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# HAATCH VENTURES ENTERPRISE INVESTMENT FUND

## Haatch Ventures/The Fund Incubator

| | Positives | Issues |
|---|---|---|
| **Why Invest** | ▶ **Strategy:** Exposure to a small portfolio of digitally-enabled companies focused on the team's areas of experience. | ▶ **Track record:** Only a small number of exits to date, mostly predating the EIS fund, but the results so far look promising. |
| **The Investment Manager** | ▶ **Team:** The team brings very strong entrepreneurial experience, having started, grown and sold several businesses. | ▶ **Company size:** The Haatch team is small, and this may act as a slight constraint if the company grows. |

### Nuts & Bolts

- **Duration:** The fund is evergreen, with a target of bi-annual closes, or whenever sufficient funds are raised.
- **Diversification:** The manager expects to provide four to six investments for each closing, with deployment within 18 months.
- **Valuation:** Usually changes at next financing, or on writedown.

### Specific Issues

- **Fees:** Combination of direct fees and company charges.
- **Performance fee:** Charged at 25% on aggregate returns between 1x and 5x, and 30% on returns thereafter.

### Risks

- **Target returns:** The target return of 10x suggests a high-risk investment strategy.
- **Companies:** Supplying risk capital to early-stage, digitally-enabled 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.

| | Adviser information | Contact details |
|---|---|---|
| | | |

### Analyst

*Brian Moretta*

0207 194 7622

bm@hardmanandco.com

- ***Scheme assets:*** *£2.4m*
- ***Scheme target:*** *£0.5m per close*
- ***EIS assets:*** *£2.4m*
- ***Total FUM:*** *£3.4m*
- ***Launch date:*** *2018*

***Co-founders and partners:***
*Scott Weavers-Wright, Fred Soneya*

***Contact:***
*Fred Soneya*
*+44 (0)1780 408 487*
*fred@haatch.com*

Disclaimer: Attention of readers is drawn to important disclaimers printed at the end of this document

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# Factsheet

| Haatch Ventures Enterprise Investment Fund | |
|---|---|
| Product name | Haatch Ventures Enterprise Investment Fund |
| Product manager | The Fund Incubator |
| Due diligence advisor | Haatch Ventures LLP |
| Tax eligibility | SEIS/EIS |
| Target return | 10x blended return on investment |
| Target income | None |
| Type of product | Unapproved collective EIS portfolio |
| Term | Evergreen |
| Sectors | Technology |
| **Diversification:** | |
| Number of companies | 4-6 |
| (Expected) Gini coefficient | 0.25-0.17 |

| Fees | Amount | Paid by |
|---|---|---|
| **Initial fees:** | | |
| Management fee | 10% (incl. VAT) | Investor |
| **Annual fees:** | | |
| Monitoring fee | Average £650 per month | Investee company |
| **Exit fees:** | | |
| Performance fee | 25%/30% | Investor – for each company see *Fees* for details |

| | |
|---|---|
| Advisor fee facilitation | Yes |
| Advisor fee amounts | As agreed with investor |
| HMRC Approved | No |
| Advance Assurance | Yes, for each investment |
| Reporting | Quarterly |
| Minimum investment | £5,000 |
| Current funds raised | £2.4m |
| Fundraising target | £0.5m for each close |
| Closing date(s) | Half-yearly or when sufficient funds raised |
| Expected exit method | Mostly trade sale |

*Source: Haatch, Hardman & Co Research*

# Fund aims

The Haatch Ventures Enterprise Investment Fund is an unapproved collective EIS portfolio, which will provide a portfolio of investments in unquoted early-stage companies. The target return is 10x the capital invested. 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, digitally-enabled company. Haatch aims to have four to six companies in each portfolio, with roughly equal size positions. Although sector diversification is limited, stock-specific risk should dominate market risk.

The target return of 10x capital suggests a high-risk strategy, and is one of the higher targets in the sector.

