HARDMAN & CO.
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PAR EIS FUND

Par Fund Management Limited

	Positives	Issues
Why Invest	▸ **Strategy:** Exposure to a small portfolio of technology companies co-investing with Business Angels.	▸ **Diversification:** While diversification has improved, and is in line with sector averages, it remains behind the best.
The Investment Manager	▸ **Team:** Diverse range of experience in team, with clear strategy and good support from its Angel network.	▸ **Growth rate:** Several new members of staff have been recruited recently, in advance of planned growth.

Nuts & Bolts

- **Duration:** The Fund is evergreen, with no formal closings, and investors simply participate in the deal flow after investment.
- **Diversification:** The manager aims to provide eight equal investments for each investor, with a recent range of seven to ten.
- **Valuation:** Usually changes at the next financing or on writedown.

Specific Issues

- **Fees:** A combination of direct fees and company charges. Four years of annual fees are deducted upfront.
- **Performance fee:** Charged at 20% on aggregate returns over 120% of subscription.

Risks

- **Target returns:** The benchmark average IRR of 15% (roughly doubling the gross investment in five years) suggests a medium- to 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 ones will do very well, but those who fail may do so completely.

	Adviser information	Contact details
Analyst	▸ ***Scheme assets:*** *£10.3m*	***Partners:***
	▸ ***Scheme target:*** *£10m p.a.*	*Paul Atkinson, Andrew Castell, Robert Higginson, Paul Munn, Andrew Noble*
	▸ ***EIS assets:*** *£10.3m*	***Contact:***
	▸ ***Total FUM:*** *£95m*	*Pauline Cassie*
	▸ ***Launch date:*** *2012*	*+44 (0)131 556 0044*
		info@parequity.com

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Factsheet

Par EIS Fund	
Product name	Par EIS Fund
Product manager	Par Fund Management Limited (Par Equity)
Tax eligibility	EIS
Target return	IRR of 15% p.a.
Target income	None
Type of product	Discretionary portfolio service
Term	Evergreen
Sectors	Technology
Diversification:	
Number of companies	7-8
(Expected) Gini coefficient	0.13-0.14

Fees	Amount	Paid by
Initial fees:		
Initial charge	1.0%/3.0% (incl. VAT)	Investor
Arrangement fee	5.0%	Investee company
Annual fees:		
Management charges	0.75% (incl. VAT)	Investor – 4 years deducted upfront
Monitoring fee	Larger of 1.25% of investment or £6,000 (£12,000 if Par Director)	Investee company
Exit fees:		
Performance fee	20%	Investor – aggregate proceeds over 120% of subscription
Management charges	n/a	Investor – balance of any outstanding management fee

Advisor fee facilitation	Yes
Advisor fee amounts	As agreed with investor
HMRC Approved?	No
Advance Assurance	Yes, for each investment
Reporting	6-monthly (as of 31 March and 30 September)
Minimum investment	£20,000
Current funds raised	£10.3m
Fundraising target	£10m in current financial year
Closing date(s)	At least quarterly
Expected exit method	Mostly trade sale

Source: Par Equity, Hardman & Co Research

Fund aims

The Par EIS Fund is a discretionary portfolio service, which will provide a portfolio of investments in unquoted technology companies. The manager highlights that it is providing genuine risk capital. The benchmark is an average annualised IRR of 15%, equivalent to doubling capital over a five-year period. Returns will be focused on capital gains, and investors are unlikely to receive any dividends. The Fund is evergreen.

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. Par Equity aims to have at least seven companies in each portfolio, with roughly equal size positions. Although sector diversification is limited, stock-specific risk should dominate market risk.

The benchmark IRR of 15% p.a. suggests medium-to-high risk and seems appropriate for the strategy.

Sourcing and external oversight

Historically, Par Equity has made investments into six to seven new companies a year. It appears to have a good network, with a strong connection to the Angel investor community generally, and within Scottish institutions in particular. The target of at least seven investments p.a. looks achievable. The Angels in the Par Syndicate co-invest and provide some due diligence input, which Par takes into account, alongside its own due diligence.

