Kuber Ventures Limited

DUE DILIGENCE SEMINAR

September 2016

Kuber VENTURES

Agenda

- Introduction, Piers Denne, Kuber Ventures
- Richard Angus, Hardman & Co
- Mark Brownridge, EISA
- James Clowes, Tysers
- Closing Remarks
- Networking

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RICHARD ANGUS HARDMAN & CO

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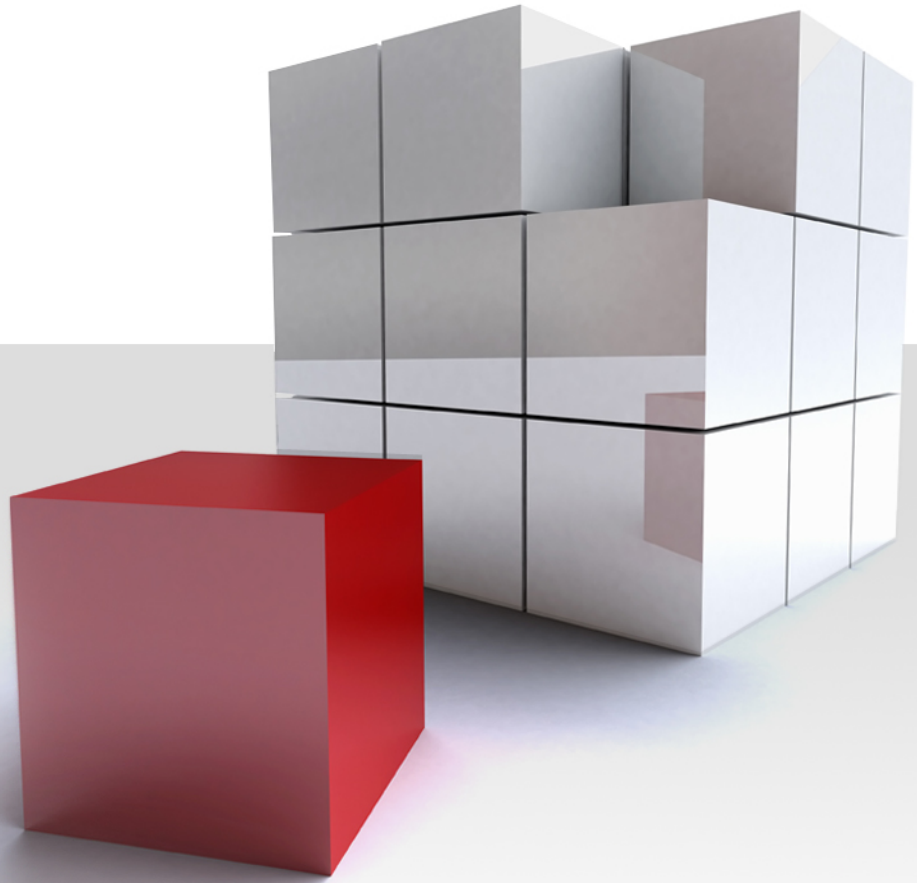
Appreciating Investment Risk

Richard Angus – Head of Business Development at Hardman & Co

Kuber Ventures Due Diligence Seminar
LONDON
28th September 2016



Kuber VENTURES
Opening the door to EIS investment

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Agenda

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I. Objectives

- To appreciate the FCA's direction of travel regarding where the onus lies in the investment decision making process
- To understand the basic investment propositions contained within an offering
- To highlight the critical investment-related questions to consider
- To feel professionally comfortable with EIS investments

II. Introduction to Hardman & Co

Who is Hardman & Co?