### *Sourcing and external oversight*

Haatch has worked hard to establish an investment pipeline. The figures for approaches and attrition rates suggest it should be adequate to provide the target number of investments. In 2019, four new investments were made, suggesting sourcing is on track.

The diligence process involves one partner sponsoring an investment early in the investment process, with the Investment Committee including one of The Fund Incubator team.

### *Ongoing support and monitoring*

The Haatch team places great emphasis on its post-investment support to investee companies. A corporate director position allows the most appropriate member of the team to attend board meetings. There will be regular ongoing contact, with a combination of mentoring and solving of specific problems to the fore.

### *Exits*

With a limited track record to date, the expectation is that, as per sector norms, successful exits will rely on 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*

The four Haatch partners have strong entrepreneurial experience, having started, grown and exited businesses. The team is small, but adequate for the current size of operations. If the company is successful, then further additions may be required in due course.

### *Track record*

Since 2013, the Haatch team has invested almost £2.3m into 13 companies. Of these, four were recent fund investments, with the balance under the team's angel activities. There has been one successful exit, with a spectacular multiple of 270x, and three complete failures. The multiple for all realised and unrealised gains is 7.6x investment. While the number of exits remains small, this shows good signs of promise.

## Regulation

### *Product*

Advance Assurance is sought for each investment.

### *Manager*

The manager of the fund is The Fund Incubator Limited. It is FCA-registered (number 208716), with fund management permissions. Submissions to Companies House appear to be up to date. The fund advisor, Haatch Ventures LLP, is not FCA-registered at the time of writing, but is in the approval process, and will become the manager of the fund.

# Risk analysis/commentary

Although Haatch is a new entrant to the EIS fund space, the team has been investing for a while and brings a broad range of relevant knowledge. The return targets for the fund are a little more aggressive than many other managers in this area. The focus is very much on finding companies that have the potential to bring big returns. Although the track record suggests the team can do this, the former is limited, and the targets may have the effect of raising the risk profile too.

Investors will be investing risk-capital into very early-stage businesses. The team looks to provide appropriate support, and the bias towards areas with which it is familiar should help with risk mitigation. Haatch sensibly guides investors towards expecting five- to ten-year holding times.

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 fund 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

Haatch looks to provide investors with a small portfolio of investments in digitally-enabled companies. Historically, investments have been biased towards retail technology and B2B SaaS, which was the main area of expertise of the two founders, but, with recent recruits, the company is looking to invest in a wider range of areas. Indicated areas of interest include smart devices, AI, on-demand services and blockchain.

Investments will be in early-stage companies, with the Haatch team focusing on companies that have a minimum-viable product and have started to get some market traction – a favoured entry point for many EIS funds. Haatch intends to be either the first external funding ("Initial Seed") or first institutional round ("Seed"), possibly as part of a round that is syndicated.

The technology needs to be disruptive and scalable. The team believes, reasonably, that both of these are needed to give the best chance of producing outsized returns.

A lot of emphasis is also placed on the management team and the product, these being areas where the Haatch team feels it has particular strengths through its experience. Its view of products is very much looking from a customer perspective.

### *Sourcing deals*

Haatch has established itself well enough that it no longer needs to actively market for deal flow, instead relying on inbound sources. Perhaps the highest quality comes from existing portfolio founders. Although Haatch does not have a very large historical portfolio, this accounts for roughly 25% of total opportunities that it sees.

The Haatch team has also worked on getting good relationships with several accelerators and incubators. This allows them to get access to companies before the end-of-programme pitch days. These companies tend to be more in the seed category for Haatch.

Referrals are also coming in from the larger VC firms with which the team has worked on later funding rounds. These tend to be companies that have come in through the VC's own deal flow, but do not fit their mandate, such as by being too early-stage. The existing investor base, which is predominantly entrepreneurs or C-suite executives, also brings deals. The team also has a presence on many angel platforms, although these are often not ready for Haatch investment, so are monitored until they are ready.

