08th June 2018

hardman&co

Eden Rock Ventures

Eden Rock Capital Management LLP

Summary

The fund's investment strategy is to invest in a diverse portfolio of EIS qualifying investments in selected technology or technology-enabled companies.

	Positives	Issues
Why Invest	► **Strategy:** Exposure to a portfolio of technology or technology-enabled companies.	► **Track record:** Only a small number of exits to date, but the unrealised figures show some promise.
The Investment Manager	► **Team:** The team is small, but experienced in a wide variety of areas in financial services.	► **Key person:** Dominic Ward is a key person for the fund. While he is committed, he is not an Eden Rock partner/employee.

Nuts & Bolts

- **Duration:** The fund is intended to be evergreen, with closings as required.
- **Diversification**: The manager expects to provide at least six EIS investments in the fund, with some SEIS exposure if available.
- **Valuation:** Reviewed twice a year, with updates on progress being sent quarterly.

Specific Issues

- **Fees:** Direct fees only, but the aggregate is low for the sector.
- **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	£0m	CEO	James Matthews
020 7194 7622	Scheme target	£15m in 2018	Contact	Fabio Morandi
bm@hardmanandco.com	EIS assets	£3.9m		+44 (0)20 7079 1600
	Total FUM	$720m		investors@edenrockcm.com
	Fund launch date	2018		www.edenrockcm.com

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Factsheet

Eden Rock Ventures	
Product name	Eden Rock Ventures
Product manager	Eden Rock Capital Management LLP
Tax eligibility	EIS (SEIS if available)
Target return	3 times investment in 4-7 years, including tax reliefs (25% IRR)
Target income	None
Type of product	Discretionary portfolio service
Term	Evergreen
Sectors	Technology
Diversification:	
Number of companies	6 – 8
(Expected) Gini coefficient	0.12 - 0.17

Fees	Amount	Paid by
Initial fees:		
Dealing charge	0.35%	Investor
Annual fees:		
Annual management fee	1% + VAT	Investor – for 5 years, deducted upfront
Custodian admin. fee	£75	Investor – 0.5% + VAT capped at £75
Exit fees:		
Performance fee	20%	Investor – portfolio basis, aggregate returns over £1
Dealing charge	0.35%	Investor
Re-registration fee	£25 per holding	Investor – only if investment transferred out of Custodian

Advisor fee facilitation	Yes
Advisor fee amounts	As agreed with investor
HMRC Approved?	No
Advance Assurance	Yes, for each investment
Reporting	Reports every three months
Minimum investment	£50,000
Current funds raised	£3.9m
Fundraising target	£10-20m in FY2018/19
Closing date(s)	Regular closings
Expected exit method	Expected mostly via trade sale

Source: Eden Rock Capital Management LLP, Hardman & Co Research

Fund aims

Eden Rock Ventures (ERV) is a discretionary portfolio service, which will build a portfolio of EIS investments in unquoted technology companies. The target return is three times capital including tax reliefs after four to seven years. Returns will be focussed on capital gains, and investors are unlikely to receive any dividends. The fund is evergreen, with closes as required.

Summary of risk areas

Note: There are generic risks from investing in EIS or unquoted companies, in addition to the specific ones commented on below. Comments on relative risk refer to other EIS investments and not to wider investments.

Investments

Portfolio risk

Each investment will be providing risk capital to an unquoted early-stage technology company. Eden Rock aims to have at least six EIS companies in the portfolio, each roughly of equal size. 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

Although the fund is a new venture, Eden Rock has been making venture investments in EIS eligible companies for over five years. It has established sources of deals, and recent rate of investment is only a little lower than the target of six companies. The Investment Committee requires unanimous decision making, with the members co-investing alongside ERV (subject to personal liquidity).

Ongoing support and monitoring

Eden Rock aims to be a 'good shareholder', supporting the investee companies as best it can. Board positions will be taken for larger investments, but the Eden Rock team will be in regular contact with the management of investee companies. Eden Rock has shown commitment in providing support to date, with the intention being to provide it in a more structured way going forward.

Exits

Eden Rock has a limited track record to date and expects that most exits will be via trade sales. The return profile of individual investments is likely to be skewed, with successful investments probably giving very good returns, while those that do not will give little or nothing back.

Manager

Team

Eden Rock has a small dedicated internal team, which has a diverse range of experience within the financial services industry. The addition of Dominic Ward provides additional support, though he is a key person for ERV without being an employee.