- Founded in 1996, Hardman & Co is an FCA registered capital markets research and consultancy business providing a wide range of services to the UK corporate sector. Our expertise covers all major sectors of industry and commerce
- Independent research and financial analysis are our core product offering, and combined with a deep understanding of our business and strategic focus, provides the ability to assess, value and advise our corporate clients
- Our business is structured to address the ever-changing regulatory landscape and to help alleviate commercial challenges in the financial services industry
- We entered the tax enhanced review business in 2015, having been encouraged to do so by industry participants, and after several months of due diligence
- We are **not** a stockbroker. We are only retained by corporates or advisers. We do, however, have a significant network of contacts

II. Introduction to Hardman & Co

Speaker bio – Richard Angus

- Head of Business Development at Hardman & Co since 2014
- Chartered Accountant
- Former fund manager
- 20 years experience in US Investment Banking
- Career largely focused on investing in or raising capital for growth companies
- Active and experienced investor

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III. Defining due diligence for today's purpose

Definition

Due diligence refers to the care a reasonable person should take before entering into an agreement or transaction with or on behalf of another party

Source: Investopedia

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III. Defining due diligence for today's purpose

Attitudes to due diligence

EITHER:

An essential step in the process of allocating my clients' assets appropriately?

OR:

An essential exercise that is carried out by other people?

OR:

Something that only comes to the fore when things go wrong and the need to avoid blame becomes paramount?

III. Defining due diligence for today's purpose

Main types of due diligence

Legal DD

Covers elements such as legal structure, contracts & agreements, litigation, regulatory compliance, ownership of title

Financial DD

Includes analysis & review of financial statements, tax issues, accounting policies, financial trends and resources, debt management, cash flow management

Commercial DD

The expert service for potential acquirers and/or investors in businesses. All of this is intended to determine whether the business plan stands up to the realities of the market

IV. The regulatory environment

Changing regulatory attitude towards DD

FCA Thematic Review TR16/1, February 2016:

"Assessing suitability: Research and due diligence of products and services"

A couple of key quotes:

"…the poor quality of an advisory firm's research and due diligence is one of the three root causes for poor consumer outcomes."

"…We were disappointed to identify issues relating to platform research and due diligence, particularly having previously published our expectations around this topic."


Financial Conduct Authority

FCA

Thematic Review

TR16/1

Assessing suitability:
Research and due diligence
of products and services

February 2016

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IV. The regulatory environment

What is 'Research & Due Diligence'? (FCA's view)

"Research and due diligence form part of a wider range of requirements which, together, combine to ensure firms deliver good client outcomes."

Competence – the advisory firm must ensure its advisers are adequately competent on the subject of the product or service concerned. Advisers are required to be competent in the regulated activities they undertake, such as advising on investments

Research and due diligence – the process carried out by the firm to assess: (a) the nature of the investment, (b) its risks and benefits, and (c) the provider. The firm needs to understand these factors in order to judge whether the solution is suitable

Assessing suitability – once advisers are competent in the nature of the investments and understand the individual product or service, they should be able to judge for each client if the solution is suitable

Conclusion: "What constitutes a reasonable level of research and due diligence will differ depending on the adviser's recommendation and the needs of the client."

IV. The regulatory environment

So…what does TR16/1 have got to do with me?

The FCA findings & observations included the following comments:

- Many firms did not show consistently good practice across all products and services

  "We were disappointed to identify issues relating to platform research and due diligence, particularly having previously published our expectations around this topic."
- The better firms had either in-built challenge in the process and/or individuals who were knowledgeable, enthusiastic and challenged the firm's approach
- File reviews should involve a genuine assessment of the recommendation rather than simply checking the presence of research and due diligence, irrespective of its quality or relevance to the client
- Many firms demonstrated inconsistent and insufficient research and due diligence in the selection of platforms. We believe this was caused in some cases by status quo bias and an 'if it isn't broke, don't fix it' attitude. We also saw evidence of some firms retro-fitting due diligence to justify the outcome the firm had already previously decided upon
- When firms have CIPs, they should ensure individual advisers understand the benefits and risks

IV. The regulatory environment

…And there is more to come from the FCA soon

"We will be publishing a second consultation paper on the implementation of the Markets in Financial Instruments Directive (MiFID II) later this year (2016). Based on ESMA's Technical Advice to the Commission of December 2014, we anticipate that this will include requirements in relation to research on products."

V. The key steps to investment evaluation

Where will the buck stop?