Ongoing support and monitoring

Support for investee companies comes through a combination of a member of the Par Syndicate being appointed to the board and support from invested members of the Advisory Panel. Both consist primarily of experienced Angel investors. Par Equity's investment team also maintains close contact with investee companies.

Exits

A growing track record shows that the expectation that most exits will be via trade sales is happening in practice. 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. The Fund had its first exit in June 2016.

Manager

Team

The investment part of the Par Equity team consists of the five partners, plus five additional team members. The team brings an interesting mix of experiences. There has been substantial recruitment over the last couple of years, and the recent additions to the team have brought room for growth.

Track record

Since 2009, Par Equity has invested in 58 companies, with 18 exits. It has produced another four exits since the end of 2018. In aggregate, the exits have produced an IRR of 27% and a 3.25x return on capital. The promise that Hardman & Co has noted before is materialising, and Par Equity is building one of the more credible track records for exits in the EIS industry.

Regulation

Product

Advance Assurance is sought for each investment.

Manager

The manager of the Fund is Par Fund Management Limited. It is FCA-registered (number 485668) with fund management permissions. Submissions to Companies House appear to be up to date.

Risk analysis/commentary

Overall, Par Equity gives the impression of being a well-run company with a credible investment process. The team brings a broad range of backgrounds with experiences in different areas. Those team members that we have met give the impression of being sober assessors of businesses, rather than technology evangelists. The depth of the track record has been improving steadily, and it now adds meaningfully to Par Equity's credibility.

Investors do need to be aware that they will be investing risk capital into early-stage technology companies. The involvement of Business Angels, with experience of the appropriate area, provides an added degree of comfort, although Par Equity's own diligence depends somewhat on these views too. The ongoing support of both Angels and Par Equity partners is also significant. Having recruited in 2018 and 2019, capacity constraints have been lightened for now.

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. Diversification within the Fund is limited, although typical for products in this area. This EIS Fund should be considered in the context of an investor's entire portfolio.

Investment process

Deeper dig into process

Par Equity looks to provide an EIS investor with a portfolio of technology investments. Although it has managed venture funds since 2010, it is primarily a manager of Business Angel investments, sourcing and managing deals for successful entrepreneurs who are looking to reinvest in new businesses. It currently has around 200 participants in the Par Syndicate, and they form a key part of its investment process.

The focus is on companies that are at the early stage of commercialisation of their technology. Companies need to be able to not just demonstrate that the technology works, but also that they have managed to earn some revenue from selling it. Broadly, Par Equity looks for companies with monthly revenue run rates of the order of £20,000-£200,000. It is very aware that it is easy to get distracted by exciting technology that may not lead to a real business. That said, it is also clear that it is providing genuine risk capital to these companies, rather than funding working capital.

Although the Par Equity team has a wide range of experience, it understands that it will never have detailed knowledge of all the technologies with which it is presented. This is the first area where the team's Angels get involved – Par Equity gets someone in its network to validate the technology it is looking at. This must include some defensible or unique aspect. The requirement is that the technology must bring an advantage in the marketplace, and this advantage should be defensible in some way.

Par Equity consequently restricts the technology areas that it will look at. The focus is on information technology and communications, clean energy and medical technologies. These are still reasonably broad categories, and previous investments have included e-commerce, social media, technical textiles and more.

Although not specifically a social investor, Par Equity gives more weight to companies that have broad society benefits, and specifically excludes armaments and weapons technology. It also, for other reasons, excludes biotechnology, which distinguishes it from some technology EIS and suggests that Par Equity may provide diversification benefits to investors with other EIS fund investments.

The quality of the management team also matters to Par Equity. The process implicitly tests the team, as, if it can sell the company to the Angel network, then this bodes well for its ability to sell its product to customers.

Sourcing deals

Par Equity gets potential deals from two main sources. Direct approaches are the most frequent but, as for many EIS managers, they are less likely to lead to an investment. Referrals from within its network are more likely to be of interest. As well as the Angels, it has a range of contacts among professional firms such as lawyers and accountants.

