eisa

enterprise investment scheme association

EIS: Managing the risks

About the EIS Association

The EIS Association (EISA) is the official trade body for the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) industry. EISA is a highly effective not-for-profit organisation that exists to aid the provision of capital to UK small and medium-sized enterprises (SMEs) through these two schemes.

EISA works closely with HM Treasury, HM Revenue and Customs, government ministers, MPs and the FCA to enhance EISs and SEISs and promote the benefits of using them to investors, companies and their respective advisers.

EISA collaborates with other trade bodies that support investment into SMEs, including the British Venture Capital Association (BVCA), the Association of Investment Companies (AIC), the Institute of Chartered Accountants in England and Wales (ICAEW) and the UK Business Angels Association (UKBAA). The EISA Director General sits on the BVCA Venture Capital Working Group, which aims to present a unified voice from all sections of the SME and venture finance industries to the UK government and the EU.

EISA's membership is drawn from all areas of the EIS/SEIS industry and includes EIS/SEIS fund managers, lawyers, accountants, tax advisers, corporate financiers, IFAs and wealth managers throughout the UK. Details of our members and membership categories can be found on our website, www.eisa.org.uk, under the 'Membership' section.

Please contact Mary Rodgers at mary.rodgers@eisa.org.uk if you are interested in learning more about EISA and becoming a member.

The EIS investment journey

There is a saying in the investment industry that lemons ripen faster than plums. It means the companies that are going to fail will do so before the ones that succeed blossom. It can make the first couple of years invested in an EIS portfolio unsettling if you are not prepared for this.

Portfolios are likely to go through a “J-curve” where initial losses are then offset and exceeded by later successes.

It is common for investors to view their current position compared to their total investment, rather than the net cost after initial income tax relief and loss relief. It is worth remembering, particularly during the early stages of investment, how these reliefs have helped offset any losses.

For an additional-rate taxpayer, loss relief can reduce exposure to the complete failure of an EIS company to 38.5p for every pound invested and to 27.5p for a SEIS company. For a higher-rate taxpayer exposure can be reduced to 42p in the pound for an EIS company and 30p in the pound for an SEIS company.

The example opposite illustrates how an EIS portfolio of 10 company investments might perform over time. Overall, this theoretical portfolio makes a good return. However, the position relative to the original investment at different points in time varies greatly.

As may be typical, four companies fail before any returns are realised. For some time after the initial investment, the investor could be feeling very negative about the portfolio. However, the successful companies are still to make their exits. It can often take some years for companies to reach their maximum potential sale value, thereby generating larger returns. The final outcome for the portfolio as a whole is good.

Quality of deal flow

"Quality follows quantity. The more deals you see, the better the likely quality of the deal that you end up investing in."

Andrew Sherlock , Oxford Capital

Having an excellent source of potential deals — or deal flow — is vital and a key criterion for choosing a good EIS manager. EIS investment managers rely heavily on contacts, often developed during their careers. This is why they often focus on specialist areas — like technology or healthcare — because of their knowledge and extensive contacts within these sectors.

Fund managers look at many sources for opportunities, such as universities; experienced professionals and senior executives in different industries and sectors; accountants, lawyers, corporate financiers and professional service providers; and successful serial entrepreneurs and investors. Their reputation may mean they receive many direct approaches from companies seeking EIS funding.

It is important that EIS managers have a good balance between how much investor money they are taking in and how many good-quality opportunities they are finding. Attracting too much money is a risk where there is a temptation to deploy money sub-optimally.

- ☐ How do the team's background and experience help with deal flow?
- ☐ What networks and contacts do they have?
- ☐ How many deals do they see?
- ☐ What proportion of deals that they want to be involved in do they end up securing?
- ☐ Does the manager specialise by sector or geographic region or focus particularly on start-ups or more mature, established businesses?
- ☐ How much money is the firm attracting and is that becoming a problem?

Investment selection

EIS managers operate a “funnel” process to filter the large number of potential investments from their deal flow down to the handful of companies that reach the final stage of investment. This is a highly complex and detailed process where meticulous consideration is given to the merits and potential of the companies.