An intelligent observer might deduce that the onus regarding the investment responsibility (as opposed to tax planning) is being pushed increasingly onto the adviser, as they are best placed to understand the needs of their client.

An Adviser might be asking questions such as:

- What do I need to know?
- What do I need to do?
- Who else, if anyone, can I rely on?

General words of advice:

- Ignorance is no defence, nor will "just going with the flow" be an acceptable practice
- Acting like a reasonable person is a good sense-check
- Get informed help in cases of uncertainty

V. The key steps to investment evaluation

The appropriate mindset to adopt

The general rules to any investment commitment include:

- Appreciate the key drivers to risk and reward
- Identify the investment processes that are applied to decision-making
- Adopt a constructive approach; and do not accept weak answers to questions and enquiries
- Understand the business proposition and importantly the current valuation
- Consider management record, contribution and reward structure
- Identify any conflicts of interest
- Division of reward - who stands to benefit?
- Absorption of losses - who takes the hit?
- Assess financial resources to accomplish aims – scale of future fundings and timing
- Obtaining additional comfort whenever necessary

VI. How Hardman & Co approaches reviews

What we look for…does it all make sense?

- Clarity of fund objectives
- Robustness of business case that underpins objectives
- Investment process – needs to be clear and consistent
- Management experience and credibility; case studies
- Valuation calculations; on what basis are these prepared
- Corporate governance standards – management of conflicts
- Risk management
- Monitoring of progress; life is not static
- Results of stress testing the business model

VII. Case study

Rocketship EIS Managers - 1

- Rocketship identifies intellectual property rights from university research projects and seeks to exploit them. It has been in operation for 10 years and currently has 10 strategic investments
- Industry gossip is that the Rocketship guys are exceptionally talented and appear to be uncovering some “interesting new opportunities” for investment
- The company retains top tier accountants and lawyers, and there has been no adverse regulatory or media news. The company’s current offer is going well and there is a degree of urgency to invest

VII. Case study

Typical Rocketship investment opportunity - 2

- WonderCo believes it can adopt IP from a UK university to make building materials out of waste ceramic and glass. It thinks its products, if produced in volume, could replace existing offerings at 50% of the current sales price. The target market is £200m in the U.K. alone
- The company needs £2m new equity to reach commercially viable sales. Today sales are < £1m
- The supply of raw inputs is unlimited and secured from reliable sources at no cost
- A patent has been granted. US patent progress is "proceeding well"
- The new chairman is a local legend who runs a highly successful private company in a related industry. His contacts are significant. He is already invested £100,000 personally in WonderCo
- The 2 scientists who developed the idea have never been outside a science lab
- A highly-regarded company has agreed to provide the new processing machinery within 3 months into the newly-leased factory
- The company thinks its green credentials are a big positive

VIII. Concluding remarks

- Maintain the 'reasonable person' stance
- Be aware of regulatory changes and anticipate the consequences
- Don't try to be an investment guru, but try to cultivate the antennae of an experienced investor
- Prepare mental checklists to allow you to grasp the key investment criteria quite quickly
- Case studies are a good way to gain knowledge rapidly
- Don't get carried on a wave of euphoria – stay grounded
- Don't assume that when Brexit is completed that the rules will become more relaxed
- Read FCA Thematic Review TR16/1 from cover to cover, and inwardly digest
- Watch out for the next FCA paper

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MARK BROWNRIDGE
EISA

Kuber VENTURES

How to advise on EIS investing compliantly and profitably

Mark Brownridge
Director General of the EIS Association

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enterprise investment scheme association


