followed by a deep-dive discussion. These are scheduled for 4pm to allow them to run on as long as necessary – often it takes three hours. The whole team is involved at this stage. With Blackfinch aiming to have around 120 of these a year, this part of the process represents a significant commitment of resources. These sessions are recorded to allow review by the team or the investment committee.

These are followed by further investigation of relevant metrics, company performance and financials.

The term sheet stage requires Investment Committee (IC) approval. When issuing term sheets, Blackfinch uses standard documentation, which it has developed internally. The team notes that this documentation is being improved on an ongoing basis.

The due diligence stage covers the usual areas, including technical, team, financial, tax, market and competitor analysis. Philip Hare Associates is used to review EIS eligibility in case anything has changed or been missed in Advance Assurance. For the technical diligence, an expert from Blackfinch's network spends a day at the company, alongside a team member. Where there are co-investors, they are usually engaged with at this stage.

A key part of the Blackfinch approach is the use of UltraNEDs. These are highly experienced people with significant sector, technical or business experience. Initially, Blackfinch looked to bring them in after the investment was made, but it is now involving them at an earlier stage, so that they can assist in the diligence process. Final agreement from the IC is then required to go to the next stage.

Full Form includes any final negotiations, as well as signing papers and making the investment. Blackfinch estimates it can go through the process in four to six weeks, but this depends on the company and diligence required.

Overall, the decision-making process seems well structured, with an unusual systematic use of technology, and satisfies best practices within the sector. The UltraNED addition is not unique, but does complement more standard processes.

Blackfinch aims to be making investments of £0.5m-£1m into companies with pre-money valuations of less than £10m (ideally less than £5m). Generally, it wishes to be leading rounds and have control over the timetable.

The aim is for investors to get exposure to at least 10 companies, although this can be waived if investment within a tax year is required. Blackfinch intends to diversify by both sector and the stage of development of the company. Weightings of individual companies must be between 5% and 20% of the investor's subscription.

In time, the Portfolio may make follow-on investments in existing investee companies. For existing investors, some account will be taken of their pre-existing holding, and a smaller investment may be made to reflect the effect on diversification.

Exits

Exits are expected to be via the usual routes, with trade sales dominating. Blackfinch guides investors to expect four to seven years for realisations.

Governance and monitoring

Advance Assurance is sought from HMRC on all investments prior to completion.

All custody and administration is handled internally by Blackfinch.

A report will be issued to investors once a year, including a valuation and performance update. Each quarter, investors will receive updates on company progress.

As indicated above, Blackfinch will find an UltraNED to take a board position with the company. It is expected that the UltraNEDs will support the company through mentoring and guidance. Although clearly Blackfinch's representative, the former does not delegate its rights to them.

In addition, Blackfinch takes information and observer rights. It expects to receive monthly financial figures, which are compared against those forecast in the company's model. If there is significant deviation, then there will be follow-up with the company. A member of the team attends all the board meetings, usually remotely. These are expected to be the main route of communication, although there is also some ad-hoc contact and direct support.

Blackfinch has developed a standard term sheet for investments. The terms are largely normal for the sector, with one exception: founders are expected to re-vest their shares over the four years after investment is received. This is an interesting way of reaffirming their commitment to the company.

Given the areas in which Blackfinch is investing, it seems likely that many investments will require follow-on funding. There is the intention to do some within the Fund, where good progress has been made and the investment criteria are still satisfied.

Track record

This is a new offering by Blackfinch. Although the company has raised significant funds for other EIS schemes, these were different in nature from the current offering. Consequently, there is no relevant track record yet.

Fees

The fees for the Portfolio are set out in the table on page 3. Most of the fees are straightforward, other than as noted below.

Initial fees

The investee company will bear the external costs of investing, including external legal fees and tax costs. Blackfinch estimates that these will typically be around £10,000, but may vary on an individual basis.

Annual fees

The Management Fee is capped at four years, so nothing is payable from year five onwards.

Board fees are typical for the sector.

Exit fees

The performance fee has a threshold of 130% of the amount invested in each company. Investors should note that this is charged on a per company basis. If any individual investments make a loss, then the effective performance fee on the portfolio as a whole may be higher than the stated rates, and a performance fee may be payable on some investments even if the portfolio as a whole does not make a net gain. The higher threshold does offset this.

Fundraising targets

Blackfinch aims to raise £20m a year. There will be no closes, with investors participating in the subsequent flow of deals until fully invested.

The minimum subscription is £10,000 for clients who are advised, rising to £50,000 for those who are not advised.

Investment manager

Blackfinch Investments Limited started over 25 years ago as Neville James Limited – a market maker in the traded endowment market. For most of the last decade, it has focused on the tax-enhanced market, with a range of EIS, BR and property-related offerings. Having been based in Malvern for many years, it recently moved to Gloucester.

Prior to 2017, Blackfinch's EIS offerings were focused on areas that are no longer eligible. Blackfinch Ventures is a relatively new operation, looking to invest in companies that satisfy the risk-to-capital criteria.

