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Due Diligence Review: Syndicate Room – Access EIS

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Company Details

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Company Background

Access EIS is run by Syndicate Room Ltd. Syndicate Room Ltd was founded in 2013 by Gonçalo de Vasconcelos and Tom Britton to create an online equity crowdfunding platform that enabled its members, retail investors, to co-invest in start-ups alongside seasoned investors. Vasconcelos has a background in start-ups and Britton has a technology background.

Syndicate Room is regulated by the FCA. It is owned by Syndicate Room Group Ltd, which was established in 2016. Syndicate Room Group Ltd has a diverse shareholder base with over 400 investors, including financial institutions (Unicorn AIM VCT). We are pleased to see that Vasconcelos has a large personal investment, but less than 50% control of the company.

Both companies' accounts were audited by Chater Allan LLP, a local accounting firm, with no exceptions recorded for the financial year ended 31st December 2018. 2019 accounts will be audited by Hillier Hopkins LLP and are yet to be published.

Until 2019, the core business of the company was the crowdfunding platform business, the objective of which was to secure the same economic terms for small retail investors as those available to large, professional investors. The crowdfunding platform has been phased out to focus on the Access EIS Fund but may be revisited at some point in future. Crowdfunding has become increasingly uncompetitive for investee companies, which means that companies seeking funding in this way are diminishing in quality. We have observed this ourselves in our work in corporate lending.

The business focus has now shifted to the fund, the key premise remains the same – to allow individual investors to invest in start-ups alongside experienced angel investors – but the format has changed and investors now have access to a portfolio of investments, rather than being able to select individual deals.

In April 2019, COO Graham Schwikkard, was appointed as a Director and he became CEO in June 2019. Vasconcelos stepped down because Syndicate Room is past the start-up phase that is his

particular area of expertise, to focus on a new venture. He remains involved as a non-Executive Director.

Financial Strength and Reputation: the companies are young and so financial history is short. Both firms (Syndicate Room Ltd and Syndicate Room Group Ltd) have reported losses in the last two years of trading.

The crowdfunding platform had built a strong reputation, winning several industry awards, including: Growth Investors Best Investment Platform Award 2015 and 2016 and Industry Game Changer 2016; AltFi Awards Alternative Finance Platform of the Year 2016 and Most Innovative Product of the Year 2016. Gonçalo de Vasconcelos also appears widely respected, winning Best Online Investments CEO 2018 at the Global CEO Excellence Awards, writing for Forbes and appearing quite frequently in financial press.

I have searched Companies House and FCA databases for information on both company founders and have found nothing of concern.

Chairman of both companies, Tim Bellis, also has a strong background having been partner at law firm Herbert Smith for over 20 years and is currently a Fellow at the University of Cambridge Judge Business School. I also note the presence of three additional independent non-executive director on the Board as a sign of good corporate governance.

If Syndicate Room were to fail and go out of business the nominee under which shares are held would be dissolved and another nominee appointed, or shares would be transferred into direct ownership of the investor. This would be administratively complicated, but the value of holdings would not be impacted. If the business were acquired, it is likely in my view that the new owners would continue to run the fund.

Fund Objective: to achieve a well-diversified portfolio of EIS investments across a broad range of sectors using a passive investment strategy at a low cost, spreading risk and maximising returns across 50+ start-ups over 12 months (expected to fall across 2 tax years).

Investment Philosophy and Process: Access EIS will invest alongside experienced and successful angel investors. Syndicate Room has agreements in place with 45 such “angels”, with the aim of achieving a high degree of diversification and benefitting from the investment skills that those “angels” have demonstrated in the past. Please see details in the appendix of how these investors have been identified and the research that has been carried out. The process has been extensive and robust.

The shift in Syndicate Room’s sourcing of deals for EIS investors is driven by the aim to secure top deal flow, which is in investors’ best interests. Around 50% of those angel investors were already working with Syndicate Room via the crowdfunding business, suggesting some strength in the relationships.

By following these investors into investment in start-up companies over 12 months, the fund aims to achieve 50 individual holdings. This focus on diversification is key and offers clients a higher level of risk management than we have seen in other portfolio-based approaches to EIS investment.