Track record

Since 2012, Eden Rock has made 23 investments into 14 companies, with another investment into an internal joint venture. With only two exits to date, the track record is limited, but follow-on fundings done so far suggest that the investments have made progress.

Regulation

Product

Advance Assurance is sought for each investment.

Manager

The manager of the fund is Eden Rock Capital Management LLP. It is FCA registered (number 432999) with appropriate fund management permissions. Submissions to Companies House appear to be up to date.

Risk analysis/commentary

Overall, although ERV is a new fund, Eden Rock has an experienced team in place who have been committed to the area for some time. The team is not large but seems adequate for the proposed rate of investments. With the company entering EIS only 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. The Eden Rock team know what is required to support these companies, with a more structured process likely to be attractive to potential investments. Although it does not have a deep pool of capital, its willingness to and experience of working with other investors suggests a network that can support follow-on investments.

Diversification is an important consideration for any investor – while the companies that succeed are likely to produce exceedingly good returns, those who do not may return little or nothing. Diversification within the fund is limited, though comparable with many other EIS funds. ERV should be considered in the context of an investor's entire portfolio.

Investment process

Eden Rock is part of a larger group of financial services businesses. The partners have been making investments into unquoted companies since 2012. Since then they have grown their activity in this area, including facilitating co-investments from external individual investors. Having built up experience and a team, ERV has been launched to continue these investments in a more structured way.

A distinction of ERV is that the partners of Eden Rock will be co-investing into each investee company (subject to personal liquidity constraints) alongside the fund investors.

Deeper dig into process

The fund will invest in early-stage growth companies. The focus will be on technology, or technology-enabled businesses, but other areas are not excluded if they fit with the fund's profile. In broad terms, and in common with several other EIS technology fund managers, Eden Rock is looking for companies that have developed a product and are about to market it.

Companies are expected to have valuations of up to £12m, with Eden Rock looking to do deals of £1-2m. At the outset of the fund, deals may be smaller, and dependent on the funds raised.

Eden Rock have given a set of five criteria which they use to score each investment:

- **Adequacy of potential return**: Whether the expected return will fit the target returns for IRR and return on invested capital in the expected timescale, allowing for expected follow-on requirements. Note that Eden Rock expect a success rate of around 60%, suggesting that individual investments should have the potential to give a five times return.

- **Risk profile**: These are specific risks of the business and will vary from company to company. They are expected to include capital risks, including use of leverage, the competitive environment and regulatory risks.

- **Relevant sector focus**: How much confidence Eden Rock has in the business, including knowledge of the business and its sector, relationship with the management and the stage of development of the business.

- **Liquidity profile**: Eden Rock is exit focussed from the time of investment, giving consideration to not only the business, but also the business sector it operates in and whether potential buyers can be identified. The potential for free cashflow generation is also considered as this will affect the types of buyers.

- **Control features**: What protections will be available to investors. Although EIS rules limit what can be put in place, Eden Rock will look at protections for minority investors, the other investors and availability of a board seat.

For each of these criteria, Eden Rock produces a score out of five for how they compare to other companies at a similar stage. The aim is not to reduce the decision to a quantitative one, but to critically assess the strengths and weaknesses of a company. Most companies that receive an investment will have scores of 4/5 in the majority of criteria, but weaknesses are to be expected in early stage companies and perfection is not realistic. A low score in one category may be accepted, with acknowledgement that indicates an area that will need addressing.

As an example, Optalysys is a company that is developing optical computing. It didn't quite have a product ready for market, but Eden Rock felt that it satisfied all the other criteria very well. Having received investments in October 2016 and August 2017, it is considering starting a Series A funding round.

Although only briefly mentioned in the criteria, the experience of the management team is critical. Eden Rock describe this assessment as a combination of 'brain and gut' together: looking at the CVs and experience rationally, together with an instinct for how determined the management are and how easy they will be to work with.

In terms of specific areas, Eden Rock does not have too many restrictions and are happy with both consumer facing, and enterprise focussed businesses. Although emphasis is firmly on technology and technology-enabled businesses, this can cover a wide range of areas which could potentially aid diversification.

Sourcing deals

Since Eden Rock joined EISA and announced the launch of its fund, it has started to get some outside approaches, but believes that the majority of deals will be sourced from within its network.

With the Eden Rock group having been around since 2001 and built several financial services businesses, albeit some that are not UK based, the partners have built up a solid network of contacts. These include some high net-worth individuals and family offices, as well as professional contacts.