I CAN'T

After the session, you will be able to…

- Save time
- Reduce risk
- Increase profit

Debunking the EIS myths and confronting the concerns

PRODUCT

Poor returns

Revolves around the tax relief

Offers tax avoidance

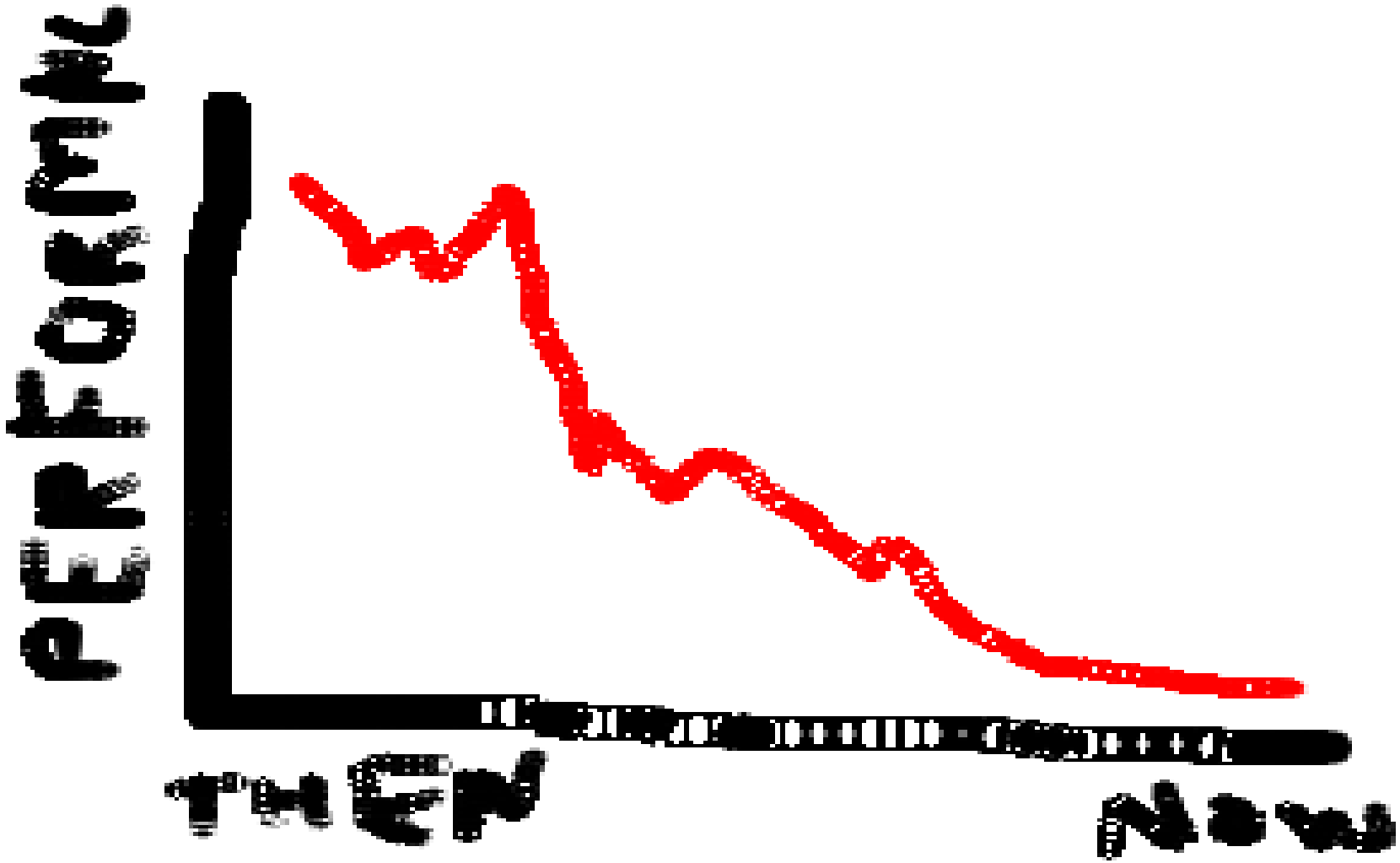
Due Diligence

Ultra HNWs only

Compliance and PI

Tool for FP

Poor Returns



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“It’s not whether you’re right or wrong that’s important, but how much money you make when you’re right and how much you lose when you’re wrong.”

