Mercia EIS Fund

Mercia Fund Management Limited

Summary

The fund's investment strategy is to invest in a diverse portfolio of EIS Qualifying companies, with an option to include SEIS, in selected technology areas in which Mercia has specialist knowledge.

	Positives	Issues
Why Invest	► **Strategy:** Exposure to a portfolio of technology companies across four sectors.	► **Track record:** Only a small number of exits to date, but the unrealised figures so far look promising.
The Investment Manager	► **Team:** A large, widely experienced team, with a clear strategy and sector specialisms.	► **Managing growth:** Funds have been growing quickly, and care will be needed to manage team and systems growth alongside this.

Nuts & Bolts

- **Duration:** The fund will have at least two tranche closings per year, in Q2 and Q4.
- **Diversification**: The Manager expects to provide 15 EIS investments in the fund, spread across its four technology sectors, with up to 5 SEIS investments (subject to capacity).
- **Valuation:** Reviewed every quarter. Investors will have ongoing access to information through Mercia's client portal.

Specific Issues

- **Fees:** Combination of direct fees and company charges.
- **Performance fee:** Charged on a portfolio basis at 20% for returns over £1.

Risks

- **Target returns:** The target return of tripling 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 investments will do very well, but those that fail may do so completely.

Analyst	Adviser information		Contact details	
Brian Moretta	Scheme assets	£0.3m	CEO	Mark Payton
020 7194 7622	Scheme target	£15m in 2018	Contact	Paul Mattick
bm@hardmanandco.com	EIS assets	£33m		0330 223 1430
	Total FUM	£337m		Paul.Mattick@merciatech.co.uk
	Fund launch date	2018		

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Factsheet

Mercia EIS Fund		
Product name		Mercia EIS Fund
Product manager		Mercia Fund Management Limited
Tax eligibility		EIS or combined EIS & SEIS
Target return		3 times investment in 5-7 years, including tax reliefs
Target income		None
Type of product		Discretionary portfolio service
Term		Limited life
Sectors		Technology
Diversification:		
Number of companies		15 (EIS) or 15-20 (EIS & SEIS)
(Expected) Gini coefficient		0.05-0.07
Fees	**Amount**	**Paid by**
Initial fees:		
Initial fee (see notes in report)	1% or 2% (plus VAT)	Investor
Dealing charge	0.35%	Investor
Arrangement fee	3%	Investee company
Annual fees:		
Annual management fee	1.75%	Investor – for 6 years, 3 years deducted upfront
Custodian admin. fee	0.25%	Investor – for 6 years, 3 years deducted upfront
Monitoring fee	Up to 3%	Investee company
Exit fees:		
Performance fee	20%	Investor – portfolio basis, aggregate returns over £1
Dealing charge	0.35%	Investor

Advisor fee facilitation	Yes
Advisor fee amounts	As agreed with investor
HMRC Approved?	No
Advance Assurance	Yes, for each investment
Reporting	Investor portal, quarterly valuation reviews
Minimum investment	£25,000
Current funds raised	£0.3m
Fundraising target	£15m in 2018
Closing date(s)	1st June 2018 and at least every 6 months thereafter
Expected exit method	Mostly trade sale

Source: Mercia Fund Management, Hardman & Co research

Fund aims

Mercia EIS Fund (MEF) is a discretionary portfolio service, which will build a portfolio of EIS investments, or SEIS and EIS investments, in unquoted technology companies. The target return is three times capital after five to seven years, including tax reliefs. Returns will be focused on capital gains, and investors are unlikely to receive any dividends. The fund is evergreen, with tranche closes at least twice a year.

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. Mercia aims to have 15 EIS companies in the portfolio, with a spread of position sizes, with up to 5 (smaller) SEIS investments. Although sector diversification is limited, stock-specific risk should dominate market risk.

The target return of three times capital suggests high risk and seems appropriate for the strategy.

Sourcing and external oversight

Over the last four years, Mercia has made over 180 investments. There is evidence of a good network, and its strong links with universities help to give it very good potential deal flow. The target of 15 to 20 investments looks achievable. Unusually, the entire Investment Committee consists of external advisors, and there are sector advisory panels too.