Par Equity has been investing in a new IT platform. This has several elements (see also *Governance and monitoring* below), one of which is a facility for companies to apply online for funding. This should lighten administration, by automatically presenting data in a systemised way. It will also help with sharing data with the Syndicate.

In geographical terms, Par Equity looks at companies across the UK, which allows it to continue to provide effective support after investing. Although it has been agnostic in principle, in practice it has a much stronger network in Scotland, and it has been working on expanding that in the north of England. More than two thirds of historical investments were based in Scotland.

We note that this is not a parochial approach – the desire is to find companies that can scale within a global market. Par Equity also observes, like others, that valuations in the north of the UK are often more reasonable than in the south-east, which is likely to lead to a corresponding effect on the portfolio performance.

Par Equity estimates that it sees around 700 potential investments a year, a figure that has increased since our last report. The stated minimum number of investments is five. However, the current aim is to give EIS investors a portfolio of eight investments, with seven to ten being the recent range. The run rate for sourcing has been around six to seven new companies p.a., plus follow-on investments – so the portfolio target should be achievable. The model is for the investments to be of approximately equal size.

Decision-making

In broad terms, Par Equity's decision-making process is similar to that of most mainstream EIS managers, although there are a couple of positive distinctions.

The triage stage is a very quick internal review to weed out companies in the wrong area or at the wrong stage. This is followed by a preliminary assessment with managements calls and meetings, and a deeper assessment of the company and technology. The latter is usually the first stage at which the Par Equity investor network is involved.

The secondary assessment extends this to the wider market, looking at competition and the business model in more detail. It is at this stage that the company is valued and issues heads of terms. Valuations are generally based on a simple DCF model, which, in turn, is based on an expected rate of progress and comparable companies. Par Equity indicates that this is as much qualitative as quantitative – most investments are at the stage where any detailed model could only be highly speculative.

Par Equity operates a co-investment model, and will only invest if Angels in its network, or in a comparable network, are also investing. As these are experienced entrepreneurs, and often very well placed to understand the technology, this effectively provides an extra layer of diligence. They may be augmented by what Par Equity brands as "First Thursday", where companies can pitch to a large number of the syndicate members. At these events, the members can also network and hear speakers. We understand that this may be changed in order to separate the pitching from the other elements.

The final stage is the detailed due diligence. Par Equity is aware that this process can be expensive, but it uses the same panel of lawyers, accountants, etc., in order to keep it as straightforward as possible. The process typically takes 12-20 weeks from first contact.

As assets and funding sources grow and companies mature, Par Equity is making bigger investment rounds into companies with higher valuations. Recently, it has increased its minimum deal size from £250,000 to £500,000, with rounds usually ranging from this up to £2m. Historically, most companies that received investment had an initial valuation of £1m-£4m, but the average over the last year has been a pre-money valuation of £4.6m. There is no set or typical percentage for the stake that Par Equity investors end up holding.

Often, Par Equity co-invests with other groups or companies, although, sometimes, they come in at later funding rounds. We note that, for investments in Scottish companies, the Scottish Investment Bank is often a co-investor. This is an arm of Scottish Enterprise, and, in practice, it tends to be more a supplier of capital than a source of expertise or additional diligence.

It also has recently been selected by British Business Investments, which will supply 20% of the capital for investments from the EIS Fund and Par Syndicate. As well as the additional capital, this brings a further endorsement to Par Equity's capabilities.

This gives more flexibility to Par Equity in terms of the size of deals it can carry out. It also gives Par Equity scope to expand, as it can invest more into its existing deal flow with a lower contribution from other parties.

Investors should be aware that, as the majority of companies are early-stage, it is unlikely that the first investment will see the company through to maturity. Further funding rounds may be dilutive, although Par Equity does try to ensure that they are done fairly and to allow existing investors to participate. Par Equity arranges many of these fundings itself, and investors should expect between a third and a half of investments to be in existing portfolio companies. This may be a factor for those looking to invest in multiple years.