As well as the partners, Dominic Ward brings additional contacts that he has built up through his career. Eden Rock is also being pro-active, including monitoring accelerators. Although the companies in these tend to be too early stage for Eden Rock's profile, by monitoring the companies it can offer investment when the time is right.

Whether or not Eden Rock finds itself in competition tends to depend on the size of investment, with the larger ones tending to have more competition. From Eden Rock perspective this is not always unwelcome as for larger deals they appreciate having a co-investor. A couple of previous deals were done alongside another manager in the tax-enhanced space.

The expectation is that investors in the fund will get holdings of approximately 10%-20% of the equity in each investee company. If smaller investments are made, which seems likely at the outset of the fund, then the holding may be smaller.

The target of six investee companies a year is slightly higher than the rate of investment that Eden Rock have been doing to date. Given the increased focus on this area and the willingness to apply the appropriate resources, it looks reasonable to expect that the rate will be achieved.

Decision-making

Eden Rock has built its decision-making process to produce investments that the team has a strong view on. Potential investments are initially subject to a filtering process, which removes companies that clearly fail any of the criteria outlined above. This is followed by the start of due diligence, with an emphasis on the majority of the investment team meeting the management.

As indicated above, the focus is on areas that Dominic Ward has a good understanding of, though Eden Rock will get independent verification where appropriate. For example, it has someone with a knowledge of programming and trading that it uses for insight into the fintech sector.

Each potential investment is scored on the criteria listed above in an investment memo in preparation for consideration by the investment committee. Usually by the time that a proposal has reached the committee, it has been subject to enough scrutiny by each of the members that it is unlikely to be rejected, though sometimes there are some small changes to the deal.

At six members, the Investment Committee is larger than usual for an EIS fund and agreement on an investment has to be unanimous. This latter point is understandable given each member will potentially be a co-investor. Although it doesn't entirely eliminate the possibility of group-think, the money that the members will be co-investing does incentivise rigour in their decision-making.

Governance and monitoring

Advance Assurance will be received from HMRC on all investments prior to completion.

The custodian for ERV 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.

The intention is to give investors exposure to six to eight companies, with roughly equal weightings in each. While the focus of the fund is on making EIS eligible investments, there may be some SEIS eligible companies too.

Reports giving updates to investors will be sent to investors four times a year. Valuations will be updated twice a year, as of 5 April and 5 October. The valuations will follow IPEV guidelines. This means that recent investments will mostly be held at cost, with subsequent transactions being used where available. Where no recent transaction is available, other metrics may be used including recent financial performance, updated projections and progress relative to business plans.

Eden Rock may take a board position in investee companies. To date this decision has depended on the size of the position, with a seat being taken for larger positions To date, board seats have been taken for three of the fourteen investments to date, with another for which Eden Rock attends as an observer. Whether a board seat is taken or not, there will be regular monitoring through meetings with management, calls and written reporting.

Like most EIS managers, Eden Rock recognises that support for the investee companies goes beyond simply monitoring. In discussions, the Eden Rock team described it as being a 'good shareholder'. To date the support has specifically included legal assistance, speaking with customers, help with fundraising and introductions to other investors. For investments made to date this has been done in an unstructured way, but the intention is to be more organised going forward.

In some of their previous investments, Eden Rock have co-invested with other tax-enhanced managers. It seems likely that this will continue to happen in the future, particularly until the resources of the fund build up. So far, the other managers have been among the best established in the sector and are a distinct positive in terms of bringing additional oversight. There may be some risks if their views on future prospects diverge in the future, but these are no more than the usual for the sector.

The fund will be mostly investing in technology companies and, as is normal for the sector, many investments will require one or more follow-on investments to reach profitability. Eden Rock will look for first refusal and pre-emption rights, so investors should be able to participate if they desire to avoid dilution.

To date, Eden Rock has made several follow-on investments. The decision to support a follow-on is not presumed: if the investee company is valuing itself too highly or isn't making sufficient progress then a further investment may be withheld. It seems likely that some fund investments will be part of follow-on funding rounds.

The Eden Rock team believe they are taking a longer-term view than many EIS technology investors. This is not a unique perspective amongst professional EIS managers but doesn't make it less true.

Exits

With only two exits achieved to date, Eden Rock notes that the usual range of exit options for technology companies will be considered. Finding an acquirer for the investee company is the most common exit for technology companies, but Eden Rock will also consider other options such as selling assets or intellectual property, using share buybacks or secondary sales. The Eden Rock team believe that they did not place quite enough emphasis on potential exits in their early investments but will be more focussed on investments where there is the probability of a natural buyer.