This difference is significant, the average number of target holdings for the EIS investments that we screened in December 2019 is 8.2 (excluding Access EIS this number falls to 7.3), so diversification in the Access EIS Fund is much higher than average. The next highest target is 15, less than half that of Access EIS. This focus on diversification is consistent with sound portfolio management, particularly in a sub-sector of equities where failure rate is high.

As companies are not selected for investment by a fund manager, in the typical way that EIS portfolios are managed, costs are low, which again is in line with our investment philosophy.

Rather than a fund manager's research, investors in the fund benefit from the due diligence that is carried out by the angel investors. A list of around 100 investors that meet Syndicate Room's criteria has been identified and so far, 45 of those have agreed to co-invest with Access EIS. It is worth noting that there is no contractual obligation for the investor to invite Access EIS to the funding, however it is an advantage to the angel to offer access to additional funds from diversified sources to prospective investee companies.

The fund aims to invest in companies identified by a minimum of 20 investors, this means there is no concentrated exposure to individual biases or preferences in company selection, which we see as an advantage over many discretionary EIS portfolio solutions.

When one of these investors participates in a deal, Syndicate Room will be invited to invest alongside them. Although Syndicate Room will carry out its own due diligence on the deal, this is done with the purpose of managing risk rather than selecting the best deals to participate in and rejecting the least attractive. The over-riding aim is to benefit from the investment strategy of at least 20 angel investors. Funding for deals will be allocated on a first-come first served basis as opportunities arise.

The fund will always receive the same share price and share class as the lead investor. To ensure that investee companies demonstrate some track record of operations, a minimum funding round size of £400k has been set.

The fund is not a single pool of capital, each investor has a personal fund that can be viewed online. To invest in a company, several personal Access EIS funds will be pooled together via a nominee account. If an investor makes a top up investment a new fund will be created for that new investment, in which case there would likely be an overlap in holdings between the two portfolios. Given the level of diversification to be achieved, this is not concerning. Each investor participates in every deal until they have a minimum of 50 holdings. The operations required to allocate investments to individual accounts is 100% technology driven, software is developed and fully functional.

Unlike other discretionary portfolio services for EIS, Syndicate Room will not be seeking representation on the investee company board and have the respective level of influence over the company. However, it is likely that the angel investor will be involved with the investee company and be providing input on an ongoing basis.

Syndicate Room focusses its own due diligence on the legal structure of investments. Each investment is structured so that the fund has pre-emption rights. This means that if there is a subsequent capital raising the fund can take part so that its initial investment is not diluted. There are also "drag along" and "tag along" rights in place, ensuring that if the investee company is acquired, the fund receives the same terms as the lead investor. Syndicate Room also undertakes background checks of company directors and verifies that the deal is EIS compliant. Evidence that the angel investor has committed funds is also received. All other due diligence on the investee company is carried out by the angel investor and the fund takes a passive approach to following that investor's decisions. Syndicate Room's due diligence focusses on the angel investors themselves.

Although the Access fund was only launched in Q419, this investment process has been used to make 17 investments in the last vintage of Fund Twenty8 and it is encouraging to see that a significant number of deals have been sourced, and invested in, already.

Investment Personnel:

Graham Schwikkard: CEO, joined Syndicate Room as Head of Operations in 2017, after seven years as a management consultant. Graham leads the Investment Committee and is focussed on the overall structure of the portfolio.

Tom Britton: Co-founder and CTO of Syndicate Room, has a background in IT product development.

Francesca O'Brien: Head of Clients and Investments, joined Syndicate Room in 2013 and has since been responsible for oversight of funding round transactions and leadership of sales, legal and deal-analysis teams.

Edward Hume-Kendall: Portfolio Manager, responsible for overseeing the work of the Clients and Investments team. He has been with Syndicate Room for almost 3 years, having joined as a graduate, and manages the underlying portfolio as well as the administration and execution of investments by SR funds.

There are also 2 investment analysts in the team, they have strong academic credentials, but are at early stages in their careers and do not have a lot of experience in investment analysis.

Fund holdings: The fund aims to hold a minimum of 50 investments. It will not invest more than 1/50th of its capital value in any single deal and a maximum of 10% of the fund will be invested in deals sourced from a single angel investor.