- [ ] Can they outline their investment process, philosophy and investment selection criteria?
- [ ] What proportion of deals from the start of their funnel do they end up investing in?
- [ ] What are the key metrics they look at in assessing the likelihood of success?
- [ ] What are the signs that a deal should not be pursued further?

Supporting an investee company

Young companies cannot afford the raft of board members and specialist managers that a listed company will have. An EIS manager will often provide support, introducing expert advisers and offering access to professional networks to help nurture an investee company. They may appoint a representative to a company’s board so they can closely monitor and advise the company or recommend personnel changes. Some offer informal and formal mentoring involving advisory boards, which is particulary important for early-stage companies.

- [ ] What support does the manager offer the investee company?
- [ ] What experience does the manager have in advising growth companies?

Fee charging structures

Fund managers use a variety of fee charging structures. Some charge the investor an amount of money upfront for their service and annual management fees. An initial fee will be taken out of the investment which will be held and released over an agreed period. A smaller number charge fees to the investee company. These approaches have different advantages, varying in their tax efficiency and burden to the investee company. There may also be a performance fee if the outcome is successful. Fees will also be liable for VAT.

- [ ] What is the fee structure?
- [ ] Does the fund manager charge fees to the company or to the investor?

Case study

OXFORD CAPITAL

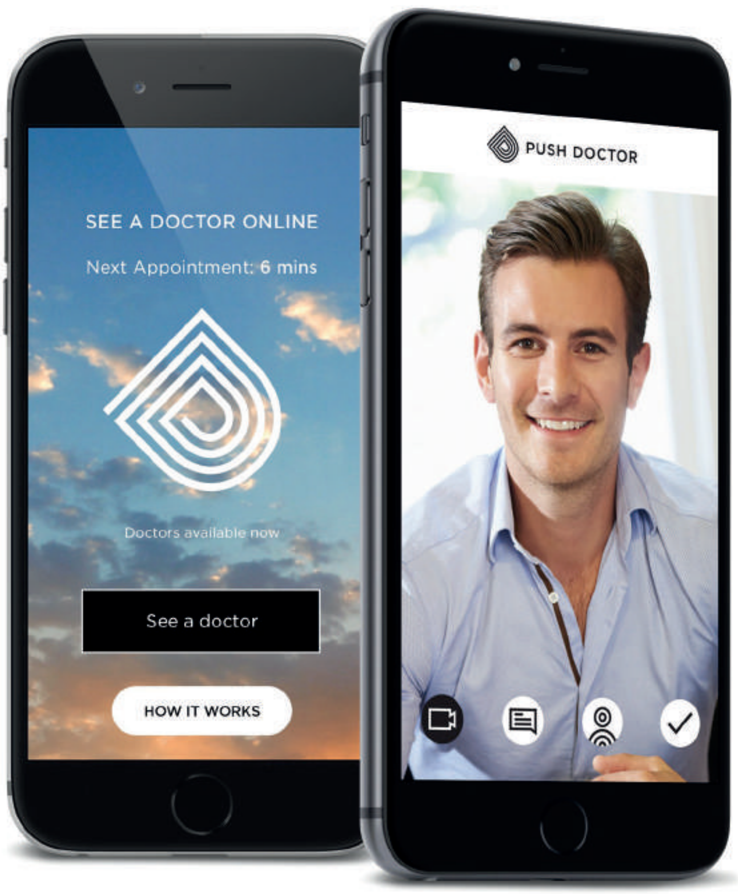
Investing early then backing progress

Push Doctor is a digital health business. Its first product has enabled patients to have video consultations with GMC-registered GPs via an app and web product and the company has quickly become the UK's best-known provider of such services. Patients can see a GP in as little as six minutes. The company has a network of more than 7,000 GPs who fit time on Push Doctor around their daily lives and normal NHS practice work.