Track record

Although the fund is a new venture, Eden Rock has been investing into EIS companies since 2012 on behalf of its partners and some clients. To date, it has made 23 investments into 14 companies, with another investment into an internal joint venture. Three of these were SEIS investments and two were not EIS eligible, including the JV.

There have been two exits to date, one of which achieved a 4.5x multiple, with the other giving a return of capital. Two other investments have been written off. Of the other 10 companies, one has been written down, three have seen no valuation change as yet and the other six have increased in value, some quite substantially.

Fees

The fees for ERV 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. In aggregate, the total of fees paid to ERV will be lower than most EIS funds, with the partners of Eden Rock intending to profit as much or more from their co-investments as from the fees.

Initial fee

There are no initial fees for investors, though the annual management fee is deducted up front.

Annual fees

The Management Fee and the Administration Fee will be charged for five years and are deducted from the initial payment before investing. The Administration Fee of 0.5% + VAT of investments is capped at £75 per annum, which will apply to almost all investors.

Exit fees

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

Investee company fees

Although the Information Memorandum says that the fund may charge investee company fees directly, they currently do not do so.

Fundraising targets

ERV is intended to be an evergreen fund, with tranches closing depending on the speed at which funds are raised and progress with potential investments. The intention is for capital to be invested within 12-18 months of receipt. The target is for £10-20m to be raised in 2018/19. Although in a very different area, we note that the group's insurance company raised approximately US$222m in 2015-2017, so there is significant fundraising experience within the group.

The minimum subscription is £50,000 (though the manager may accept lower amounts at their discretion), with higher amounts in multiples of £1,000.

Investment Manager

Company

Eden Rock is part of a larger financial services group with six businesses. These are a mixture of international operations, including a Bermuda based insurance company, a US based broker dealer, and UK based operations. The partnership has eight members, with the group having 58 full time employees and roughly $720m of assets under management.

The main function of Eden Rock Capital Management LLP is to manage the investments of the fund and the earlier investments.

People

Dominic Ward – Consultant

Having started in corporate finance for real estate investments, he moved into private equity with the Wellcome Trust, becoming Co-Head of Direct Investments. The only member of the IC who is not a partner in Eden Rock, he has committed to allocating whatever time is required.

James Matthews – Partner

Joined Spear, Leeds & Kellogg in 1996 where he was a derivatives trader, and founded Eden Rock Securities in 2000. He subsequently co-founded Eden Rock Capital Management, overseeing its development.

Michael Staveley – Partner

Has an extensive background in credit markets at a variety of well-known institutions including Citicorp, SBC Warburg, General Re and Commerzbank. He is the Chief Investment Officer at Eden Rock.

Fabio Morandi – Partner

A Chartered Accountant, he qualified at PwC where he specialised in the asset management industry. He subsequently moved to HSBC, working first in internal audit then as an equity analyst covering banks. He joined Eden Rock in 2006.

David Higgins – Partner

Began as a trader at Nordic Options, first in arbitrage, followed by market-making in Scandinavian equites. Moved to Eden Rock Securities, working mostly on equity index products, and joined Eden Rock Capital Management in 2005. Oversees data acquisition and management at Eden Being.

David Gervais – Partner

Has worked in various areas, including leasing with Natexis and General Electric Capital, credit analysis with REFCO and structuring asset backed lending with Bank of America. Joined Eden Rock in 2007.

The Investment Committee consists of all the above. With the members all co-investing, decisions have to be unanimous. We note the Partners have a variety of backgrounds from different parts of the financial services industry suggesting a diversity of perspectives.

Appendix 1 – due diligence summary

Summary of core due diligence questions

Manager	Eden Rock Capital Management LLP	Validated by
Founded	2004	Hardman & Co
Type	Limited liability partnership	Hardman & Co
Ownership	Eight partners	Hardman & Co
FCA Registration	Yes – 432999	Hardman & Co
Solvency	Confirmed	Hardman & Co
EISA member	Yes	Hardman & Co
PI arrangements	Yes	Hardman & Co
Administrator		
Company	Handled between Eden Rock & The Share Centre	Information Memorandum
FCA Registration	Yes – 432999	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 Eden Rock Capital Management LLP. The partners are Edward Horner, James Matthews, Michael Staveley, Nicola Corrin, David Gervais, David Higgins, Peter Loo and Fabio Morandi. The last accounts published were as of 31 December 2016. As of that date, the LLP had £3.5m of equity and is comfortably solvent. Its Companies House filings appear to be up to date.

