Arie Capital Technology EIS

Arie Tech LLP / Sapphire Capital Partners LLP

Summary

The fund's investment strategy is to invest in a portfolio of EIS qualifying technology companies, with a particular emphasis on fintech, mobile applications, big data, the internet of things and medical technology.

	Positives	Issues
Why Invest	**Strategy:** Exposure to a portfolio of technology companies using proven technology with an emphasis on B2B areas.	**Past performance:** The fund is new and has no past performance, though we note that the team has two exits from other investments.
The Investment Advisor	**Team:** Through Arie Capital, they have significant experience of the technology market and an established infrastructure.	**Track record:** Although they have extensive experience of alternative investments, including media EIS and a single company tech EIS, this is their first tech EIS fund.

Nuts & Bolts

- **Offer period:** The first closing date will be 23 March 2018, or earlier if required.
- **Diversification:** The aim is to invest in 4 or more companies.
- **Valuation:** There will be little or no change in the valuation except at further fundings, and investors will receive regular updates on progress.

Specific Issues

- **Fees:** Mixture of direct fees and charged via the investee companies.
- **Performance fee:** Subject to a threshold of £1.35 for each £1 invested on a per company basis. Above this, the Fund receives 20% of the investor share of the return.

Advisor information

Scheme assets	£0m
Scheme target	£10m
EIS assets	£5m
Total FUM	£510m
Launch date	2017

Risks

- **Target returns:** The target return of doubling invested capital over five years suggests a higher risk strategy within the EIS area and is appropriate for the strategy.
- **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.

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Factsheet

Arie Capital Technology EIS	
Product name	Arie Capital Technology EIS
Product manager	Sapphire Capital Partners LLP
Company mentor	Arie Tech LLP
Tax eligibility	EIS
Target return	£2 for every £1 invested after 5 years
Target income	None
Type of product	Discretionary portfolio service
Term	3-5 years
Sectors	Technology
Diversification:	
Number of companies	At least 4
(Expected) Gini coefficient	Up to 0.25

Fees	Amount	Paid by
Initial fees:		
Initial fee	2.50% (excl VAT)	Investor
Arrangement fee	Up to 5.00% (excl VAT)	Investee company
Annual fees:		
Annual fee	Higher of £6,000 or 1.5% (excl VAT) per year	Investee company
Exit fees:		
Performance fee	20%	Investor share of proceeds over £1.35 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	6 monthly
Minimum investment	£10,000
Current funds raised	£0m
Fundraising target	£10m in current financial year
Closing date(s)	23 March 2018, or earlier as required
Expected exit method	IPO / trade sale or other exit opportunity

Source: Sapphire Capital Partners LLP, Hardman & Co research

Fund Aims

Arie Capital Technology EIS is a discretionary portfolio service which will invest in at least four technology companies. The target return is a return of £2 for each £1 invested over 5 years. Returns will be focussed on capital gains and investors are unlikely to receive any dividends. The fund is primarily aimed at the current tax year, but some investments may take place in 2018/19.

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

- **Fund Manager:** Sapphire Capital Partners LLP, who do fund management and compliance.
- **Company Mentor:** Arie Tech LLP who source and manage the projects.

The fund will also receive advice and services from Taurus Asset Finance, which is linked to Arie Tech.

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 4 or more companies. There is no target for sector diversification, but each investment will be expected to perform independently of the others.

The target return of 2x return over five 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 which has been built up for Arie Capital. This may include exposure to Israeli technology licensed to investee companies for sale in the UK.

Ongoing Support and Monitoring

The focus will be on good corporate governance and helping the company reach the next stopping point, which generally will be the next funding round. Arie Capital may be able to help with future funding needs from its own funds.

Each investee company will have a director representing the fund and with a regular flow of management information to Arie.

Exits

The intention is that exits will come through trade sales or other normal exit routes, though there may be scope for Arie Capital to be involved.

Manager / Mentor

Team

The Arie Capital and Taurus team are experienced in the investment world. There is a team in place for Arie Capital which will be able to provide support for the new fund.

