NEXUS INVESTMENTS' SCALE-UP FUND

Nexus Investment Management Limited

	Positives	Issues
Why Invest	▶ **Strategy:** To fund fast-growth companies in data, digital, education and healthcare, which have existing products, and support them in scaling up.	▶ **Track record:** No exits to date from the current set-up, but the unrealised figures show some promise. Nexus Group has had exits from earlier investments.
The Investment Manager	▶ **Team:** The team has broad experience in corporate finance, tax and accounting, as well as investment. The Nexus Group also manages a £2.3bn healthcare REIT.	▶ **Small team:** The team is small, and is dependent on a couple of key people, although it is part of the much larger Nexus Group.

Nuts & Bolts

- **Duration:** The fund is expected to have a lifespan of up to eight years, with closings as required.
- **Diversification:** The manager expects to provide each investor with 8 to 10 EIS investments, although that range may be exceeded.
- **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:** The target return is 2.5x capital, which 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.

Manager information

Analyst

Brian Moretta

0207 194 7622

bm@hardmanandco.com

- ***Scheme assets:*** *£1.7m*
- ***Scheme target:*** *£10m*
- ***EIS assets raised:*** *£10.1m*
- ***Total FUM:*** *£2.3bn*
- ***Fund launch date:*** *2018*

Contact:

Matthew O'Kane, MD
0207 104 2059
Matthew.O'Kane@nexusgroup.co.uk

Cameron Kavanagh, Investment Associate
0207 104 2068
Cameron.Kavanagh@nexusgroup.co.uk

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 Ventures Limited
Tax eligibility		EIS (SEIS in limited circumstances)
Target return		2.5x capital
Target income		None
Type of product		Alternative Investment Fund
Term		Up to eight 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	Up to £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, unless one available for recent round
Reporting	Reports every six months
Expected exit method	Expected mostly via trade or other sale
Fundraising:	
Minimum investment	£25,000
Current funds raised	£1.7m
Fundraising target	£10m
Closing date(s)	Regular closings

Source: Nexus Investment Management, Hardman & Co Research

Fund aims

Nexus Investments' Scale-Up Fund (NISUF) is an Alternative Investment Fund, which will build a portfolio of EIS investments in unquoted companies in data, digital, education and health. The target return is 2.5x capital. Returns will be focused on capital gains, and investors are unlikely to receive any dividends. The fund is expected to have a lifespan of up to eight years, 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 that range may be exceeded. Despite sector diversification being limited, stock-specific risk should dominate market risk.

The target return of 2.5x capital seems appropriate for the strategy, which suggests high-risk individual investments.

Sourcing and external oversight

Although the fund is only a year-old, Nexus has been making venture investments in EIS-eligible companies for five 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 members are external, with only those from Nexus 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. In practice, board positions are taken about half the time. The Investment Committee adds to the team's capability, although its involvement has been limited so far.

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 73 investments into 22 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. At the time of writing, one investment was in discussions that seem likely to lead to a partial exit. There have been a couple of exits from corporate investments made prior to the current team set-up being in place.

Regulation

Product

Advance Assurance is sought for each investment, unless one is available from a recent round.

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 only a year-old, 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 six 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 has experience in supporting these companies, with the addition of the members of the Investment Committee extending 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 (NIML) 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 the £2.3bn 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 invested £275,000 into the fund.

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.

Nexus links some of these sectors to core attributes that it finds attractive. It likes platform companies for their scalability; it also likes data and technology companies that are defensible, and food and drink companies that are diversifiable. Although Nexus is looking at UK companies, the latter should be internationally aware and ambitious to expand at the appropriate time.

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 managers. It also looks for a continued ability to compete – whether through product leadership in the area or some kind of IP.

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

- **People:** Nexus is looking particularly for "mission-driven" founders – the team expresses a very strong preference for these 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 rejects 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 digital companies, as these are easier to scale than many other businesses.

Although the Nexus Group would seem to have natural strengths in education and health, the majority of investments since 2014 have been in the data and, particularly, digital sectors. In practice, the exposure to each sector will be determined largely 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 – although 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. To date, the fund has only invested in three of the ten possible follow-on fundings.

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 investments 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. In the first 11 months, the fund made eight investments, further supporting this. If the deal flow continues to increase, then a higher number of investments could be sourced.