The fund will not invest in companies with operations in weaponry or unregulated gambling. There are no other sector restrictions. Should natural deal flow lead to a concentration in any sector, Syndicate Room will not intervene, but will allow market forces to shape the portfolio.

All deals participated in are pre-approved for EIS status by HMRC.

There is good visibility on the deal pipeline (which we have been able to review), which includes 27 potential investments across a variety of sectors.

All investee companies must be actively trading, or able to demonstrate steps towards first sale (e.g. contact for services.

Risk: Legal structure is tightly monitored and controlled to ensure an investor's position is protected in line with professional investors.

Although Syndicate Room carries out limited due diligence research of individual deals as the principle of investment is to leverage the skills of the angel investors, there are some measures in place to manage risk. There will be background checks on the directors of the investee company and the registration status of the company will be verified. Syndicate Room also reviews company bank statements and accounts to ensure there is sufficient financial strength to make the current funding round successful.

All investee companies will be required to sign up to Syndicate Room's subscription agreement, which sets out standards of information disclosure about the capital raise, secures pre-emption rights on future share issues, secures voting rights (which Syndicate Room will exercise on the investor's behalf) and lays out standards of ongoing reporting (min. quarterly updates).

As we have already highlighted, investment risk is managed by the high level of diversification in the fund, although it must be borne in mind that investment in early stage companies is high risk and investors must have a commensurately high risk tolerance.

Performance: Access EIS was launched in October 2019 and has no performance to report. We review Syndicate Room's previous EIS funds to assess track record of the group.

	Fund Twenty8 2016	Fund Twenty8 2017	Fund Twenty8 III	Fund Twenty8 IV	Growth Fund
Completed deployment	March 2018	March 2019	Ongoing	Ongoing	June 2019
Companies in portfolio	32	32	27 so far	28 so far	7
% change in portfolio value (ex. EIS)	3.38%	7.3%	1.25%	2.49%	1.56%
# companies revalued	23	11	4	1	1
# companies up in value	11	9	3	1	1
# companies down in value	10 (incl. 3 failures)	2	1 (due to internal share transfer)	0	0
Exits	1 (Engenie acquisition)	1 partial (Cambscuisine)	0	0	0
Failures	3	0	0	0	0

Source: Syndicate Room February 2020. Past performance is not a guide to future performance.

The results of the various vintages of Fund Twenty8 are in keeping with investment in early stage companies and demonstrate the benefits of diversification in the fact that they are all in positive territory.

Fees: The fund is subject to a 1% initial fee. This compares well to the universe of EIS portfolio services we reviewed where the average entry fee is 1.3% ranging up to 2.5%.

The AMC is 1% for up to 7 years, which is also low compared with multi-sector EIS portfolios, where the average AMC for funds in the top quartile by diversification is 2.2% (Source: Micap December 2019). 4% of charges is deducted from the initial subscription amount, so 96% of total subscription is invested. The remaining fees will be deducted from cash returns.

The fund has a performance fee of 10% after 110% initial capital and all fees have been returned to the client. This is applied on individual deals, so it is possible that clients may pay a performance fee while losing capital value across the whole portfolio in aggregate.

Performance fees are standard for EIS products and this is below the average of 20% for the performance fees that we observed, the hurdle rate is competitive against most funds in this universe, which often apply a 100% hurdle. There are no exit fees.

Investee companies are charged a service fee for raising capital through the platform with an initial fee of 2%. This is low compared to the initial and ongoing fees of products in the market and should make the fund attractive to prospective investee companies and aligned with angel investors.

Financial Planning Considerations: the fund opened in October 2019 and has exceeded its minimum raising of £2.5.m (as at 15.1.20) and is expected to raise up to £10m over 12 months. The fund will remain open and continue investment into companies on an ongoing basis. 38% of investments received so far are from existing clients, so the fund is attracting new investors.

EIS tax certificates will be issued when individual investments are made in the investor's own portfolio. The certificates are saved to the SR Dashboard and can be exported for HMRC self-assessment. The dashboard will also reflect the status of certificates not yet received from HMRC. A single spreadsheet showing all investments in the portfolio can also be downloaded and used for self-reporting.