The Fund will rarely invest in SEIS companies – Par Equity is generally looking for larger deals than SEIS can offer. Members of the Syndicate sometimes make SEIS investments, which may later get follow-on investments from the Fund.

Exits

The majority of successful exits to date have followed industry norms and been trade sales. The nature of these businesses is that the date of this has to be uncertain, and exits will often take longer than the minimum three-year period that EIS requires. The Par Equity target return is over five years, but it is more likely that failures will be quicker and successes will take longer.

Governance and monitoring

Advance Assurance is sought from HMRC on all investments prior to completion.

All client assets, including shares and cash, will be held by Kin Capital, which is the Administrator for the Fund. We note that this has been changed from the Share Centre since our last review.

The values of investments are reported to investors every six months (31 March and 30 September), along with a brief update on each company. Investments are most likely to be unquoted, and hence valuations will generally move at specific events. Positive revisions are most likely to happen when follow-on investments take place, when the latest price is used. Downward revisions are more at Par Equity's discretion, although we note that it has been proactive in doing so historically. For a typical investment, success is usually validated by a further need for capital, while failure tends to happen relatively quickly, as a company runs out of funding.

As indicated above, Par Equity has developed an online platform. For an EIS investor, this has two functions of interest:

- The first is an administrative function, and is already active. This gives investors basic information on their holdings, such as number of shares and copies of relevant paperwork.
- The second is more ambitious, and will give investors access to more detailed information on their investee companies on a close to real-time basis. This has been a long-standing intention, and we understand is still some way off. Nevertheless, this would be an interesting development for investors who take a more active interest.

Par Equity also runs regular investor meetings in Edinburgh, which it calls First Thursday. These usually have some investee companies giving brief presentations, and they allow investors to meet and get updates from management. This is an unusual format among EIS managers, which many investors will appreciate. It has also started to hold occasional meetings in London.

The Advisory Panel

Generally, Par Equity looks to have someone appointed to the board of investee companies. Usually, this will be someone from the Par Syndicate who has invested in the company, although, exceptionally, it may be a member of staff. His/her main role is to protect investor interests and be a relationship manager with the company.

A large part of ongoing support, however, comes from the Advisory Panel. This is a subgroup of the Angel network, which is willing to take a more active role in helping investee companies. Usually, this is in support of their equity investment – Par Equity is understandably wary of consultants looking to suck out fees from companies. As the investee companies develop, they will have different needs at different times – so the aim is to provide a flexible pool of expertise, rather than having too many specific board appointees.

We understand that, to date, the Panel has been run in a reasonably informal way, but it is currently being looked at in conjunction with the pitching events. The new IT system is intended to help with this.

Track record

The Fund has been in existence for almost eight years, and had it first exit in June 2016. Par Equity has had exits from investments pre-dating its EIS funds, of which two were EIS-eligible. The investment process is essentially the same for the non-EIS investments, so we briefly examine Par Equity's entire record, as it has more substance, highlighting some EIS figures as appropriate.

To March 2020, Par Equity had made investments of £76m into 58 companies, of which 18 have led to exits. Four of these have taken place since the end of 2018. Over the 18 investments, two were not meaningful in a portfolio context (one buyback, one writeoff). Seven have given exits with positive multiples, with the other nine being written off, although some had small recoveries.

While 2019 did not see a repeat of the spectacular exit in 2018, it still brought two exits with IRRs comfortably above the target. Most of the successful exits have produced IRRs in the 35%-45% range, with one lower (22%) and one much higher (129%). In aggregate, the return on capital is 3.25x and the IRR 27% – both very good figures, well ahead of Par Equity's targets and a small increase over last year's aggregates.

Excluding investments that were not EIS-eligible brings the exits down to 14, with 8 returning cash and an aggregate multiple of 5.1x. The EIS Fund has now exited five companies, of which three returned cash to investors, with an aggregate multiple of 2x.

The remaining portfolio of 40 companies is showing a small writedown of 4.0% – a deterioration over last year. Of these, 17 companies show an uplift and 12 companies a loss. The writedowns on most of the latter are reasonably aggressive, with some residual values based on loan notes, rather than equity. The majority of the unchanged investments have been made in the past year or so.