Track Record

As a new fund, Arie Capital Technology EIS does not have any track record, though the people behind it are experienced in the technology sector. Arie Capital was founded in 2013 and does not yet have a meaningful track record for exits, with one achieved to date. Taurus has also achieved an exit from its technology investments.

Regulation

Product

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

Manager

The Fund Operator of the Fund 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.

Arie Capital is not FCA registered.

Risk Analysis / Commentary

Although the Fund is new in the EIS space, the principals bring experience of and contacts in the Israeli, UK and Chinese technology markets in particular, but also elsewhere. The involvement in Arie Capital suggests they can raise and deploy capital, albeit there are no performance figures yet. The Arie/Taurus team have also managed investments in property, technology and media, including film and television EIS and single company technology EIS.

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, though the aim of achieving fast fails may minimise their impact. Individual investments, as is normal in the technology area, may be high risk.

The expected diversification within the product may be limited, particularly at the lower end of the target number of investments. 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 Arie Capital Technology EIS will look to invest in technology companies focussed in several areas:

- Fintech and other web based technologies;
- Smart phone applications;
- Big data and the internet of things;
- Medical technologies, most notably linked to smartphones and connected devices;
- Consumer and industrial electronics.

Within these the bias is very much towards B2B markets rather than consumer ones.

There are several criteria which potential investments are expected to satisfy. The primary one is that the investee company must have some sort of asset base or technology in place. The fund intends to fund technologies that are ready for market, not at the R&D stage. Arie indicate that they are willing to consider technology that isn't perfect, but it must be working.

The technology should also be innovative, which has the advantage of reducing potential competition but can also lead to challenges in establishing a new market. It must also give some sort of barrier to entry, whether that is via IP or have market agreements in place.

A suitable management team is also seen as critical, with a 'no jerks' policy being in place.

There are several other criteria that Arie cite:

- Must have a route to market, whether already being revenue producing or have an agreeable sales plan.
- Licensing agreement in place for any technology being used.
- A licensing company capable of giving appropriate support.
- Patents and/or other IP protection.
- A satisfactory business plan, which should be simple and credible to implement.

Hardman & Co note that these criteria are sensible and have much in common with other participants in the market: this makes implementation key.

The fund may also look to invest in technology developed in Israel and elsewhere, but licensed for use in the UK.

Israel has gained a deserved reputation for producing a large number of technology startups. There are several reasons for this, including direct government support for the sector and indirect support through the military in particular, where many people developed their skills. There is also significant supporting infrastructure that has built up around the industry, including numerous incubators and a venture capital industry. The tech industry there has had some notable successes, though the usual risks remain.

Taurus, and its CEO Stephen Margolis, launched Arie Capital in 2013 as an institutional venture capital manager investing into technology companies, primarily, but not exclusively, in Israel. The new fund is intended to be complimentary to that. There will be no overlap between the two as each is aimed at different size companies (Arie Capital's normal smallest investment size is $3m), reducing potential conflicts of interest.

The intention is not to invest directly in the Israeli or overseas developer/owner of the technology (which generally would not qualify for EIS investment), but instead to fund a UK based company which licenses the technology for domestic sale. Investors should note that this will most likely restrict the potential market for the investee company to the UK, with the parent company most likely retaining international rights. It is possible that this may act as a constraint on long-term growth, but it should not have much short-term effect.

The terms of the licensing agreement will vary from company to company. Arie will make sure that its duration and terms are appropriate – they do not want the licensor syphoning off all the profits.

Sourcing Deals

It is anticipated that deals will come from direct applications and through the network of the Arie directors. They have been getting an increasing number of direct approaches, something that we would expect to increase now the fund is launched. To date, their network has been more productive, partially as it is easier to get referrals for the right sort of companies.

As well as UK sources, some deals may come through the network in Israel that Taurus has built up through their management connections and Arie Capital. Arie Capital has an office in Israel, with two scouts looking out for potential investments. While these resources have to produce deal flow for the existing fund, the nature of the venture capital world is that they will come across a wider range of investments than is appropriate for that. By sharing resources, Arie aim to keep the costs to the funds lower than it would otherwise manage.

