

INNVOTEC TECHNOLOGY EIS & SEIS FUND

Innvotec Limited

	Positives	Issues
Why Invest	<ul style="list-style-type: none"> ▶ Strategy: To invest in a range of technology companies in targeted sectors with a bias towards impact investments. 	<ul style="list-style-type: none"> ▶ Track record: Although Innvotec has been (S)EIS investing for over a decade, it is under new ownership and management.
The Investment Manager	<ul style="list-style-type: none"> ▶ Team: The Innvotec team has well-rounded experience in technology and entrepreneurship, and is a good size, with plenty of support around it. 	<ul style="list-style-type: none"> ▶ Growth ambitions: The team is more than adequate for current operations, but Innvotec's growth plans could require it to be significantly expanded.
Nuts & Bolts	<ul style="list-style-type: none"> ▶ Investing: The fund operates with semi-annual closes. Deployment will usually take place within a quarter, but always within the relevant tax year. ▶ Diversification: A portfolio of between three and ten companies across several technology subsectors. ▶ Valuation: Valuations are updated monthly and provided on an ongoing basis through Innvotec's investor portal. 	
Fees	<ul style="list-style-type: none"> ▶ Fees: Mixture of direct fees, and charged via the investee companies. ▶ Performance fee: 30% on gains over £1.30 for each pound invested. 	
Risks	<ul style="list-style-type: none"> ▶ Risk mitigation: As well as its own diligence, Innvotec funds only part of a round, so companies will need to have convinced other funders to invest. The team aims to have close contact with investee companies to supply ongoing monitoring and support. ▶ Target return: No explicit target return is given, although each investment will be at the higher end of the risk spectrum. As usual in this area, successful companies will give an excellent return, but there is a real risk of loss for those that don't. 	

	Manager information	Contact details
Analyst	<ul style="list-style-type: none"> ▶ Scheme assets: £0.4m ▶ Scheme target: £10m p.a. ▶ EIS assets: £16.0m ▶ Total FUM: £16.3m ▶ Fund launch date: 2020 	<p>Tofiq Qureshi +44 7501 668383 tofiq.qureshi@innvotec.co.uk</p> <p>Chris Buchanan +44 7956 854449 chrisb@innvotec.co.uk www.innvotec.com</p>
<i>Brian Moretta</i> +44 20 3693 7075 bm@hardmanandco.com		

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Factsheet

Innvotec Technology EIS & SEIS Fund		
Product name	Innvotec Technology EIS & SEIS Fund	
Product manager	Innvotec Limited	
Investment adviser	n/a	
Tax eligibility	EIS/SEIS	
Target return	No explicit target	
Target income	None	
Type of product	Discretionary portfolio service	
Term	Five years onwards	
Sectors	Technology	
Diversification:		
Number of companies	3-10	
(Expected) Gini coefficient	0.1-0.33	
Fees	Amount	Paid by
Initial fees:		
Arrangement fee	Usually 6% (excl. VAT)	Investee company
Annual fees:		
Annual fee	1.0% (excl. VAT) of investment	Investor – see Fees on page 10
Monitoring fee	Usually 1.5%-2.5% (excl. VAT)	Investee company
Exit fees:		
Performance fee	30%	Investor share of aggregate proceeds above £1.30
Advisor fee facilitation	Yes	
Advisor fee amounts	As agreed with investor	
HMRC Approved fund	No	
Advance Assurance from HMRC	Yes	
Reporting	Available online on an ongoing basis	
Minimum investment	£5,000	
Current funds raised	£0.4m	
Fundraising target	£10m p.a.	
Closing date(s)	Semi-annually, at 31 March and 30 September	
Expected exit method	Trade sale, IPO or other exit opportunity	

Source: Innvotec, Hardman & Co research

Fund aims

The Innvotec Technology (S)EIS Fund is a discretionary portfolio service focused on investing in a portfolio of technology companies across targeted sectors with a bias towards impact investments. No specific target return is given, although the performance fee includes a hurdle of 130% of the subscription, which suggests the expectation is of a return to investors in excess of that. There is no income target.