As is normal for any EIS manager, there is also a fair amount of cold approaches. One of the founders, Scott Weavers-Wright, has a reasonably high profile within his area, which is helpful for attracting deals that are within the team's expertise. However, as usual, cold approaches are more quantity than quality.

In geographical terms, Haatch has no preferences. In practice, the majority of historical deals have been in London and the south-east, and a similar profile in the future seems likely.

The team estimates that the rate of new inbound deals is approaching 100 per month. Even allowing for usual industry attrition rates, there would seem to be sufficient for Haatch to achieve its target of four to six investments within 18 months of closing. The sourcing of four investments in 2019 gives further encouragement that the target is achievable.

### *Decision-making*

In broad terms, Haatch's decision-making process is similar to that of most mainstream EIS managers.

The first step for new opportunities is the application of some simple filters. Haatch is reasonably strict at this stage, with about half going to the next step, which is a half-hour conversation with a Haatch partner.

The partners have a weekly pipeline meeting at which opportunities that have progressed past the first two steps are discussed at a high level. If there is agreement to pursue it further, then usually a partner will act as that company's sponsor. He will do further work, returning to the pipeline meeting a couple of weeks later.

If this proves satisfactory, then the full team gets involved in a deeper due diligence process. This has two stages, with the focus at this stage on the business and technology aspects. The Haatch team highlights its strong experience in the latter, having done the same earlier in their careers. This includes getting into the architecture of the code or underlying technology. There is a lot of emphasis on the technology being ready to scale-up.

Within the diligence process, Haatch uses a "Deal Matrix" to assess its deals. Companies are scored on each, although the aim is more to assess opportunities in a systematic way, rather than turn selection into a quant process. Not every element in the matrix is given equal weight, either, with the team being given greater emphasis. In particular, Haatch will not invest in companies with a single founder, having had bad experiences with these in the past.

Having completed this stage, a term sheet will be issued. This is a relatively simple document, being a standard format and 1.5 pages-long. The terms are mostly standard, although Haatch emphasises two elements. The first is that founders will have to re-vest their shares over four to five years. The second is carving out an option pool for the early members of the team.

Acceptance leads to an Investment Committee meeting, and full legal diligence. The latter is always done by the same legal firm, which also produces the documentation for the deal. The shortest time a deal has taken is three months from first approach, but, sometimes, it may be 12 months to 18 months after first contact.

To help ensure the paperwork is done properly, Haatch now supervises all the EIS3 certificates being produced electronically and ensures the Companies House filings are completed.

The Information Memorandum anticipates that the fund will invest in a mixture of SEIS and EIS deals, with "Initial Seed" tending to be the former, and "Seed" the latter. Haatch sets no targets, but notes that 80% of deals to date have been Seed and EIS-qualifying.

There may be follow-on investments in existing portfolio companies. The expectation is that almost all investments will require further funding rounds, with the dilution effect that usually accompanies that. Haatch funds may participate but, given the stages of investment on which the funds are focused, only the first couple of subsequent rounds may fit the investment criteria.

### *Exits*

With limited exits to date, the majority are expected follow industry norms and to come through trade sales. Haatch guides that realisations will take five to ten years, although it will start working towards that after the three-year minimum holding time. This includes supporting the company in making itself deal-ready, so that any diligence process can run smoothly. This guidance seems sensible, given the early stage at which investments will be made.

Haatch has set a demanding target return of 10x the initial investment, with ambitions to beat this. The team is clearly aiming for high-return investments, and investors should set their risk expectations similarly.

# Governance and monitoring

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

All client assets, including shares and cash, are held by the Mainspring Nominees Limited (FCA registered – no 591814), which is the Administrator for the fund. We note that the custodian was previously Reyker Securities.

Reporting is expected to take place on a quarterly basis, including a statement of ownership and a management report on each investee company. Valuation movements will only be given when a company is valued by a third party, e.g. a follow-on fundraise, or when written down.

Haatch will take a corporate board position in every investee company, including rights to a board seat, board observer seat and information rights. The corporate seat allows the attendee to be the most appropriate person for the issues being discussed at the meeting.