Ongoing support and monitoring

Support and monitoring of investee companies come through Mercia being appointed to the board, with an Investment Manager attending each meeting. The aim is to provide strategic guidance, determine progress towards future funding needs and transfer good practice where possible. Investments are reviewed quarterly.

Exits

Mercia has a limited track record to date, but 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. The innovative Share Exchange scheme may allow earlier partial exits at a lower share price.

Manager

Team

Mercia has around 30 investment professionals. The team is diverse, with the senior members having decades of experience in the sector. Mercia is growing the team, and is aware that, as its portfolio of investments grows, it will need a larger team to manage them, although it notes that, as the portfolio matures, exits should slow growth in the future.

Track record

Since 2014, Mercia has made 181 investments into 73 companies. There have been 12 full exits, one of which was a sale, and two partial ones. Mercia has also provided exit options for seven other companies through its Share Exchange scheme. Hardman & Co sees the track record as promising, although the small number of exits means it lacks some maturity. The improvement in a broad spread of the more mature current investments suggests that this may arrive in due course.

Regulation

Product

Advance Assurance is sought for each investment.

Manager

The manager of the fund is Mercia Fund Management Limited. It is FCA registered (number 524856) with fund management permissions. Submissions to Companies House appear to be up to date.

Risk analysis/commentary

Overall, Mercia Fund Management seems to be a well-run company with a credible investment process. Its selection as a manager of Northern Powerhouse and Midlands Engine funds gives added support to its credibility. The sizeable team brings a broad range of backgrounds with experiences in different areas. With the company entering EIS only five 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 technology companies. Mercia's biggest strength for supporting these companies is providing a pathway to the ongoing capital needs that success will bring for these companies, with the parent company's balance sheet giving a significant advantage in its ability to potentially provide funding beyond EIS.

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 significant, and better than many products in this area. This EIS fund should be considered in the context of an investor's entire portfolio.

Investment process

The MEF is very similar to the series of Mercia Growth Funds that preceded it. The investment policy is the same as for the immediately preceding Mercia Growth Fund 8, but there are some differences in the structure. The most notable are that the MEF is effectively evergreen, and is now open to retail clients.

Deeper dig into process

The Mercia Group can trace its roots back to 1982, when it started in Birmingham, with Mercia Fund Management being created to manage third-party funds at the time of a management buyout in 2010. The group focuses on technology investments across four different sectors:

- **Life Sciences and Bio-Sciences:** Mercia's investments here are focused on capital-efficient areas such as digital healthcare, meditech services and diagnostics. Mercia does not invest in drug development, where success depends on trials and requires significant ongoing capital support.

- **Digital and Digital Entertainment:** Investments in this area are mostly in video gaming, an industry in which the UK has a deservedly strong reputation.

- **Software and the Internet:** Application software and security solutions have been Mercia's main targets.

- **Materials and Manufacturing/Engineering:** The focus in this area is on generating IP and monetising it through licensing. Mercia is less keen to fund the building of manufacturing facilities.

Each sector has a team of Investment Directors, Managers and Associates dedicated to it, and is headed by an Investment Director with specialist knowledge and commercial experience in that particular field. For example, the head of the Digital and Digital Entertainment sector is an ex-CEO of Sega. Potential investments are assigned to a team.

Three of the areas have an advisory board, each composed of four experienced industry people. These provide information on strategies and developments in the industries, as well as contacts and, very occasionally, deal flow. An advisory board is currently being put together for Materials and Manufacturing/Engineering, the fourth sector.

Investors in the fund should expect to get exposure across all four sectors, although there are no rigid guidelines on weightings, as Mercia prefers to be guided by the quality of the deals that it accesses over the investment period. Aggregating across previous funds, about a third of funds have gone to each of Life Sciences and Software, with the balance to the other two areas. While not definitive for future investments, this does suggest a stronger ability to source deals in the two larger sectors, and investors will probably have more exposure to these areas.

A distinctive feature of Mercia is its ability to provide what it describes as "The Complete Capital Solution". In short, the Mercia Group has access to different pools of capital that can be used to fund different stages of a company's development. Very few technology companies will reach any sort of maturity from a single round of funding, and access to follow-ons is essential for success. The 'fail fast' model is followed by Mercia, where interest in providing future funding is determined by the progress of the company. This limits exposure when a company does not perform well.