Summary of risk areas

Note: There are generic risks from investing in EIS-qualifying 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 an early-stage or scaling-up technology company, with a bias towards specific sectors and impact investments. The target is for investors to receive shares in three to ten companies. Each investment is likely to perform independently of the others, with idiosyncratic risk dominating market risk.

There is no target return for the fund, other than the minimum hurdle rate mentioned above. Each company will be at the higher end of the risk spectrum.

Sourcing and external oversight

Innvotec's focus is on sourcing opportunities through its substantial network, including universities, incubators and "centres of excellence". It has built up a network of direct contacts, rather than relying simply on official structures. There may also be follow-on investments into the large historical portfolio of over 100 companies. Innvotec appears to have adequate capacity to source the targeted number of investments.

Two members of the Investment Committee are non-executive and bring an external perspective. Innvotec takes only a percentage of a round, so it needs other investors to be equally convinced of a company's merits and investment terms.

Ongoing support and monitoring

Board seats are usually taken only when Innvotec has a large equity position. It aims to have a close relationship after investment, with a member of the core team appointed as the point of contact. Meetings with management are arranged at least quarterly to review progress. Innvotec ensures the door is open between these meetings, with engagement on an "as required" basis.

Exits

Management guides investors to expect exits from year five onwards. While failures may occur earlier, this looks like sensible guidance.

Manager

Team

The investment team is a good size for Innvotec's current level of activity, with the senior management being very experienced in technology and entrepreneurship. We note the ambitions to grow the company, and that expansion of the team will be required in due course. Innvotec also has a strong, supportive, international

shareholder base, which can support investee companies as they expand globally and with the intention of supplying funding from Series A onwards.

Track record

While Innvotec has a lengthy track record, an ownership and management change in 2019 may make the historical record less relevant. Between 2009 and 2019, £13.8m was invested, with realisations of £1.7m and a residual valuation of £16.0m, giving a 28% total uplift. The new team has raised and invested almost £290,000 so far, with no revaluations.

Regulation

Product

Advance Assurance will be sought from HMRC prior to each company investment.

Manager

The Fund Manager is Innvotec Limited. It is FCA-registered (number 122365), with fund management and custodian permissions. Submissions to Companies House appear to be up to date.

Risk analysis/commentary

While Innvotec is long-established within the (S)EIS space, the recent change of ownership and management means it has some characteristics of a new manager. The team inherited infrastructure and a large historical portfolio, while bringing strong relevant experience. It has developed a coherent approach to investing, with an interesting and distinctive product range. The sourcing strategy shows a thoughtful approach to the competitive market for university spinouts, although it sees better early-stage opportunities from “centres of excellence”. Bringing in its international shareholder base also provides options for supporting expansion and later funding rounds.

Diversification within the fund is limited, although typical of products in the EIS area. There will be a spread of target technology sectors, each of which has good potential investment characteristics, which should help with diversification. Individual companies that succeed are likely to give excellent returns, but those that do not may return little or nothing. We do not mind the lack of a return target, believing that many of these are rather arbitrary in the first place.

Overall, while this EIS should be considered in the context of an investor’s entire portfolio, Innvotec will be looking at some exciting areas that could give a good risk/reward balance for its investors.

Investment process

Deeper dig into process

Like many technology investors, Innvotec’s ideal investment point is the inflection point in the J-curve at which a target company has started to achieve product/market fit and is looking to scale up. While it is expected that many of the EIS investments will fit that profile, there will be a good proportion of earlier-stage investments. SEIS investee companies will, by definition, be earlier stage too. These may have a product under development or be at the point of starting their market entry.

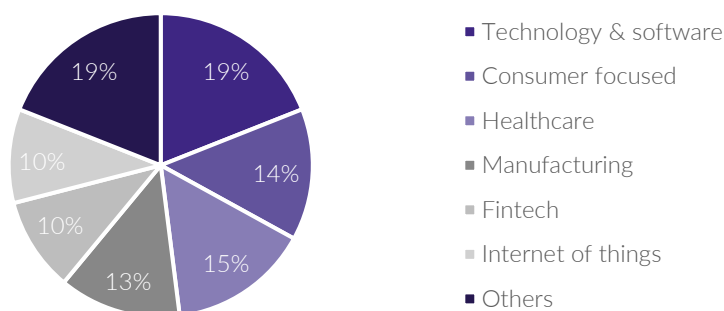
The fund will seek opportunities that have an impact bias, with a preference for companies that could provide a social or environmental benefit.