Decision-making

Nexus has put together a decision-making process for the fund that is a little different from what it did before it was created. This has been developed 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 Principals and the Investment Associates. At this stage, the emphasis is on whether the company fits within the remit of the fund, primarily using the criteria outlined above. 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, the company is short-listed and an investment paper is prepared for the Investment Committee. The members will know of the pipeline roughly one week before a meeting, giving them a chance to check with their own network before reviewing the proposal in detail.

Nexus has put a process in place to optimise the involvement of the members of the Investment Committee, with the intention of directly adding value to investments. This is still work in progress and, so far, there have only been a couple of instances. Nevertheless, this adds to the capability of the small team.

The overall figures that Nexus gives average four to five investments in new companies 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, unless the company is in receipt of EIS certificates from a recent round.

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. 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. Investors in the first tranche have already received exposure to each of the four areas of focus.

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

In addition to the written reporting, Nexus holds capital days for investors (the first was in July 2019), where they can meet the managements of investee companies and get direct updates on progress.

Nexus looks to take a board position in investee companies, although it expects that, in some cases, this can be a monitoring role, especially where a board already has appropriate directors. To date, only one member of the Nexus team (Matthew O'Kane) has taken a full board or advisory board position in a majority of the investee companies. Since the fund started, board positions have been taken in exactly half. 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 one if its particular strengths, 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 and international venture capital firms. 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 expected lifespan for the fund of up to eight years, it is clear that Nexus is investing for the longer term. While Nexus expects to start to achieve exits and return cash after five years or so, it is possible that not all companies will achieve exits within the eight-year term. 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 EIS investments since 2014, the Nexus team can only express expectations. As is normal for these investment areas, trade sales should be the most common exit route for successful companies, although other options will be considered. The possible partial exit described in the next section is a secondary sale. 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 yet if this will be significant.

Track record

Although the fund has only been open since 2018, 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 73 investments into 22 companies, with an aggregate investment of £8.4m. 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 July 2019. As of that date, no exits had been achieved, although, at the time of writing, discussions were in progress for a partial exit. It is anticipated that the latter may allow early investors, but not later ones, to receive a 4.75 multiple. This lack of exits 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 22 companies, three have been written down to zero, eight are valued at the entry price and 11 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 1.60x.

The Nexus Group has also made investments prior to 2014 that were EIS-eligible for other investors. Since early 2018, it has exited a couple of these at healthy multiples. Given the changes in the team and limited data available on other investments, these are supportive, but investors should not attach too much weight to them.

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 is 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 deferred and only paid from subsequent realisations.

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

The IM allows companies to be charged a director's fee and a monitoring fee. In practice, where Nexus appoints a director, there has been a single fee agreed to cover the director's time and input at board meetings, as well as monitoring work. Where there is no director from Nexus, a monitoring fee is still agreed and is often 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. To date, none have been charged.

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. Closes could be up to monthly (four to date), and investors participate in deals after the close of that tranche. The intention is for capital to be invested within two years of the close of each tranche, with the hope being that this can be done more quickly, although neither is guaranteed. Eleven months after the first tranche closes, 80% of those funds are invested. Investments may be spread across multiple tax years. The target is for £10m to be raised.

We note that, for the investments made prior to the fund, over 75 individuals have co-invested over £8m. This suggests that, although this is the first fund from Nexus, it already has fundraising capability.

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 Limited (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 £2.3bn UK REIT that invests in primary healthcare premises. It was also the manager of another, smaller, educational property fund – which was sold in May 2017.

Other group 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 worked at Baltic plc, where he was Finance Director and Deputy MD, and at PwC.

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.

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.

Keith Mansfield – Investment Committee

Another Chartered Accountant, he was a Partner at PwC for over 20 years. He has been advising companies, and been involved in transactions and IPOs across a number of territories.

The Investment Committee consists of the above. The members of the committee seem to bring a variety of backgrounds and areas of experience.

As well as the Managing Director, there are two Investment Associates, an intern and two experienced corporate financiers in the dedicated team.

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	Hardman & Co
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, in turn, is owned by Nexus Tradeco Holdings Ltd. This is 100%-owned by Harry Hyman. The last accounts for NIML are dated 31 December 2018, and these show £140,000 of capital, which is well in excess of its 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, if required.

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

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

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(Disclaimer Version 8 – Effective from August 2018)

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Member of
eisa
enterprise investment scheme association

www.hardmanandco.com

35 New Broad Street
London
EC2M 1NH

+44(0)20 7194 7622

taxenhancedservices@hardmanandco.com