The main pools of capital in the group can be split into three groups. Firstly, Mercia Fund Management can provide early-stage/start-up capital at the SEIS level. The second category, EIS funding, is the main focus, with most investment for development funding. Investors can access both EIS and a small element of SEIS through the fund. Finally, the parent company, Mercia Technologies plc, also invests its balance sheet and provides capital for further stages of growth. As of its last interim results (September 2017), it had around £337m of investments, with unrestricted cash resources of around £49m, adequate to fund two to three years of expected requirements. It also has an arrangement with some of the PLC’s significant shareholders, whereby they may co-invest in companies that require larger investment rounds.

The latter is particularly helpful. One of the issues in the UK venture capital market is a lack of capital for companies between EIS/VCT size and those large enough to attract private equity funding. That Mercia has ready access to capital at this stage is a distinct positive, and distinguishes it from many other EIS managers.

For all new investments, the Mercia process includes assessing what a company’s future investment requirements are likely to be. Mercia is looking for businesses that need less than £5m to become cashflow-positive, which would allow the group to be the principal funder, although it is not restricted to being so.

For a typical investment, Mercia expects to be the first professional funder, something that allows it to be the price setter. It may still be the sole funder for the next round or two, but it expects other sources to come in as a company grows. If the parent company invests, it is common for its investment to overlap with (S)EIS investors, although interests are mostly aligned at this stage.

Investors should note that, under the Mercia structure, they will only get follow-on investments in a company if the tranche in which they are invested makes that investment. These opportunities are not made available to individual investors, which may have some consequences for dilution, although investors are often unable to follow on in sufficient amounts to maintain stakes anyway.

Sourcing deals

Potential deals arise from two main sources.

Mercia has agreements with 19 universities around the UK to fund potential spin-outs or IP-related companies. This has increased since our last report, with the addition of Edinburgh University. All these agreements are non-exclusive, which avoids any obligation to fund investments. The full range of universities is listed on Mercia’s website. They are predominantly located in the Midlands, the north of England and Scotland. Mercia’s view, with which Hardman & Co concurs, is that institutions in London and Oxbridge are well supplied with capital, but those elsewhere have less support.

This gives Mercia a good opportunity, as there is generally less (but still some) competition for deals, and this makes it easier for Mercia to be the price setter. Mercia has a team of four people dedicated to maintaining relationships with the university partners, and roughly a third of potential deal flow comes from this source.

Working with academics does have distinct challenges, which Mercia is aware of. While they are usually very intelligent, they often lack business experience. At the seed stage, funding is usually to bring in commercial support to build towards monetising IP or technology work from the academic side. Where an idea is at a very early stage, then Mercia may use money from its regional incubator programme to explore whether something is potentially commercial – MEF investors will have exposure to companies beyond that stage.

The other main source of deal flow is the network of Mercia and its staff. With around 30 investment professionals, many of whom have been in the industry for some time, and almost 20 other people on its various advisory panels, its network is extensive. In addition, it does some marketing to incubators and has an NHS/Feeder Fund, which also provides deal flow. Mercia estimates that it looked at approximately 2,000 potential investments in 2017.

The network is also focused on the Midlands and the north of England, where most of Mercia's eight offices are located, although there is also an office in Scotland. That said, it remains open to sensibly-priced investment opportunities located in other areas, including London, although these will remain a small proportion of the total.

Overall, it is clear that Mercia has access to very strong deal flows and should be able to source the targeted investments for the fund in the expected timescales. It has exceeded the required pace over the last couple of years, with the last EIS fund reaching 95% deployment in just 75 days.

Mercia has some clear criteria for potential investments. Some of these are set by the (S)EIS legislation. For SEIS investments, these include a clear path to being EBITDA-positive within two years and a credible exit plan in four to seven years. For EIS investments, the company should be better developed, with additional criteria including a clear sales pipeline and a strong management team with a track record of success. These may not be original, but are very clearly set out.

Typically, the fund will look to take an equity position of 10%-40%. The Mercia Group as a whole may build even larger positions, but avoids having the majority of the voting rights.