While the fund will invest in a broad range of technology sectors, it highlights several that fit most strongly with the team’s existing knowledge and skills:

- ▶ Clean technology: aiming to reverse or mitigate mankind’s adverse environmental impacts.
- ▶ Virtual/augmented reality: while this is an area that has promised much for a long time, it does seem to be finally delivering on commercialisation.
- ▶ Cyber security: already a large market, but one that is still getting increased attention.
- ▶ Robotics: another large market, but one that still has strong forecast growth.
- ▶ Artificial intelligence: has come of age in the last few years, but is still at the early stage of application.
- ▶ Medical diagnostics: although a slower-growing market than some of the others, there are many segments still with scope for improved or more affordable diagnostics.
- ▶ Fintech: still one of the fastest-growing areas for venture capital investors.

Although there is no explicit target for diversification across these sectors, there will be a spread in each investment tranche. Within these sectors, the team has various preferences: it prefers software to hardware and B2B, rather than consumer-facing companies. These are not exclusions, but will rather affect the balance of investments.

Sector exposure of historical investments



Source: Innvotec, Hardman & Co Research

Innvotec also has a portfolio of historical investments that may receive follow-on funding. These cover a broader range of market sectors, but are still 30% health, fintech and cleantech, with another 33% within the more general technology classification.

Although the fund has a technology focus, and will be comfortable with deeptech approaches, the team is keen to emphasise that it is not looking at technology for its own sake. Companies should be applying technology to a specific problem and looking to solve it. There also has to be a willing and global market, with a product that a consumer or business will be willing to purchase.

There is a clear preference for companies with tremendous IP, particularly if its exploitation can bring an additional revenue stream or provide a barrier to entry. However, this remains secondary to the application of the technology. Investee companies should also have the potential for global expansion. This is an area for which Innvotec's international shareholder base can provide particular support, through financial and local market knowledge, especially in the Middle East and south Asia.

Overall, there seems to be a credible outline of what Innvotec is looking for and what investors can expect. As usual, discipline in its execution remains a key factor in whether it will be successful.

Sourcing deals

Innvotec's strongest avenues for sourcing lie within its network, including universities, incubators and what it calls "centres of excellence", with connections in both the UK and the US. Although much of the team is relatively new to Innvotec, it has been working in technology and startup investing for some time, and has built up good connections. Of the new management, Tofiq Qureshi has the highest profile, and also has good connections in the Middle East.

To Innvotec, "centres of excellence" are organisations that take research and start to develop it in a commercial way. These may be quasi-public sector, such as hospitals and specialist sector organisations, or private sector. For example, the current portfolio has strong connections with Appledore Shipyard, for renewable energy fabrication, and Agri-EPI Centre, which looks at agricultural engineering. These seem to be a lesser area of focus for other managers.

The team has worked actively on its network within universities and centres of excellence, going beyond the commercialisation offices and connecting with relevant individuals. Its experience would suggest that Innvotec is recommended because it would be a good fit in the exploitation process.

The fund has no geographical restrictions and will invest across the UK.

The aim is to give investors three to ten investments in each quarter's tranche, although companies may get investment over more than one quarter. The historical portfolio has 140 investments. Although the latter, as would be expected, contains a significant proportion of failures and underperformers, there are enough investee companies making good progress to also give a steady flow of potential investments.

While many are competing in the university spinout and early-stage sectors, Innvotec appears to have established some direct links, which should give quality dealflow. With credible networks and the historical investments, we believe Innvotec has the capability to source adequate dealflow to reach its investment targets.

Decision-making

The decision-making process follows a similar pattern to that of most EIS managers. The Innvotec team carries out the selection, appraisal and review of all potential investments, with some technical outsourcing where appropriate.

The initial screening is done by one of the analysts. This is based on the candidate's pitch deck, and uses the criteria outlined above. Innvotec estimates that it gets over 70 decks a quarter, and around 40%-50% are cut at this stage.