We note that Arie is currently building up connections in China on a similar basis to what they have done in Israel and have opened an office in Beijing. The links between the Chinese and Israeli tech sectors do seem to be increasing. While it is too early to use these to source investments for the fund, this may have potential for developments in the future. In particular Arie/Taurus is developing a distribution network for medical technologies, which may be helpful to some of the fund's investments.

It is clear that for a lot of these connections Stephen Margolis (see People below) is the key person.

Decision Making

The initial filtering of investments will be primarily done through Taurus and Arie, in effect at the sourcing stage described above. Before investment the criteria listed above must be satisfied, and various KPIs and hurdles will be set to measure progress. Arie will produce a report on potential investments for the Investment Committee.

Approval of investments sits with the Investment Committee. The expectation is that decisions will be unanimous.

The expected equity stake will be of the order of 20-40%, though the fund will have preferential arrangements to control certain decision making and to ensure a board seat.

The intention is to have a portfolio of at least 4 investments. 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, though given the nature of the projects each should perform independently of the other.

Investors should note that although the Fund is an EIS one, there may be SEIS opportunities. These will arise when a company that is to be funded via EIS is also eligible for the SEIS and investments may be staged to permit that. It is not expected that there will be any SEIS only investments.

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, Woodside Corporate Services. Woodside will also carry out the fund administration.

Investors will receive reports on their investments every six months. As unquoted investments, we would not expect there to be significant changes in share values. However, there should be reasonable visibility on progress against the milestones and revenues.

The fund will expect to have a board position on each investee company. This role will most likely be taken by one of the members of the Investment Committee.

Following the Arie Capital model, the intention is to ensure that the investee companies have good corporate governance. This includes at least eight board meetings per year and production of management accounts on at least a quarterly basis.

Much will be geared to what Arie call the next stopping point, which will normally be the next stage at which funding will be required. The intention is to operate something of a fast fail model, and investors should be aware they are likely to see the companies who fail do so before the good ones succeed.

Arie hope that they will be able to operate a lifespan funding model for investee companies, with follow-on funding coming from funds operated by the Company Mentor, principally Arie Capital. They remain open to follow-ons coming from other sources too, which is prudent given the relative immaturity of both sides of the operation and that successful companies may well have other options.

The intention is that the investee companies will effectively be in an accelerator programme, with the members of the Investment Committee working with companies to improve their opportunities.

Exits

Exits are most likely to occur through trade sales, though other options are not ruled out if appropriate. If the Arie management feel they can develop the company further, then there may be the option for a sale to Arie Capital. If this happens investors should note that these are related parties and may wish to have any transaction price independently validated.

Track Record

The fund is a new venture and does not have any past performance. Arie Capital does not have a long history, and as an institutional fund operating in a different part of the market, may not give a lot of read across. It has deployed $30m of capital, with only one exit to date, which was at a multiple of 2.3x the investment over 8 months.

Over the last couple of years, Taurus has also separately raised £9.5m for two technology investments. One of these was EIS qualifying, and, at the time of writing, Arie has started to fundraise for another. We understand that there has been a profitable exit at 1.8x, the details of which are subject to confidentiality.

The individuals involved do have considerable experience (see People below).

Fees

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

- **Performance fee:** This is calculated on the investors' share of profits above £1.35 for each £1 invested on a per company basis. This structure may lead to performance fees being paid when the fund as a whole has not outperformed, but is offset by the threshold being higher than many other funds.
- **Other costs:** These may arise in the sale of the investee companies.

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 minimum size of the fund will be £500,000, with a closing date of 23 March 2018, or earlier if required, and a maximum fund size of £10m. The number of investee companies is to some extent dependent on the amount raised.

The minimum subscription is £10,000, which is at the lower end of the range for EIS products.

Fund Operator 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 have each won EISA best individual rising star in 2015 and 2016.

Arie Tech LLP is a UK based partnership that sources and manages venture capital opportunities. It has common beneficial ownership with Taurus Asset Finance.