With its wide range of sources, Mercia has managed to source adequate investments for its previous funds, which have had similar diversification targets. Mercia believes that it sees enough deal flow for it to deploy significantly more capital than it does currently. Hardman & Co has no concerns about Mercia being able to source enough investments for the current MEF targets.

Decision-making

There are several stages in deciding whether to proceed with an investment for the fund. Potential investments are usually assigned to one of four sector teams. If it is sufficiently interesting, then an Investment Manager is assigned to the project. The latter prepares an initial briefing note and does some light due diligence, and these are then presented to the Investment Committee, which also has an initial meeting with the potential investee management.

Assuming the Committee wishes the investment to be pursued further, the Investment Manager will then negotiate a term sheet with the investee company management and prepare a full briefing note. Further due diligence will be performed. This is also overseen by an Investment Director. Once all this is done, the Investment Manager presents to the Investment Committee. The latter has a chance to do its own background research, and also has an intensive meeting with the investee company management team to see how it responds under pressure.

In practice, very few opportunities are rejected outright at this stage, with those not being approved usually able to return to the Committee subject to additional conditions. This may, for example, involve further due diligence, or there may be a need for more information about the company.

Once accepted by the Committee, there will be further legal diligence before the investment is made.

Governance and monitoring

Advance Assurance will be received from HMRC on all investments prior to completion. Mercia is currently working with HMRC to streamline the process.

The custodian for MEF is The Share Centre Limited. Cash will be held by the latter on behalf of the underlying investors, with share certificates held in their nominee, Share Nominee Limited.

MEF will invest in EIS companies, although there is an SEIS option for those who desire it. The capacity for the latter is expected to be around £0.6m in each tranche and it may close earlier than the main fund. The target is for investors to get exposure to 15 to 20 investments. The expectation is that EIS-only investors will get around 15 companies, with combined EIS and SEIS investors getting closer to 20. Although the track record is immature (see below), the performance to date of Mercia's EIS investments has been significantly better than for SEIS, even allowing for the additional tax advantages of the latter.

As Mercia has grown its assets under management, it has widened the pools of capital to which it has access. In 2017, it won a mandate for two Northern Powerhouse Investment Funds (NPIF), one of which overlaps with MEF. This has been positive in terms of giving more funding options for companies, but investments have to be allocated between these pools. In practice, the NPIF will get priority for investments in the prescribed areas of Yorkshire & Humber and Tees Valley. There may be some co-investments with MEF if the deal is large enough.

Client reporting is provided via a proprietary portal accessible via a mobile-friendly website, which allows investors to access the latest valuations, tax certificates and news updates.

Company valuations are revised quarterly and follow the IPEVC guidelines. Broadly, where it is externally validated, the last transaction will usually be used. There will be exceptions if the company is profitable, in which case an enterprise value multiple may be used, or if there is a provision. For the latter, the company is benchmarked against its plan and, if it is behind, may be subject to a provision of 25%, 50% or 75%. In cases where failure us inevitable, companies will be written down to 1% of cost. Mercia stresses that it expects some failures and is pro-active about writing down investments as required (see *Track record* below).

Mercia will take a board position in investee companies through Mercia Fund Management Nominees Ltd. Usually, the attendee will be the investment professional who negotiated the investment, but an Investment Director may also attend quarterly to keep up to date.

Like most EIS investors, Mercia recognises that support for the investee companies goes beyond simply monitoring. Mercia sees its primary role in supporting and shaping the strategy and funding requirements. Broadly, it will not get involved in running the company, but will provide support through transfer of good practice from elsewhere or support from within Mercia's network. To help facilitate this, it brings together the CEOs of investee companies so that they can share experiences and network.

Each quarter, Mercia does a full investment review of each investment for reports to its Advisory Boards or the board of Mercia Technologies plc, the manager's parent company. Performance is assessed against the expected milestones – usually sales or cashflow. Where a company has fallen short, the Mercia team will have discussions with the company management about whether mitigating actions are required and, if so, what form they will take. Usually, they involve cost-saving measures to help make the current funding last as expected.

If the underperformance continues, then the issues will come to a head when funding is next required. As referred to above, companies are usually not fully funded at initial investment. If adequate progress is not achieved, then the next round will not occur, leading to the 'fail fast' model. Where necessary, Mercia will take advice from an insolvency practitioner.