People

Dr Reuben Wilcock – Ventures Director

Having gained a PhD in electronics, he has been a serial entrepreneur. He co-founded Dolphin IP (fabless IP core chip design), Bar Analytics (IoT for liquid dispense monitoring) and MyJoulo (smart energy), and founded Custom Idea (geotagging for Nikon cameras) and Future Worlds (University of Southampton accelerator).

Stuart Tyler-Lloyd – Senior Ventures Manager

Has spent his career in asset management, starting at Lincoln Financial Group, where he rose to Senior Investment Analyst. In 2009, he moved to Zurich Insurance, where he was Head of Securities and Chief Investment Officer.

Pablo Fernández – Ventures Manager

Started his career in Spain, promoting classical music at Fundación Isaac Albéniz, followed by spells at Europark and Yelmo Cineplex. Moved into investment management in 2007 with Morgan Stanley and La Caixa.

Richard Cook – Founder and CEO

Had short spells in banking roles at Merrill Lynch and Bank of New York before founding Blackfinch in 2004. Has been CEO since 2009.

Richard Simmonds – Chief Investment Officer

After spells with Credit Suisse and NFU, moved into projects and corporate finance, with a focus on asset-backed investments. Has been Managing Director of Baldenhall Consulting since 2012, joining Blackfinch as CIO in 2015.

Richard Bucknell – Ventures Investment Committee

Headed up Barclays Ventures Midland office for six years, before joining ISIS Equity Partners, where he led origination for Baronsmead VCT. Was Fund Principal for the Catapult Growth Fund, before becoming Investment Director at Chelverton Asset Management in 2014, where he focuses on private equity.

David Horner – Ventures Investment Committee

Qualified as a Chartered Accountant with Deloitte, followed by positions in 3i Corporate Finance and Strand Partners. Set up Chelverton Asset Management in 1998, where he is still Managing Director and manages various equity funds.

The IC consists of the two independent members indicated above, plus the CEO and CIO. The members have a wide range of experience and bring significant independence to their oversight. Although the investment team within this area at Blackfinch is not large, it is appropriate for the current scale of operations. It is also being expanded in anticipation of future growth.

Appendix 1 – due diligence summary

Summary of core due diligence questions		
Manager	**Blackfinch Investments Limited**	**Validated by**
Founded	1992	Hardman & Co
Type	Private limited company	Hardman & Co
Ownership	Blackfinch Group Limited	Hardman & Co
FCA Registration	Yes – 153860	Hardman & Co
Solvency	Confirmed	Hardman & Co
EISA member	Yes	Hardman & Co
Administrator		
Company	Blackfinch Investment Limited	Information Memorandum
FCA Registration	Yes – 153860	Hardman & Co
Fund Custodian		
Company	Blackfinch Investment Limited	
FCA Registration	Yes – 153860	Hardman & Co

Source: Hardman & Co Research

Blackfinch Investments Limited was started as Neville James Limited. It has had two other name changes – AVD Wealth Limited (2010) and Blackfinch Investment Solutions (2013) – before taking its current name in 2015.

The manager of the Fund is Blackfinch Investments Limited. It is FCA registered with appropriate permissions for both investment management and custodian operations. The last accounts (31 October 2018) had total equity of £1.78m, which is ample capital.

The ultimate parent of Blackfinch Investments Limited is BF Inter Limited. This is majority- owned by Richard Cook, with Richard Simmonds also holding a significant interest. There are another three smaller, related, shareholdings.

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	£750,000
VAT on company fees is offset against revenue	

Source: Hardman & Co Research

Calculations					
		Hardman & Co standard			Target
Gross return		-50%	0%	50%	200%
Amount (pre-tax relief)		£100,000	£100,000	£100,000	£100,000
Initial fees – from investor	Rate				
Portfolio establishment fee	3.00%	£3,000	£3,000	£3,000	£3,000
Initial fees – from company					
Closing fee	1.00%	£970	£970	£970	£970
External legal and other costs	£10,000 per company	£1,293	£1,293	£1,293	£1,293
Total		£5,263	£5,263	£5,263	£5,263
Annual fees					
Net investment		£97,000	£97,000	£97,000	£97,000
Annual fees – from company					
Annual management fee	2% (max 4 years)	£7,760	£7,760	£7,760	£7,760
Directors' fees	£12,000 per company	£7,760	£7,760	£7,760	£7,760
Gross fund after investment return		£48,500	£97,000	£145,500	£291,000
Exit fees					
Performance	20% over 130%	£0	£0	£3,880	£32,980
Net amount to investor		£48,500	£97,000	£141,620	£258,020
Gain (pre-tax relief)		-£51,500	-£3,000	£41,620	£158,020
Gain (post-tax relief)		-£22,400	£26,100	£70,720	£187,120
Total fees to manager		£20,783	£20,783	£24,663	£53,763

Source: Hardman & Co Research
Notes: post-tax relief figures assume initial income tax relief only; other reliefs may be available to investors

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