This is followed by an internal conversation with the senior team. Four companies a month, ca.15% of initial approaches, proceed to preliminary diligence. There is a strong focus on company management, with managements' qualifications, experience and track record all being assessed. The management's capabilities are assessed through engagement, with assistance given by Innvotec's connections at City Business School.

Innvotec notes that, when dealing with spinouts, there is often the classic problem of a technically talented academic with little or no business experience. Its experience is that initial management tends to be better at getting the technology right than getting it to market. In such cases, the team will often either bring in someone to support the company's development or introduce the company into parts of its network that can supply such support.

Certain technologies will get validated at this stage, particularly if new. While the Innvotec team is strong in some areas, it does tap into its network when necessary. This is particularly common in medtech companies, where clinicians are consulted. The aim is to avoid doing a lot of work and only later find that the technology is not up to scratch.

The preliminary diligence also includes work on the quality of the business plan, including whether the financial model is credible, the potential market for the product and the commercialisation strategy

If the preliminary diligence works out, then there is a deeper dive into the company, with the aim of putting together the internal investment document. The financial plans are dug into, including future funding needs, as are the plans for getting the company's product into the market.

Valuation is also discussed at this stage. Innvotec uses a variety of methods, with the stage of the company determining what is appropriate: discounted cashflow, enterprise value and comparator valuations are all used.

The Investment Committee gets the investment document early, and frequently sends back questions for further investigation. If it approves the investment, then a term sheet is issued.

Innvotec takes only a proportion of any given investment round. This is usually up to 20%, but is occasionally a little higher. It expects to make investments averaging £100,000-£150,000, within total rounds of ca.£500,000. Any investment is conditional on the rest of the round being filled: Innvotec is firm that investment cannot take place without that. This has meant some proposed investments falling through, because the investee company could not sufficiently fill its round.

To help with this, Innvotec has its Investors platform, which it uses to get third parties involved in investments, including non-fund investments. While this does not have the scale of the big crowdfunding platforms, it can be a useful additional source of funding for portfolio companies. We note that some of the newer shareholders

in Innvotec are looking for dealflow access, so it may be that this problem will diminish in time.

Typically, the process takes four to five months from first contact, although this depends on the investee company's stage. This is a little longer than sector averages, but only slightly. Investment may take place over more than one tranche, in which case it may depend on achieving agreed milestones.

A fund investor's split between SEIS and EIS investments is determined by the size of their commitment, with smaller commitments getting a higher proportion of SEIS.

Expected SEIS/EIS proportions		
Commitment size	SEIS proportion	EIS proportion
£5,000 to £30,000	40%	60%
£30,000 to £50,000	30%	70%
£50,000 to £100,000	20%	80%
£100,000 to £1m	10%	90%

Source: Innvotec

Governance and post-investment monitoring

Before being added to the portfolio, all companies will be in receipt of Advance Assurance from HMRC.

Investors will have ongoing access to Innvotec's investor portal, which includes company reports, updated valuations, a quarterly newsletter and other documentation. Valuations will follow BVCA guidelines, and changes are updated monthly. Innvotec believes that it has a conservative approach, and sometimes discounts valuations when methodology gives something higher than it thinks is reasonable.

A board position will be taken when Innvotec takes a large equity position, but it has not done so recently, to keep staff commitments reasonable. When a board seat is taken, it is usually by a team member, but appointees from within its network are also used.

Once an investment is made, a member of the team is appointed as the point of contact. Meetings with management are arranged at least quarterly to review progress. Innvotec wants to be close to investee companies, and makes sure that its door is always open between quarterly reviews. In practice, it finds that companies usually engage when they need help, but can be quiet in-between. We note that, as there will be other investors in a round, the investee companies may have other investors that they can turn to for support.

Innvotec also intends to help bring funding beyond the EIS stages. It has an international shareholder base that is looking for dealflow from Series A onwards. It also intends to add an institutional fund in due course. These should make it more attractive to investee companies.

ESG

While the fund is not explicitly an impact fund, the Innvotec team describes it as having an impact bias. While a couple of the technology sectors on its list have a clear impact theme, Innvotec prefers companies that will have a positive effect on the wider community and whose businesses are solving a social problem. It also has excluded areas, such as weapons or gambling.