Exits

The expectation is that the majority of exits will come through trade sales and, as is common for technology managers, this is Mercia's preferred option, as it is most likely to provide a cash return. Mercia may not object to a listing, but it observes that, in its sectors, this is often accompanied by a fundraising and does not necessarily provide liquidity for existing investors.

The multiple capital pools within the Mercia group allow the company to offer an interesting alternative exit method, albeit under specific circumstances. Called the Share Exchange, under this scheme, Mercia Technologies plc (the parent company) may offer to buy shares from investors, typically at a 25% discount to the share price. Normally, this offer will be available when the parent company has made a follow-on investment and is willing to buy more shares. If the parent receives enough shares in the follow-on then no offer will be made. Investors should expect the offer to be available only for a limited time, the number of shares that will be purchased will be limited and available on a first-come first-served basis.

This is an interesting innovation in a sector that has lacked liquidity, although investors will need to decide if the discount represents good value for them.

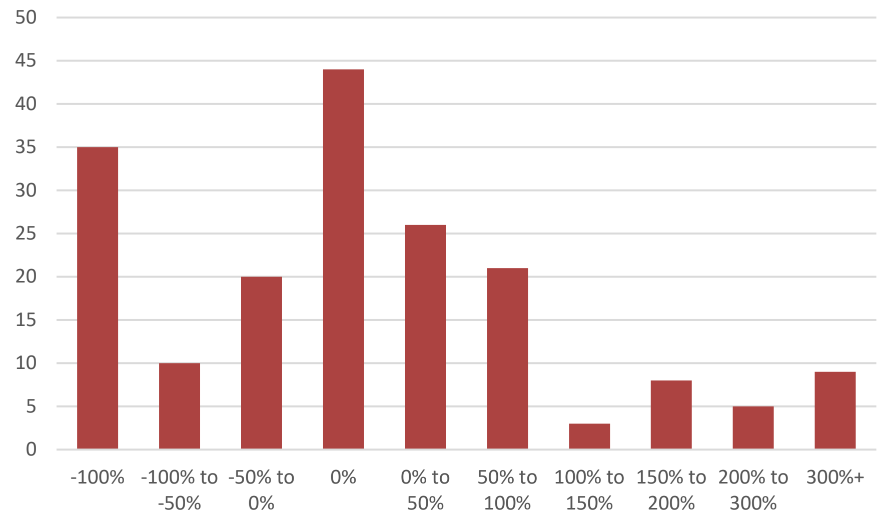
Track record

Mercia has raised (S)EIS money for a total of ten funds, with the first funding closing in January 2014. Nine of these are fully invested, with the tenth expected to be 95% invested within 75 days of closing. Given that the first fund closed four years ago, investors will see that none of these have been able to complete a full investment cycle yet. The data with which we have been supplied are as of 30th September 2017.

The funds are showing good performance so far, with the caveat, discussed below, that much of this is based on unrealised investments. On a pre-tax, pre-performance fee basis, the six funds that have been invested for more than 12 months are showing a 1.7x return for EIS investments and a 1.1x return for SEIS, for an overall average of 1.3x.

To September 2017, across all the funds, 181 investments had been made into 73 companies. Across all the investments, the weighted average return on invested capital is 14%, with a median of 0%. If we exclude figures for investments made in 2017 (which are immature and mostly have not moved), these figures become a weighted mean of 19% and median of 0%. These figures do not include tax relief or performance fees and are based on the current valuations.

Pattern of returns on individual investments



Source: Hardman & Co research, Mercia Fund Management

As the chart above shows, the pattern of returns on individual investments is somewhat skewed, as is normal for technology investments, with the largest return being 540%. Of those that have moved, 65 have been written down, 35 of which are complete losses, with 72 showing gains.

With only four years since the launch of the first fund, there have been very few exits to date. Reflecting the 'fail fast' model, the majority have been write-downs. So far, there has been one complete exit, two partial exits and eleven company write-downs. The complete exit was a sale at 0.93x the investment. This was AIM-listed, and the price had been volatile. Mercia timed the exit well, selling the shares during a peak in the share price. Since the sale, the share price has fallen by over 50%. Most of the write-downs have been SEIS investments, with the sale and one of the write-downs being in EIS-funded companies. The two partial exits were sales through the Share Exchange. These have given much better returns, with one being valued at twice the total investment and the other six times.