The EIS Fund has unrealised investments in 29 companies to date, valued at £9.1m. The average unrealised gain on these is 3.5%. While this is slightly better than the overall portfolio, the difference is not significant enough to suggest that the EIS portfolio will perform differently from it. We note that, as older investments mature, the differences between the investments of each are shrinking.

For the past couple of years, Hardman & Co has seen Par Equity's track record as very promising, although lacking some maturity. In terms of cash returned to investors, it is a leader in the EIS industry, albeit much of that predates the Fund. Nevertheless, this is one of the few industry track records that can be looked on as a credible indication of ability. The quantum of exits, the overall success rate and good IRRs suggest that Par Equity is capable of producing a good performance. The improvement in a broad spread of the current investments suggests that existing investors will see some further good returns in due course.

Fees

The fees for the Fund are set out in the table on page 3. Administrator fees are paid from Par Equity's charges, other than as noted.

Initial fees

Advised clients will be charged an initial fee of 1%. Non-advised clients will be charged 3%, reducing to 2% for repeat subscriptions.

Annual fees

Four years' worth of annual fees are deducted from the subscription at outset. The balance of any Management Charge is paid at the time of exit.

For advised investors, the initial deduction is therefore 4% for management fees (initial fee, plus four years of annual fees). The fees deducted at the outset are not eligible for EIS tax relief. The annual fee is charged from the account using quarterly deductions.

Exit fees

The performance fee has a threshold of 120% of the aggregate subscription. The performance fee is based on the aggregate capital return over the investor subscription, and is charged after the other fees.

Investee company fees

Companies usually pay an arrangement fee of up to 5%. In addition, there is a monitoring fee of the larger of 1.25% of the investment, or £6,000 p.a., raised by £12,000 where a staff director is appointed (although, as noted under *Governance and monitoring*, this is pretty rare). Par Equity observes that the monitoring fees tend to be negotiated away over time. Over the year to 31/3/20, they were estimated at 0.58% of capital deployed. For an EIS investor, there is a dilutive benefit from these being charged to the company, rather than the Fund.

Fundraising targets and deployment

Par Equity's fundraising targets are soft, with an aim of raising £10m in the current financial year, but this is significantly higher than in previous years. Par Equity says it could cope with this level of inflows by taking higher proportions of investments and reducing co-investors' shares. There are no closing dates, with investors simply participating in the deal flow from receipt of funds.

The minimum subscription is £20,000, with higher amounts in multiples of £1,000.

Deployments will take place into the next available deals after funds are received. Since 2016, that has taken an average of around ten months. Over the last year, this has come down to under seven months, and Par Equity is optimistic that this rate can be sustained.

Currently, EIS3 Certificates take an average of just over 120 days from investment to be received.

Investment manager

Par Fund Management Limited has been a source and manager of investments for Angel investors. As well as the £52.8m of venture capital assets attributable to the Syndicate and the EIS fund, there is a further £32.5m in other asset classes. These include property investments and a forestry fund.

It is worth noting that the partners all invest in the Fund and, in aggregate, have contributed ca. 7% of Par Equity's investments.

People

Paul Atkinson – Founding Partner
Was the founder of Direct Resources, an IT recruitment business, which he sold in 1999, and Recruitment Scotland, which was sold in 2000. He remains the majority shareholder in Head Resourcing, although he stepped down from an executive role to start Par Equity. He is a serial Angel investor.

Andrew Castell – Founding Partner
Started his career at Touche Ross in audit, and then management consultancy. After several corporate advisory roles, he became Group Finance Director at Goshawk Insurance Holdings plc. He was also one of the architects of Insurance Capital Partners LP, an innovative underwriting fund.

Robert Higginson – Founding Partner
Started as a programmer in 1980, and joined Reuters as the manager of real-time systems in 1986. Subsequently, he joined Telekurs AG, before moving to strategic roles at ABN AMRO and Royal Bank of Scotland. From 2002, he worked with various universities on start-up technology spin-outs.