As the business has built its audience for GP consultations it has also extended its product and range of services at the point of primary care. GPs can prescribe, refer or issue fit-to-work notes and these services are seamlessly integrated with other touch points such as pharmacies. The company is also expanding its range of secondary services to enable Push Doctor's customers to receive personalised care for chronic conditions and other health and lifestyle-related matters.

Oxford Capital's Tom Bradley says: "When we first invested in Push Doctor in 2015, it was one of several UK early-stage digital health companies, none of which had significant traction. However, we were impressed by the ambition and focus of the founders, Eren Ozagir and Matt Elcock, the quality of their product, the high customer satisfaction scores and their vision for how best to tackle the emerging digital health opportunity."

Oxford Capital's early investment was split into tranches. An initial £1m was followed by a second tranche of £1m a year later. This phase was all about proving that demand existed for the product and that it could be captured at a sensible cost. The second tranche was dependent on conditions involving the number of paid primary consultations facilitated and the marketing spend used to achieve these. Bradley says: "There is no better due diligence than working with a company for 12 to 18 months and it has been great to see the team execute so clearly on its plan."



Continued monitoring of progress, including appointment volumes, repeat appointments, conversion of visits to appointments and customer acquisition costs, demonstrated that Push Doctor had proven demand for private pay-online consultations at significant volumes and sustainable costs.

This success enabled Push Doctor to raise a large follow-on funding round of £20m in July 2017, led by new investor Accelerated Digitial Ventures and supported by Oxford Capital.

Push Doctor continues to grow as one of Europe's largest digital health services.

Case study

A diversified portfolio's journey

Symvan's first technology-focused SEIS fund, the Symvan Seed EIS Opportunities Fund, launched in 2014 with just four companies and offers a good illustration of a portfolio progressing through the cycle we have described in this document. Of Symvan's original investee companies, one is finalising a sale, two are making good progress through strong revenue growth and one has been liquidated.

- **Buying Butler**, a personalised buying platform, received investment in June 2014 following its graduation from the Microsoft Accelerator programme. Buying Butler created a JV with and incubated a separate business in which it holds an approximate 32% stake that offers a transformative digitial experience for insurance claimants. Its aim is to make the claims process considerably more cost-effective and efficient for both the company and the client, whilst increasing the accuracy and timeliness of the claims function. Buying Butler is currently being acquired by another company, with a Series B investment expected in the combined entity during 2018.

- **Bayncore** effectively addresses the glaring skills gap and performance issues in high-performance computing and AI, and is Intel's preferred partner for the EMEA region. Symvan originally invested in late 2014. Further equity has since been raised, with the latest achieved at a price implying a 58% return to the original SEIS investors.

- **VMS Me**, which has created a patented "one tap" voice-messaging mobile app, received funding in February 2015 and has demonstrated strong revenue growth in Europe from media and infrastructure customers. Additional funding has been raised at a price implying a 136% return to the original SEIS investors.

- **WonderLuk**, offering personalised 3D-printed accessories and jewellery on demand, received funding at the end of 2014. Some successes were achieved (notably distribution through Topshop and Jaeger) but the business was unable to scale. In March 2017 a Members' Voluntary Liquidation was completed, returning 1.7% of equity to investors, and allowing them to claim loss relief.

Symvan's Kealan Doyle says: "Getting involved with a company at an early stage means not all investments will succeed, but we believe if you don't talk about the failures, you cannot understand this asset class. We are proud of the success of Buying Butler in less than four years from the launch of the fund, and believe that there is a strong chance that this will make investors a 10x return on their investment in the next 12 to 24 months. Two other portfolio companies have achieved additional funding from other investors at substantially increased valuations, meaning the overall investment returns for investors should meet our £2.85 target for each £1 invested. The prospects for our second SEIS fund, with 12 companies and now fully invested, are already looking exciting. This means that our larger tech-focused EIS fund that focusses on more mature businesses has a healthy pipeline from those companies that are successful following SEIS investment."

Conclusions: The opportunity in EIS

Any investment carries a risk that its value might go down as well as up. With EIS investments, due to their focus on younger and smaller companies, the risk is inherently high.