George Soros

Revolves around the tax relief

Income tax relief	30% upfront income tax relief (up to a maximum investment of £1 million in the current tax year, plus the ability to carry back to the previous tax year)
Capital gains exemption	Any capital gain is tax free (provided income tax relief has been given and not withdrawn) after a minimum holding period of three years
Capital gains deferral relief	Unlimited capital gains tax deferral for life of the investment
IHT relief	100% inheritance tax relief after two years (provided the investments are held at time of death)
Loss relief	Any loss (calculated after deducting the income tax relief) may be offset against taxable income or capital gains
Dividends payable are taxable	

HMRC Research Report - The Use and Impact of Venture Capital Schemes Feb 2016


Ipsos MORI
Social Research Institute

February 2016

The use and impact of venture capital schemes

HMRC Research Report 355

Matt Colahan, John Higton, Lucy Joyce, Rebecca Klahr and Jayesh Navin Shah, Ipsos MORI

Professor Marc Cowling, University of Brighton

- "Certain investors said they would have invested regardless of the tax reliefs – especially those investing for entrepreneurial or philanthropic reasons – but pointed out that they were able to afford to invest a higher amount due to the reliefs. Similarly, certain investors said they had made more risky investments than they normally would due to the tax reliefs, which is in line with the policy intent of the schemes."

- "One EIS investor noted that while tax reliefs did not affect the affordability of an investment for them, they preferred to invest as part of a group of investors and the reliefs had helped to bring other investors on board. Being part of a group of EIS investors in a business gave reassurance about the potential of the business and helped this investor meet like-minded individuals."

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Coryton advanced fuels

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Offering tax avoidance

Due Diligence

- Flexibility
- Charges
- Liquidity
- Tax
- Features
- Track record
- Management experience
- Downside protection strategy (if applicable)
- Upside potential
- Deal flow
- Investment strategy
- Exit strategy

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Due Diligence – Do and Don’ts

- Do it Yourself
- Use but don’t rely on 3rd parties
- Set your own criteria
- Don’t follow the crowd
- Ask the questions they don’t want you to ask
- Don’t rely on one manager
- Keep it under review
- Keep an audit trail

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Ultra HNWs only

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Compliance and PI

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Tools for planning

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Profit extraction from a business

Higher Rate Tax Payer Business Owner

Dividend (£)	100,000
Dividend less £5,000 allowance (£)	95,000
Effective rate of tax	32.50%
Tax (£)	30,875
Net cash extracted (£)	**69,125**
EIS investment required to reduce tax to nil, i.e. Tax/30% (£)	**102,917**

Nothing contained in this presentation is intended to be, nor should it be construed as being, investment, legal, financial or tax advice

Improving cashflow

	YR 1	YR 2	YR 3	YR 4	YR 5	YR 6
EIS INVESTMENT	£100K	£100K	£100K	£100K	£100K	£100K
CUMULATIVE INVESTMENT	£300K					
30% INCOME TAX CREDIT	£30K	£30K	£30K	£30K	£30K	£30K
CUMULATIVE INCOME TAX CREDIT	£30K	£60K	£90K	£120K	£150K	£180K

IF THE CAPITAL FROM THE YEAR ONE INVESTMENT IS RETURNED IN YEAR FOUR, THEN THESE FUNDS CAN BE USED TO MAKE A FURTHER EIS INVESTMENT AND GAIN ANOTHER 30% INCOME TAX CREDIT.

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“It's nice to have a lot of money, but you know, you don't want to keep it around forever. I prefer buying things. Otherwise, it's a little like saving sex for your old age”

Warren Buffett

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JAMES CLOWES TYSERS

Kuber VENTURES

SEIS/EIS, Due Diligence and Risk Transfer

28th September 2016

About Tysers

- Established 1820
- Oldest Lloyd's insurance & reinsurance broker
- 100% owned by the employees
- 290 employees
- £53,000,000 group revenue – no debt!
- £750m+ group premium into the market
- Single office in the heart of the world's largest market
- Expertise in all classes of Insurance & Reinsurance
- Service provider to Airmic, members of UnisonBrokers and UNA Alliance
- Authorised & Regulated by the FCA

IFA's and Risk Transfer

- Professional Indemnity Insurance is compulsory for IFA's as set out by the Prudential Regulatory Authority

- Minimum levels of cover required: Gabriel Returns – limits, exclusions

- IFA's have purchased PI far longer than some professions, and certainly relevant to the explosion in 'contractual PI' purchasing that now occurs.