In parallel to this fund, Innvotec has an EIS Female Ventures Fund. This has had benefits for the Technology Fund, as 25% of its current portfolio is female-led, comfortably ahead of the industry average.

Exits

Exits are forecast to come through the usual routes for technology companies, with trade sales dominating. While interviewing the Innvotec team, it stressed several times its emphasis on quality over quantity. It is clearly aiming to reduce the failure rate, although time will tell whether it is being successful in this regard.

Innvotec guides that successful exits will come from year five onwards. This is reassuringly realistic, although we note that any failures may come earlier.

Track record

Hardman & Co has been supplied with data as of December 2020.

Innvotec, as a company, has a lengthy track record. Since 2009 and prior to the change of management in 2019, it has invested £13.8m through 23 (S)EIS funds into ca.140 companies. There have been £1.7m of realisations from seven of these funds, with the remaining investments being valued at £16.0m. The aggregate uplift is 28%, with slightly over half being unrealised gains. If we look at the funds from 2013 and before, where most of the exits have been achieved and will be the most mature, the aggregate uplift is 86% on £2.0m of investments.

Given the new team in place, this track record may have little relevance to new investors. Since the team came in, Innvotec has launched two funds, including this one, and has so far deployed just under £290,000 into eight companies. As yet, there have been no revaluations.

While the new Innvotec team has shown some ability to deploy funds, it is way too early to assess its track record yet.

Fees

The fees for the EIS are set out in the table on page 3, and are a mixture of direct investor and investee company charges. These are straightforward, other than as noted below:

- ▶ **Annual management fee:** the first year's fee is deducted from the investor's subscription – so the amount invested is 98.8% of the subscription. After that, it is additional to the subscription, and payable via direct debit.
- ▶ **Performance fee:** this is charged on a fund basis, with a hurdle rate of 130% of the gross subscription.

The fees charged to companies are averages, and may be more or less, in practice.

Unless otherwise noted, the fees and charges are quoted exclusive of VAT. Where investee companies have sufficient VATable revenue, the VAT paid can be offset, but where a company is pre-revenue or unsuccessful, this may not be the case.

Fundraising targets

The maximum fundraise is £10m each year. Closing dates are semi-annually, at 31 March and 30 September. Although the Investment Memorandum commits to deploy funds within the tax year of receipt, generally, it takes place within a quarter.

The minimum subscription is £5,000 per investor, with increments in multiples of £1,000. This minimum is among the lowest for (S)EIS funds.

Average delivery of EIS3 Certificates to investors varies. For EIS investments, three to six months is typical, while SEIS investments take six to nine months. Innvotec notes that companies are variable in the timing of their submission of the forms to HMRC.

Fund manager

Innvotec is a long-standing venture capital and private equity firm, having been established over 30 years ago. There was a change in 2019, when the existing team largely retired and new management bought into the company.

It has raised and invested over 20 small SEIS and EIS funds historically, and currently has two evergreen EIS funds: this fund and the Female Ventures Fund. Its regulated permissions include offering corporate finance advice, covering fundraising, M&A and restructuring work for both investee and non-investee companies.

It has joined the Investors platform, to bring investment directly into individual investee companies. In the near future, it intends to add a technology-focused institutional fund, and will look to expand its investment focus overseas, although it is waiting for the general business and economic climate to settle down before making any progress with these ambitions.

Some of these ambitions relate to an interesting shareholder base. As well as management, it includes several family offices from the Middle East and south Asia, with the intention of adding more. These can take two roles in supporting investee companies. The offices are connected to existing businesses around the world and networks that can support international expansion. They are also interested in dealflow and may provide funding from Series A onwards.

The company has a team that can amply cope with its current level of activities. As well as the five active directors, there are four other people in the investment team, plus several active shareholders who can bring advice and support. We note the plans to grow the company, and Innvotec intends to add to the team in due course.

The Investment Committee consists of the four directors listed below.

Key people

Roderick Collins – Chairman

Was an investment manager at N.M. Rothschild Asset Management, before taking management roles at Trade Development Bank, American Express and James Capel. Later became a director of Matheson & Co, working in private banking.