Taurus Asset Finance is a UK based financier who focusses on alternative asset classes. It has offices in London and Los Angeles, and services across Real Estate, Intellectual Property, Media and Tax Enhanced products. The founder, Stephen Margolis, has raised money under EIS for film and technology products.

People

Stephen Margolis – Founder & CEO, Taurus Asset Finance

A qualified lawyer, he founded Future Films in 2000 and has since been credited with Producer, Executive Producer and Financier for over thirty films. In 2011, Future Films was incorporated into the newly formed Taurus Asset Finance. Companies House has 194 current appointments for him.

Simon Tobelem – Founder, Arie Capital

Formerly an Economic Adviser to the Israeli Finance Minister, Head of Corporate Finance at Israeli Discount Bank and President of Goodlad, Managing Partner at Conseil & Stratégie and Realis investment houses before co-founding Arie Capital.

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 a number of 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 JP Morgan 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 until she left to become a partner in Sapphire Capital. She is a qualified accountant.

The Investment Committee comprises of Simon Tobelem, Stephen Margolis and Boyd Carson.

Appendix 1 – Due Diligence Summary

Summary of core due diligence questions		
Fund 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
Company Mentor		
Company	Arie Tech LLP	Information Memorandum
Founded	2015	Hardman & Co
Type	Limited Liability Partnership	Hardman & Co
Ownership	Taurus Capital (DM) Limited, wholly owned by Taurus Capital Limited, which is owned by Taurus Future Finance Group Ltd, which is wholly owned by Stephen Margolis.	Hardman & Co
CRN	10405040	Hardman & Co
FCA Registration	NA	Hardman & Co
Solvency	No	Hardman & Co
EISA Member	Arie Tech LLP	Information Memorandum
Company	Taurus Asset Finance	Information Memorandum
Founded	2008	Hardman & Co
Type	Limited Liability Company	Hardman & Co
Ownership	Taurus Capital Limited, which is wholly owned by Taurus Future Finance Group Ltd, which is wholly owned by Stephen Margolis	Hardman & Co
CRN	07481235	Hardman & Co
Solvency	No	Hardman & Co
EISA Member	NA	Hardman & Co
Fund Custodian		
Company	Woodside Corporate Services	Information Memorandum
FCA Registration	467652	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 2016. The company has confirmed its solvency and has appropriate investment management permissions from the FCA.

Arie Tech LLP has accounts filed to 26 February 2017 and currently has one member. Other submissions to Companies House appear to be up to date.

Taurus Asset Finance Limited has accounts made to 31 January 2016. Other submissions to Companies House appear to be up to date.

Appendix 2 – Example Fee Calculations

This calculates the estimated amounts payable both directly and indirectly under certain assumptions.

Basic Assumptions	
Term	5 years
Investor amount	£100,000
Company investment	£500,000
VAT is reclaimable by investee companies.	

Source: Hardman & Co research

Calculations					
		Hardman & Co Standard			Target
Gross Return		-50%	0%	50%	122%
Amount (pre-tax relief)		£100,000	£100,000	£100,000	£100,000
Initial Fees	**Rate**				
Initial fee	2.5% (excl VAT)	£2,500	£2,500	£2,500	£2,500
Arrangement fee (paid by company)	5.0% (excl VAT)	£5,000	£5,000	£5,000	£5,000
Total		£7,500	£7,500	£7,500	£7,500
Net investment		£97,500	£97,500	£97,500	£97,500
Annual Fees					
From company					
Annual fee	1.5% = £7,500 pa per company (pro-forma)	£1,500	£1,500	£1,500	£1,500
Total over 5 years		£7,500	£7,500	£7,500	£7,500
Gross fund after investment return		£48,750	£97,500	£146,250	£216,250
Exit fees					
Performance	20% above £1.35	£0	£0	£2,250	£16,250
Net amount to investor		£48,750	£97,500	£144,000	£200,000
Gain (pre tax relief)		-£51,250	-£2,500	£44,000	£100,000
Gain (post tax relief)		-£22,000	£26,750	£73,250	£129,250
Total fees paid		£15,000	£15,000	£17,250	£31,250

Source: Hardman & Co research

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