The net effect of this activity is that the two funds that are more than three years-old have started to distribute cash, with MGF1 having paid out 25p and MGF2 having paid 17p for each £1 gross invested. Mercia, through the Share Exchange, has made nine offers to purchase shares across five different funds for an aggregate value of £3.3m. This would have returned figures from 68p to 124p for each pound invested, while still leaving additional unrealised investments. However, the take-up by investors has been very limited. This is understandable, given that the discount on offers through the Share Exchange means that, if investors choose to sell shares through that route, they are unlikely to realise the full value of a portfolio. Additionally, some of the offers were within the minimum three-year holding time to keep tax relief. There is no guarantee that Mercia will make any future Share Exchange offers.

Mercia's experience to date is that its EIS investments have outperformed its SEIS investments. For pre-2017 investments, those made under EIS have a weighted average return of 22%, compared with 14% for SEIS. The differential tax break would appear to more than balance this out. It is not clear yet to what extent this is a lack of maturity in the portfolio – as noted above, the failures generally come before the successes – or whether this is something that may persist.

There have been some differences in sector performance, with digital entertainment having done very well and software lagging. Mercia tells us the latter is due to some slower-than-expected progress, and we note that most of the write-offs have been in this area. Again, the lack of portfolio maturity suggests that investors should not read too much into this difference yet.

Hardman & Co sees the track record as promising, although the small number of exits means it lacks some maturity. The improvement in a broad spread of the more mature current investments suggests that this may arrive in due course.

Fees

The fees for MEF are set out in the table on page 3. Compared with many funds, these are reasonably straightforward, although investors should note the points highlighted below. These have changed a little from the previous funds, with a reduction in the performance fee rate and a slight increase in the initial and annual fees. If the investments perform in line with targets, the overall effect would be a net reduction.

Initial fee

The fee will be reduced to 1% for investors who are advised or are existing investors in Mercia Growth Funds.

Annual fees

The Annual Management Fee and the Custody and Administration Fee will be charged for six years. Investors will pay three years upfront, with subsequent years being invoiced if there are insufficient exits to cover the charges.

Exit fees

The performance fee is charged on a portfolio basis, being 20% of gains above the net investment.

Investee company fees

Mercia charges investee companies a 3% placement fee and an annual monitoring fee of up to 3%. For the latter, we understand the charge is on a case-by-case basis, with 2%-4% being normal, although, in later-stage companies, it may vary.

Fundraising targets

MEF is intended to be an evergreen fund, with tranches closing at least twice per year. The targets are £7.5m by 1st June 2018 and £15m in 2018. Earlier closing is possible if fundraising goes well, which is expected for the SEIS element. The formal deployment target is to invest funds within 12 months of the closing. For the June closing, Mercia would hope to deploy most or all of the funds within the same financial year, but this may be contingent on the amount raised.

The minimum subscription is £25,000, with higher amounts in multiples of £1,000.

Investment Manager

Company

Unusually, the Investment Committee consists entirely of people external to the Manager, although they are incentivised with a share of performance fees. The team is substantial, and its members have a variety of backgrounds, in both industry and venture capital, which contrasts well against some other EIS managers.

Being part of a larger group also gives access to greater resources, if required. For example, the client services team for the EIS funds consists of four people. If required, this can be boosted immediately, or temporarily, by moving some of the existing 30-person administrative team.

As noted above, Mercia has been successful in growing both its EIS assets and funds from other sources. The management acknowledges that, as the funds grow, it will need to keep growing the team, suggesting that more staff will be required to manage the existing investments. There were substantial additions to staff in 2017, and, at the time of writing, there is further ongoing recruitment. The equity investment team is expected to grow from the current 30 people to around 40 in the next year.

People

Dr Mark Payton – Managing Director

While working at Oxford University and Isis Innovation, he helped with the spin-outs of BioAnalab, Oxford Immunotec, Oxitec and Natural Motion. He was Vice President at Oxxon Therapeutics and was on Abzena plc's board (before its IPO).