It is important to note that full investment will not occur in the current tax year and full tax relief may not be achieved until the following tax year. Syndicate Room estimates that all tax certificates will be available within 15 months of the initial investment to the fund, but this is not guaranteed and there may be delays that Syndicate Room has no control over.

Minimum investment is £5000 and application is online. This is the lowest of funds screened and makes EIS more accessible to individual investors.

Investee companies will provide online quarterly updates via the Syndicate Room dashboard.

The fund is held on the Syndicate Room platform with no associated platform charges.

If a company held in the fund is acquired or sold through IPO, cash proceeds are returned to the fund holder. If this occurs within less than the 3 year minimum holding period the investor loses the tax benefits associated with that holding and would need to pay back any income tax that had been reclaimed or pay any CGT that had been deferred in association with the EIS investment. This is standard for any EIS that monetises ahead of the HMRC 3-year limit. Cash due to the individual investor would be calculated on a pro-rata basis considering the size of the total holding in the fund and the proportionate size of the holding that had been divested. This would be an administrative burden but is in line with other EIS portfolio solutions. Syndicate Room has confirmed it would be able to provide evidence of the investment made on the client's behalf and associated EIS(3) issued to the Fund for that investment.

After approximately 7 years, the fund structure is expected to be dissolved and any remaining shareholdings would be transferred to the investor.

Conclusion:

- The underlying fund holdings are high risk being early stage companies. This is in line with HMRC intentions for EIS tax relief.
- The fund management process appears robust but is unproven.
- As the fund is likely to always be a minority investor in the company, it may have less influence over company strategy than could be the case at other EIS funds. We note that the angel investor making the introduction to the company will be likely to have influence that will benefit all investors.
- The fund has a high degree of diversification relative to other EIS portfolio solutions, having a target of 50 holdings. This is way above competitor funds. This degree of diversification offsets the unproven nature of the investment process and the inability of the manager to influence companies held. It also manages the high degree of risk inherent in early stage companies.
- Fees are competitive relative to other EIS portfolio solutions.

Appendix: Excerpt from Access EIS Information Memorandum November 2019

Methodology

STEP 1

By accessing Companies House records (via our research partner, Beauhurst) we identified all angel investors who had invested in the early rounds of TOP100 companies.

STEP 2

We then analysed each investor's entire portfolio since 2014 (when reliable, digital records began) to discover which investors were the best-performers.

We took into account over 6,000 companies, more than 10,000 funding rounds and not fewer than 20,000 cap table entries to calculate each investor's capital growth across their portfolio.

The analysis was able to determine angel investors':

- Portfolio size and value
- Number of exits and failures
- Sector and location of investments
- Rate of return (IRR)
- Investing frequency and average investment size
- Average deal size and average valuation of startup at time of first investment

A note on the data. For the sake of accuracy, investments made before January 2014 weren't taken into account and have been discounted from the analysis. The analysis was based on companies' self-reported filings to Companies House, thus even though the filings themselves are compulsory, there may be a level of inaccuracy in the data. Every possible effort has been taken to remove data points where there is any doubt in having a high level of confidence in their accuracy. Analysis demonstrates that minor discrepancies in the raw dataset do not materially impact the overall findings.

STEP 3

We then applied additional filters that we had identified to correlate well with cash returns:

1. **Market-beating capital growth:** portfolio growth greater than 28% per year (the market growth level, established from this same dataset) over 5 years
2. **Regular deal flow:** making at least one investment per year over 5 years
3. **Portfolio size and value:** putting meaningful amounts into companies, comprising a combined portfolio size of at least £100,000 over a 5 year period

This analysis narrowed the list into a shortlist of 93 super angels. Our calculations propose that investing alongside these active, highly-connected and well capitalised individuals would have yielded capital growth of **42% per year over a 5 year period.**

The number of qualifying super angels will increase as we discover new individuals that meet our quality thresholds who were previously unknown to us through new introductions and analysis. It may also decrease if for any reason we consider it inappropriate to partner with a particular individual upon our more detailed, subjective assessment of their past or ongoing investment behaviour (more on this later on). We will conduct a full reevaluation of the list of super angels annually, and no later than Q3 2020.