The government is keen to support Britain's most promising entrepreneurs and businesses and that is why it is willing to sacrifice tax income to release private capital and investor expertise to help nurture these companies to success.

The reliefs are generous and mitigate the investment risks significantly. By considering some of the factors highlighted in this guide you can mitigate those risks further and increase your prospects of a very successful outcome.

We leave you with four key conclusions:

Risk can be balanced within your EIS portfolio by diversification.

Risk can be mitigated by the choice of good EIS investment managers.

Risk can be mitigated by a well-defined investment strategy.

Risk can give the opportunity for super returns.

This guide's sponsors

A number of EIS Association members have sponsored the production of this guide. We have acknowledged their contributions here by way of thanks and to highlight the breadth and depth of expertise offered by our membership.

Oxford Capital

Venture Capital investments into early-stage technology companies have been at the heart of our business since we launched our first fund in 1999. Our London-based Ventures team has more than 50 years of investment experience. They back entrepreneurs who are aiming to solve big problems in innovative ways.

Our Growth EIS aims to back ambitious entrepreneurs who are building companies in sectors where the UK leads the world. Online marketplaces, fintech, future of mobility, digital health, machine learning and artificial intelligence are all current areas of interest.

Our investment strategy is clear and well-defined: we mitigate risk and enhance return by investing around 40% of an investor's subscription into early-stage companies, with the balance going into follow-on investments in companies where positive progress has already been demonstrated.

Contact:
info@oxcp.com

01865 860 760

Symvan Capital

Symvan Capital is an award-winning EIS/SEIS technology venture capital fund manager. We invest in companies seeking to have a material impact in their industry with the potential to deliver exceptional investment returns within a realistic time frame. We provide investors the opportunity to access today's most exciting early-stage tech companies. They aim to become tomorrow's most exciting growth companies.

Our Lifecycle Approach is designed to help each investee succeed. We begin with a highly selective portfolio via SEIS investments, followed by funding support from angel investors and our larger EIS fund where companies have demonstrated initial success and need to scale.

Our team of experts and eminent advisers have a breadth of experience that is rare in early-stage technology investing. They range from world-leading technologists in areas such as artificial intelligence and machine learning to industry compliance experts.

Contact:
info@symvancapital.com

020 3011 5095

Kuber Ventures

Kuber Ventures is a groundbreaking independent platform that is a one-stop shop dedicated to Enterprise Investment Schemes (EIS), Seed EIS (SEIS) and Business Property Relief (BPR) investments.

Founded in 2012, Kuber provides an easy-to-use digital solution for financial advisers and investors considering tax-efficient investments and wanting to build diversified portfolios of many companies within EIS/SEIS and BPR investments. Kuber Ventures was the first dedicated multi-manager platform focused exclusively on EIS/SEIS and BPR.

Our range of tax-efficient EIS/SEIS and BPR portfolios blends together the investment strategies and expertise of a carefully selected panel of product providers (investment managers) who have passed our stringent due-diligence criteria, in order to offer investors exposure to diversified portfolios built from a wide range of investments.

Contact:
info@kuber.uk.com

020 7952 6685

Mills & Reeve

Mills & Reeve is a top UK law firm with offices in six UK cities: London, Birmingham, Cambridge, Leeds, Manchester and Norwich.

What really sets Mills & Reeve apart from other law firms is the way we work with you. We understand that clients no longer want a traditional law firm in the 21st century – you want one that embraces forward-thinking approaches to service, billing, commercial know-how, innovation, people management and community engagement.

Increasing complexity in the legal and tax systems means that now – more than ever – you need the right advice. Our specialist tax and venture team offers market-leading breadth of knowledge, expertise and experience in setting up EIS funds and acting for EIS fund managers, for companies raising EIS funding or for investors looking to claim the relief, to help you make the most of the opportunities offered by EIS.

Contact:
neil.pearson@mills-reeve.com
zickie.lim@mills-reeve.com

0344 880 2666