Chris Buchanan – CEO

Has held senior IT roles, mostly within banking and insurance. This includes roles at Commerz, UFJI, EDS/ABN, Noble Group and Aviva. Since 2013, has taken strategic roles at Unum, William Russell, Maersk and BCS, before joining Innvotec in 2016.

Tofiq Qureshi – Managing Director

Spent his early career working in technology deployment at ATTI, nscglobal, Orange and COLSA Corporation. In 2009, joined the board of Investment Development. Since 2013, has been involved in early-stage companies in a variety of sectors, with a spell at Milamber Ventures.

John Marsden – Founding Director

Started in a media-technology business, before moving into investment management with Baillie Gifford in 1986. Joined Innvotec in 1990, becoming Managing Director in 2001. Stepped back in the 2019 restructuring.

Appendix 1 – due diligence summary

Summary of core due diligence questions		
Manager		Validated by
Company	Innvotec Limited	Information memorandum
Founded	1986	Hardman & Co
Type	Private limited company	Hardman & Co
Company number	OC 02030086	Hardman & Co
Ownership	See below	Hardman & Co
FCA registration	122365	Hardman & Co
Solvency	Yes	Hardman & Co
EISA member	No	Hardman & Co
Fund Custodian		
Company	Innvotec (Nominees) Limited	Information Memorandum
FCA registration	No separate authorisation	Hardman & Co

Source: Hardman & Co Research

Regulation

Innvotec has 26 shareholders. It is 68%-owned by directors and staff, and 32% by family offices and private investors. There has been no controlling shareholder since July 2019. Its FCA authorisation is as a Small Authorised UK AIFM (Sub-Threshold) with appropriate permissions for a fund manager.

The company is comfortably capitalised, with the last accounts (31 December 2019) giving £643,000 of shareholders' funds. The latest Capital Adequacy Capital is £445,000, 174% of its requirement. Submissions to Companies House appear to be up to date.

Innvotec (Nominees) Limited is the custodian for client assets and cash, and is a wholly-owned subsidiary of Innvotec Limited. It has no separate FCA permissions, but falls under the parent company.

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
VAT is reclaimed by investee companies	

Note: fees as listed on page 3; Source: Hardman & Co Research

Calculations		Hardman & Co standard			Target
		-50%	0%	50%	120%
Gross return		£100,000	£100,000	£100,000	£100,000
Amount (pre-tax relief)					
Initial fees					
	Rate				
Initial fee (investor)	1% (+VAT)	£1,200	£1,200	£1,200	£1,200
Arrangement fee (paid by company)	6%	£6,000	£6,000	£6,000	£6,000
Total		£7,200	£7,200	£7,200	£7,200
Net investment		£98,800	£98,800	£98,800	£98,800
Annual fees					
Monitoring fee (from company)	1.8%	£2,000	£2,000	£2,000	£2,000
Annual fee (investor)	1% (+VAT)	£1,200	£1,200	£1,200	£1,200
Total over five years		£14,800	£14,800	£14,800	£14,800
Gross fund after investment return		£49,400	£98,800	£148,200	£217,360
Exit fees					
Performance	30% over £1.30	£0	£0	£5,460	£26,208
Net amount to investor		£49,400	£98,800	£142,740	£191,152
Gain (pre-tax relief)		-£50,600	-£1,200	£42,740	£91,152
Gain (post-tax relief)		-£20,960	£28,440	£72,380	£120,792
Total fees paid		£22,000	£22,000	£28,460	£50,608

Notes: tax relief allows for only basic relief and makes no allowance for any loss relief or other benefits; Source: Hardman & Co Research

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Status of Hardman & Co's research under MiFID II

Some professional investors, who are subject to the new MiFID II rules from 3rd January, may be unclear about the status of Hardman & Co research and, specifically, whether it can be accepted without a commercial arrangement. Hardman & Co's research is paid for by the companies, legal entities and issuers about which we write and, as such, falls within the scope of 'minor non-monetary benefits', as defined in the Markets in Financial Instruments Directive II.

In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public...'

The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: <http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf>

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.



www.hardmanandco.com

1 Frederick's Place
London
EC2R 8AE

+44(0)20 3693 7075

taxenhancedservices@hardmanandco.com