It is FCA registered with permissions to arrange, advise and make transactions in investments and manage an unauthorised AIF. It can control, but not hold, client money.

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

Source: Hardman & Co Research

Calculations

		Hardman & Co standard			Target
Gross return		**-50%**	**0%**	**50%**	**110%**
Amount (pre-tax relief)		**£100,000**	**£100,000**	**£100,000**	**£100,000**
Initial fees	**Rate**				
Dealing	0.35%	£328	£328	£328	£328
Total		£328	£328	£328	£328
Annual fees					
Manager	1.00% +VAT	£1,200	£1,200	£1,200	£1,200
Custody	Max £75	£75	£75	£75	£75
- Deduction upfront (5 years)		£6,375	£6,375	£6,375	£6,375
Net investment		£93,297	£93,297	£93,297	£93,297
From company					
None					
Gross fund after investment return		£46,649	£93,297	£139,946	£185,924
Exit fees					
Performance	20%	£0	£0	£7,891	£19,048
Dealing fee	0.35%	£163	£327	£490	£686
Net amount to investor		£46,485	£92,971	£131,565	£176,191
Gain (pre-tax relief)		-£53,515	-£7,029	£31,565	£76,191
Gain (post-tax relief)		-£25,525	£20,960	£59,554	£104,180
Total fees to manager		£6,866	£7,029	£15,084	£26,436

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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Hardman & Co Research Limited (trading as Hardman & Co)
35 New Broad Street
London
EC2M 1NH

+44 (0) 20 7194 7622
Follow us on Twitter @HardmanandCo

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Hardman & Co team

Management team			
+44 (0)20 7194 7622			
John Holmes	jh@hardmanandco.com	+44 (0)20 7194 7629	Chairman
Keith Hiscock	kh@hardmanandco.com	+44 (0)20 7194 7630	CEO

Business development and investor engagement			
+44 (0)20 7194 7622			
Richard Angus	ra@hardmanandco.com	+44 (0)20 7194 7635	Business development
David Banks	db@hardmanandco.com	+44 (0)20 7194.7622	Corporate Advisory/Finance
Max Davey	md@hardmanandco.com	+44 (0)20 7194 7622	Investor engagement
Antony Gifford	ag@hardmanandco.com	+44 (0)20 7194 7622	Investor engagement
Ann Hall	ah@hardmanandco.com	+44 (0)20 7194 7622	Business development
Gavin Laidlaw	gl@hardmanandco.com	+44 (0)20 7194 7627	Investor engagement
Vilma Pabilionyte	vp@hardmanandco.com	+44 (0)20 7194 7637	Business development

Analysts			
+44 (0)20 7194 7622			
Agriculture		**Bonds / Financials**	
Doug Hawkins	dh@hardmanandco.com	Brian Moretta	bm@hardmanandco.com
Yingheng Chen	yc@hardmanandco.com	Mark Thomas	mt@hardmanandco.com
Building & Construction		**Consumer & Leisure**	
Tony Williams	tw@hardmanandco.com	Steve Clapham	sc@hardmanandco.com
Mike Foster	mf@hardmanandco.com	Mike Foster	mf@hardmanandco.com
		Jason Streets	js@hardmanandco.com
Life Sciences		**Media**	
Martin Hall	mh@hardmanandco.com	Derek Terrington	dt@hardmanandco.com
Dorothea Hill	dmh@hardmanandco.com		
Grégoire Pavé	gp@hardmanandco.com		
Mining		**Oil & Gas**	
Paul Mylchreest	pm@hardmanandco.com	Angus McPhail	am@hardmanandco.com
Property		**Services**	
Mike Foster	mf@hardmanandco.com	Mike Foster	mf@hardmanandco.com
Special Situations		**Tax Enhanced Services**	
Steve Clapham	sc@hardmanandco.com	Brian Moretta	bm@hardmanandco.com
Paul Singer	ps@hardmanandco.com		
Yingheng Chen	yc@hardmanandco.com		
Technology		**Utilities**	
Milan Radia	mr@hardmanandco.com	Nigel Hawkins	nh@hardmanndco.com

Hardman & Co

35 New Broad Street
London
EC2M 1NH

Tel: +44(0)20 7194 7622

www.hardmanandco.com