In the early-stage companies in which Haatch will be mostly investing, the expectation is that board meetings will be largely informal initially, with increased formality as it progresses towards a series A round.

The Haatch team stresses that the focus will be on ongoing contact, with a mixture of mentoring and problem-solving to the fore. It places a lot of emphasis on the first meeting after investment, where there is an opportunity from sitting on opposite sides of the table to a cooperative relationship. A 90-day plan is also put in place, and a Slack channel is used to allow easy access in both directions.

In practice, the team works with company management as much or as little as is needed. There is some persuasion of those who are less pro-active: some founders know what they need, while others need some education.

The expectation is that the board relationship will be a long-term one, with the belief that the value that Haatch will add makes it less likely it will leave when later funders come in. While this will be an endorsement of its ability to support companies, it may require expanded resources as the portfolio grows.

There is a small potential for conflicts of interest, where companies funded through Haatch Angels may seek further funding. We understand that, if this happens, then the members of the team that were not involved in the predecessor will take the lead on any transaction.

# Track record

The Haatch team has invested £1.1m into five companies since the founding of Haatch Ventures, and another £1.12m into 11 companies as earlier angel investments. Of these, four were EIS- or SEIS-eligible, with several of the others being overseas companies.

The four fund investments were all made in 2019. One of these has had subsequent funding at a 2.7x uplift, while the others are unchanged. Given it is less than a year since investment, little movement would be expected.

Of the earlier ventures, three have been failures, and one was a huge exit – Elevaate. A member of the Haatch team had an executive role in the latter, making it slightly unconventional for an angel investment. Of the active angel investments, all five that are more than a year old are showing significant uplifts, based on subsequent funding rounds. The total unrealised and realised multiple across all investments is 5.9x. Excluding Elevaate, this still gives a healthy 2.1x, albeit as yet unrealised.

Given that the Haatch team has only been investing since 2013, a limited number of exits is to be expected. Although the data are limited, they show good signs of promise.

# Fees

The fees for the fund are set out in the table on page 3. The fees are straightforward, other than as noted.

### *Annual fees*

Haatch will charge a monthly monitoring fee to companies. The team notes that this tends to cease when later funding rounds come in.

### *Exit fees*

The performance fee is tiered, with a rate of 25% on profits between 1x and 5x investment, and 30% on profits above a 5x return. The performance fee is calculated on a per company basis, which could lead to performance fees being paid when the fund has not made a profit.

## Fundraising targets

The fund is evergreen, with a minimum target for each close of £500,000. The fund will initially have two closes a year, but Haatch hopes to move to quarterly closes over time.

The minimum subscription is £5,000 – a lower-than-usual limit for EIS funds.

The intention is to deploy funds within 18 months of receipt. This will mean that some tranches overlap, with allocations between different tranches based on a formula.

# Investment manager

Haatch Ventures rose out of the angel investing activities of the two founders, which took place under the Haatch Angels brand. The team is now focused on EIS fund investing and not seeking any further angel investments, although some may arise in companies that are not EIS-eligible. All of the team has invested into the fund.

## People

*Scott Weavers-Wright – Co-founder and Partner*

A serial entrepreneur, he has founded, grown and sold two business. Kiddicare.com was an e-commerce business that was developed over 14 years, before being sold to Morrisons for £70m. Elevaate enabled better supplier monetisation programmes for online retailers, and was sold after four years for 276x. He started Haatch, and has been angel-investing since 2013.

*Fred Soneya – Co-founder and Partner*

Started his career at Kiddicare, where he delivered several technology projects, continuing in the same role after the acquisition by Morrisons. Since leaving the latter in 2013, he has been angel-investing with Haatch.

*Simon Penson – Partner*

Another serial entrepreneur, his first company, Net Create, developed niche affiliate sites. He also edited a couple of magazines, before founding Zazzle Media, a content marketing agency, in 2009. This merged in 2015, before being bought in 2016 by IPG Mediabrands. He joined Haatch full-time in 2018.