Matt Mead – CIO

Formerly a Senior Manager at E&Y, he subsequently spent 14 years as a partner at 3i, specialising in technology. He later became CIO for NESTA. He has held several non-executive directorships and has been Strategic Adviser for Finance Wales.

Peter Dines – Head of the EIS investment team, COO

Has a strong background in healthcare, most notably at Surgicraft, where he quadrupled sales in three years. He has also had executive roles at Newtech Ortho, Surgi C Group and Diagnostic World, as well as non-executive ones at Whisk and Cisiv.

Peter Gardner – Chairman, Investment Panel

Founder of Micro Technology Group and Micro Technology Limited, and then CEO of Sintrom (LRT) and Cristie Electronics before becoming Communications and Technology Sector Head at 3i. Currently CEO of Gardner Innovations.

Nick Wheelwright – Investment Panel

A former Audit Manager at PwC, CEO of Codemasters and Monumental Games, and Founder and Executive Chairman of Newslark. He is the Founder of Playground Games Ltd and is Executive Chairman of Virttrade and Soccer Manager.

Jim Reid – Investment Panel

After gaining management experience at Axis-Shield plc, S.A Roche and others, he founded ChimaeraBio Investment Partnership in 2000. He was Chairman of Lumora at its sale in 2015.

Martyn Booth – Investment Panel

Previously a fund manager at The Midlands Growth Fund, he currently sits on the investment panel at North West Equity Fund and the South East Growth Fund. He is currently director of West Midlands Enterprise Ltd.

Appendix 1 – due diligence summary

Summary of core due diligence questions

Manager		**Validated by**
Founded	2009	Hardman & Co
Type	Limited Company	Hardman & Co
Ownership	Mercia Technologies plc – listed on AIM	Hardman & Co
FCA Registration	Yes – 524856	Hardman & Co
Solvency	Confirmed	Hardman & Co
EISA member	Yes	Hardman & Co
PI arrangements	Yes	Hardman & Co
Administrator		
Company	With support from parent company	Information Memorandum
FCA Registration	NA	Hardman & Co
Fund Custodian		
Company	The Share Centre	Information Memorandum
FCA Registration	Yes – 146768	Hardman & Co

Source: Hardman & Co research

The manager of the fund is Mercia Fund Management Limited. It is FCA registered with fund management permissions as a Small Authorised UK AIFM. It can control, but not handle, client money. The company is owned by Mercia Technologies plc, which has a substantial balance sheet, and solvency is very comfortable. Its Company House filings appear to be up to date.

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
Assumed investor is advised and gets reduction in initial fee	

Source: Hardman & Co research

Calculations

		Hardman & Co standard			Target
Gross return		**-50%**	**0%**	**50%**	**252%**
Amount (pre-tax relief)		**£100,000**	**£100,000**	**£100,000**	**£100,000**
Initial fees	**Rate**				
Manager	1.00%	£1,000	£1,000	£1,000	£1,000
Dealing	0.35%	£350	£350	£350	£350
Company	3.00%	£3,000	£3,000	£3,000	£3,000
Total		£4,350	£4,350	£4,350	£4,350
Annual fees					
Manager	1.75%	£1,750	£1,750	£1,750	£1,750
Administrator	0.25%	£250	£250	£250	£250
- Deduction upfront (3 years)		£7,350	£7,350	£7,350	£7,350
Net investment		£91,300	£91,300	£91,300	£91,300
From company					
Directors' fee	3.00% pa	£13,695	£13,695	£13,695	£13,695
Gross fund after investment return		£45,650	£91,300	£136,950	£321,278
Exit fees					
Balance of annual manager fee	1.75% (2 years)	£3,500	£3,500	£3,500	£3,500
Balance of administrator fee	0.25% (2 years)	£500	£500	£500	£500
Performance	20%	£0	£0	£6,690	£43,556
Dealing fee	0.35%	£148	£307	£467	£1,112
Net amount to investor		£41,502	£86,993	£125,793	£272,610
Gain (pre-tax relief)		-£58,498	-£13,007	£25,793	£172,610
Gain (post-tax relief)		-£31,108	£14,383	£53,183	£200,000
Total fees to manager		£29,543	£29,702	£36,552	£74,063

Source: Hardman & Co research

Notes: Several fees are expected to be payable for six years, but we have used five, in line with our standard assumptions

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