Paul Munn – Managing Partner
Brings a corporate management background, having worked with blue-chip companies in consumer goods, manufacturing and healthcare. He was Group Finance Director and then CEO at Dawson International (textiles), where he led a successful restructuring. Before joining Par Equity, he worked for Hermes Fund Managers on corporate governance.

Andrew Noble – Partner
Having spent eight years as a skier, competing at the 2010 Olympics, he joined Par Equity in 2010. He left in 2013, and had spells with McKinsey and as an investor focusing on management buyouts. He returned to Par Equity in 2019.

In addition to the partners, there are now five other investment personnel, with a total staff of 17.

The Investment Committee consists of the partners, with the other team members in attendance. The team brings an interesting mix of experiences that contrast well with those of some other EIS managers. The management acknowledges that, at times in the past, the small size of the team has been a constraint on growth but, over the last year, it has added sufficient capacity for planned growth. It has continued to add to its administration team too, and intends to recruit on the investment side ahead of need.

Appendix 1 – due diligence summary

Summary of core due diligence questions		
Manager	**Par Fund Management Limited**	**Validated by**
Founded	2008	Hardman & Co
Type	Limited Company	Hardman & Co
Ownership	Par Equity LLP, which is 89%-owned by founders	Hardman & Co
FCA Registration	Yes – 485668	Hardman & Co
Solvency	Confirmed	Hardman & Co
EISA member	Yes	Hardman & Co
Administrator		
Company	Kin Capital	Information Memorandum
FCA Registration	Yes – 656789	Hardman & Co
Fund Custodian		
Company	Kin Capital	
FCA Registration	Yes – 656789	Hardman & Co

Source: Hardman & Co Research

The manager of the Fund is Par Fund Management Limited. It is FCA-registered with fund management permissions. The balance sheet is healthy for a small firm. At the last accounts (31 March 2019), it had just over £390,000 of shareholders' funds. We note that the company has plans to grow, but clearly is not constrained by capital.

Par Fund Management Limited is wholly-owned by Par Equity Holdings Limited, which, in turn, is 89%-owned by Par Equity LLP. The four co-founders are partners in the latter, together with Malcolm MacPherson, Jim Kilcullen, Simon Best and Andy Ley. Malcolm MacPherson and Andy Ley are partners in HBJ Gateley, a law company that is one of the panel law firms used.

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
Company investment	£750,000
VAT on company fees is offset against revenue	

Source: Hardman & Co Research

Calculations					
		Hardman & Co standard			Target
Gross return		**-50%**	**0%**	**50%**	**100%**
Amount (pre-tax relief)		**£100,000**	**£100,000**	**£100,000**	**£100,000**
Initial fees	**Rate**				
Manager	1.00%	£1,000	£1,000	£1,000	£1,000
Company	5.00%	£4,800	£4,800	£4,800	£4,800
Total		**£5,800**	**£5,800**	**£5,800**	**£5,800**
Annual fees					
Manager	0.75%	£750	£750	£750	£750
Deduction upfront (4 years)		£3,000	£3,000	£3,000	£3,000
Net investment		**£96,000**	**£96,000**	**£96,000**	**£96,000**
Annual fees – from company					
Monitoring fee	1.25% pa	£6,000	£6,000	£6,000	£6,000
Gross fund after investment return		**£48,000**	**£96,000**	**£144,000**	**£192,000**
Exit fees					
Balance of annual fee (1 year)	0.75%	£750	£750	£750	£750
Performance	20%	£0	£0	£4,650	£14,250
Net amount to investor		£47,250	£95,250	£138,600	£177,000
Gain (pre-tax relief)		-£52,750	-£4,750	£38,600	£77,000
Gain (post-tax relief)		-£23,950	£24,050	£67,400	£105,800
Total fees to manager		£15,550	£15,550	£20,200	£29,800

Source: Hardman & Co Research
Notes: post-tax relief figures assume initial income tax relief only; other reliefs may be available to investors

Notes

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