*Mark Bennett – Partner*

Has had a varied career. He had commercial roles in the music industry with EMI and Warner Music, before becoming Head of Digital at HMV UK in 2004. Following a spell with Microsoft, he took senior roles in developing digital music and other services at Sainsbury and Tesco. Since 2015, he has been at Google, with director roles in Google Play, and he currently heads up hardware partnerships. He will be averaging about a day a week with Haatch.

The Investment Committee consists of the Partners, plus one of the Fund Incubator team. The team brings very strong entrepreneurial knowledge, with particular experience across a variety of digital businesses. With a relatively small number of investments, the team size should be adequate for the foreseeable future, but, if successful, then some expansion may be required.

# Appendix 1 – due diligence summary

| Summary of core due diligence questions | | |
|---|---|---|
| **Manager** | **The Fund Incubator Limited** | **Validated by** |
| Founded | 2001 | Hardman & Co |
| Type | Private limited company | Hardman & Co |
| Ownership | Four shareholders | Hardman & Co |
| FCA Registration | Yes – 208716 | Hardman & Co |
| Solvency | Confirmed | Hardman & Co |
| EISA member | No | Hardman & Co |
| | | |
| **Due diligence** | **Haatch Ventures LLP** | |
| Founded | 2018 | Hardman & Co |
| Type | Limited liability partnership | Hardman & Co |
| Ownership | Four partners | Hardman & Co |
| FCA Registration | No | Hardman & Co |
| Solvency | n/a | Hardman & Co |
| EISA member | Yes | Hardman & Co |
| | | |
| **Fund Custodian** | | |
| Company | Mainspring Nominees Limited | |
| FCA Registration | Yes – 591814 | Hardman & Co |

*Source: Hardman & Co Research*

The manager of the fund is The Fund Incubator Limited. It is FCA-registered, with fund management permissions. At the last accounts (31 March 2019), it had just over £110,000 of shareholders' funds, which should provide adequate capital. Of its four shareholders, none has a majority holding, but Barry Lawson and Stephen Geddes are listed persons with significant control.

Haatch Ventures LLP has four members, who are listed on the preceding page.

We understand that FCA authorisation will be coming shortly, after the date of this report. This will lead to Haatch becoming the fund manager, with The Fund Incubator continuing to supply compliance support. The latest Haatch accounts (30 April 2019) showed a deficit of £6,781 for members' interests. Moving forward, it will have a capital requirement of £5,000 and intend to maintain at least this level of capital moving forward.

# 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 | £200,000 |
| VAT on company fees is offset against revenue | |
| Monitoring fee payable for three years | |

*Source: Hardman & Co Research*

| Calculations | | | | | |
|---|---|---|---|---|---|
| | | Hardman & Co standard | | | Target |
| **Gross return** | | **-50%** | **0%** | **50%** | **1000%** |
| **Amount (pre-tax relief)** | | **£100,000** | **£100,000** | **£100,000** | **£100,000** |
| **Initial fees** | **Rate** | | | | |
| Management | 10.0% | £10,000 | £10,000 | £10,000 | £10,000 |
| **Net investment** | | **£90,000** | **£90,000** | **£90,000** | **£90,000** |
| **Annual fees – from company** | | | | | |
| Monitoring fee | £650 pm | £11,700 | £11,700 | £11,700 | £11,700 |
| **Gross fund after investment return** | | **£45,000** | **£90,000** | **£135,000** | **£990,000** |
| **Exit fees** | | | | | |
| Performance | 25%/30% | £0 | £0 | £8,750 | £247,000 |
| Net amount to investor | | £45,000 | £90,000 | £126,250 | £723,000 |
| Gain (pre-tax relief) | | -£55,000 | -£10,000 | £26,250 | £623,000 |
| Gain (post-tax relief) | | -£28,000 | £17,000 | £53,250 | £650,000 |
| Total fees to manager | | £21,700 | £21,700 | £30,450 | £288,700 |

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

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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