- PI Insurers and IFA's – not a match made in heaven!

Insurers' concerns with the IFA sector:

- Financial Ombudsman – non-specialised adjudicators, protecting the 'little man'.

- FCA – Changing attitudes – best practice becomes worst practice

- Fluctuating Economic environment

  Impacts investment returns
  Effects client's expectations

  Both of these cause complaints

- Changing legislation e.g. 2015 Pension Reforms

Insurers thinking

- Insurers naturally try to stay ahead of anticipated risks

  e.g. changing legislation and economic shifts.

- In reality a lot of insurers react retrospectively to systemic market events.

I. SCARP/Precipice Bonds
II. Arch Cru/Key Data
III. Pension Review
IV. Film Finance Partnerships/Tax Avoidance

- Risks facing IFA's are ever changing and diverse and insurers are always nervous of the next 'thing'. It is for this reason that the IFA insurance market is so restricted.

Economic cycle and product evolution/development

- De-regulation/regulation and the fluid nature of the economy lead to the rise and fall of new investment products.
- As part of this overly complex products or increased regulatory oversight can lead to an increased claims e.g. UCIS products, ICOBS 4.2.1.
- The recent economic conditions (low interest rates/reduced credit) have provided further evolution and the development of SEIS & EIS.
- Changes in the lifetime allowance and IHT regime have driven their increased their popularity. As such insurers are taking closer consideration.

SEIS/EIS Benefits. But not for everyone?

- 50% up front income tax relief
- No Capital Gains Tax
- Reduce the potential inheritance tax due on your estate
- Potential growth of investment in smaller companies. Even if SEIS company fails this loss can/could be offset against your tax liability.
- All of these points are attractive to any investor, but EIS are only suitable for specific investors. At the centre of determining this are KYC/TCF and due diligence, and which are the cornerstones of reducing insurance claims.

Duty of Care and Due Diligence:

- Where does the duty begin & end? FCA has made it clear that IFA's even have a duty of care on execution only business. New Pension legislation – insistent clients.

- Independent/Restricted Advice – Independent advice causes onerous levels of due diligence. Where does it start & stop? FOS can argue either way.

- Kuber platform provides a very robust due diligence process and it is a potential solution. However is this enough?

FCA Statement on third party tools:

'A firm that uses a third party system or 'tool' must satisfy itself through an appropriate due diligence process that the system or 'tool' is, and continues to be, fit for the purpose intended by the firm'.

- Insurers concern on this point are based on the inconsistent views of FOS and clients in the event of a complaint/claim.

Insurers and High Risk Products

- A lot of insurers have pre-conceived perceptions on individual product types. The more moving parts/complexity will be considered as higher risk by insurers.

- Certain insurers underwrite on the micro (product type) level and hence can simply impose:

  Higher premiums
  Product exclusion

  e.g. Pension Transfers and esoteric investment products

- Whilst certain products have a higher claims frequency not enough consideration is given by insurers to client suitability when considering higher risk products.

- Demonstrating client suitability can form a large part of the broking process.

An imperfect Solution?

- Due diligence + KYC + TCF

Under the TCF guidelines this ensures:

I. Products and services marketed and recommended are designed to meet the needs of identified client and are targeted accordingly.

II. Where clients receive advice, the advice is suitable and takes account of their circumstances.

- This ensures no miss-selling; but also a robust fact find and advice documentation process ensures that a complaint can be defended.

- There will always be complaints, justified or not, but the IFA's focus must be ensuring that they can demonstrate suitability born from product knowledge, KYC and TCF.

Conclusion:

EIS/SEIS – A concern for insurers?

Insurance - An imperfect solution?

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CLOSING REMARKS

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