Mercia EIS Fund

Tax-Advantaged Investments

EIS Review

DECEMBER 2019

MJ HUDSON
Allenbridge

Contents

Overview

Offer: Mercia Fund Management Limited ("Mercia" or "the Manager") is looking to raise up to £15 million for the Mercia EIS Fund ("the Fund"), for the tax year 2019/2020. The Fund will target early-stage, high-growth technology businesses, with a focus on four subsectors: Digital & Digital Entertainment; Software and the Internet; Life Sciences & Bio-Sciences; and Electronics, Materials & Manufacturing/Engineering. The Fund also provides the potential to choose an allocation toward SEIS qualifying investments.

This Fund in its current structure launched in March 2018, however when including the previous close-ended funds, Mercia has invested £49 million to date under the current strategy.

Investment Details:

Score:	86
Offer Type	Discretionary Non-Approved Portfolio
EIS Strategy	Generalist
Fund AUM (Pre-Offer)	£50 million
Manager AUM	£782 million
EIS Risk Level	Medium-High

Investment:

Minimum subscription	£25,000
Maximum qualifying subscription per tax year	£1,000,000
Early bird discount	None

Closing Date:

There is no closing date for the EIS Fund, but it will undertake tranche closures on 31 March, 30 June, and 31 December each year

This document verifies that *Mercia EIS Fund* has successfully completed our independent due diligence process, having passed through all stages of the governance process in the run-up to the report's publication on the date listed below. It has therefore been awarded the MJ Hudson Cornerstone Trustmark.

Risk Warning for EIS Schemes

Individuals should always read and bear in mind the risk warning notices that are included within providers' investment offer literature / documentation, including prospectuses, information memorandums, securities notes, brochures and other related marketing literature. Whilst the following list is not exhaustive, some of the main risks to be aware of include:

- Investments are in small, unquoted companies and should be considered as high risk;
- Investments are illiquid and need to be held for at least three years in order to retain the initial income tax relief;
- An EIS/Seed EIS investment should be viewed as a long-term investment;
- Legislation, along with the nature and level of tax reliefs is subject to change. There can be no certainty that investments will be eligible or remain eligible for EIS/Seed EIS Relief;
- Historic investment performance cannot be used as a guide to future performance, and the value of any given investment may rise or fall;
- Many EIS/Seed EIS Schemes involve investment in a single company or sector and therefore should only be considered as a small part of an overall portfolio;
- Investors may not have independent representation on the Boards of investee companies which can mean their interests are not adequately considered relative to the executive team;
- EIS/Seed EIS investments should only be considered by sophisticated investors who understand, and have given careful consideration to, the underlying investment strategy and associated risks. For help in determining potential investment suitability, professional advice should be sought;
- Often there will be no regulatory oversight and investors will usually not be eligible for compensation if things go wrong.

Executive Summary

MANAGER:

Mercia Fund Management Ltd ("Mercia" of the "Manager") is a subsidiary fund management business within Mercia Asset Management PLC. The investment team spans both entities and other group fund management entities and focuses on early-stage technology investments in the UK. Mercia Asset Management PLC listed on AIM in 2014 and, it recently announced its intention to acquire NVM Private Equity's three VCTS, and once completed will increase Mercia's AUM from approximately £508 million, to almost £800 million, a move which will move Mercia closer to its goal of achieving AUM of £1 billion by 2022. Aside from these VCTs, Mercia Fund Management Ltd manages multiple EIS and SEIS Funds, including the EIS Fund series (formerly the Growth Fund series), and at the time of writing we understand that existing EIS/SEIS hybrid Funds account for £50 million of assets.

The Manager distinguishes itself from others in several ways: a UK-wide geographic presence, primarily focused on the Midlands, Northern England, and Scotland; a "Complete Capital Solution", whereby investments made by the Manager can potentially benefit from the PLC providing later-stage follow-on funding; and an online "Investor Centre" portal which provides individuals with a useful range of downloadable fund-related information and documentation.

PRODUCT:

The Mercia EIS Fund (the "Fund") was previously offered as a series of single tranche EIS and SEIS funds (previously known as Mercia Growth Funds). The Fund, which targets significant capital growth from early-stage technology investments, now operates the same strategy under an evergreen structure, with tranche closures. The default option is to invest fully into EIS investments, although investors can choose to allocate 15% of their subscription to SEIS investments. The strategy is focused on the theme of commercialising intellectual property, primarily across four core technology subsectors:

- Digital & Digital Entertainment;
- Software & the Internet;
- Life Sciences & Bio-Sciences;
- Electronics, Materials, & Manufacturing/Engineering.

The Manager aims to be fully invested within 12 months of the closure of each tranche. The Manager is targeting a return multiple of greater than 2.5x in five to seven years, and we understand that historically EIS investors have been fully deployed within seven months.

SUMMARY OPINION:

Mercia is becoming a fixture in the EIS growth space, having initially launched the first Growth Fund in 2013. As part of the larger and well-resourced Mercia Asset Management PLC, the Manager brings with it certain benefits in terms of governance and financial stability. Furthermore, the recent acquisition of the Northern VCT's shows the Manager's commitment to the tax-advantaged space. Its key personnel are highly qualified, well connected, and have a long relevant track record. The majority of the Manager's assets under management are not concentrated in the tax-advantaged space and therefore the Manager is less vulnerable to changes in tax rules than many of its peers. The EIS has an external Advisory Committee to provide an independent perspective of the Funds progress, timing of returns, and overall corporate governance which could provide additional comfort to some investors.

Mercia's PLC parent company allows it to offer investee companies a "Complete Capital Solution" over its growth journey; it has a regional focus different to those of other similar products in the market (which makes for a useful point for investors seeking diversification across geographies). Its core investment team has impressive sector expertise and have been working together for a number of years. However, Mercia's lack of co-investment from its investment team (excluding investment directors who share in the carry) on the same terms as investors, as well as no hurdle before performance fees kick in, does mean that it could better align its interests with investors. Mercia can demonstrate its ability to generate a positive exit, having successfully exited three companies with an average return of 2.8x; although this is tempered by 15 write-offs. However, Mercia's parent, and by extension the same investment team involved in the EIS have a far broader exit record to point to. Further, the favourable level of diversification, with investments to be spread across up to 15 investee companies, should mean there is less idiosyncratic risk than many EIS products.

The Manager's increased growth in assets and balance sheet, its considerable advantages as an entrenched incumbent in the spin-out space with line of sight pipeline, and co-investment with other Mercia funds, as well as its admirable track record of returns to investors, makes Mercia a strong consideration for investors with existing exposure to tax-advantaged investments wanting exposure to higher-risk, early-stage technology-focused EIS opportunities in their portfolio.

Positives

AT THE MANAGER LEVEL:

- Mercia has been successful in winning the mandates of governmental regional funds, which is a mark of approval from both the Government and other stakeholders;
- The Manager has shown that it is willing to commit to investing in the team and infrastructure in order to grow the business;
- Mercia has a strong regional presence, particularly in the Midlands and the North of England, which may enable it to differentiate itself from other providers in a crowded market;
- The recent announcement of its intention to acquire the Northern VCT's not only allows Mercia to expand its product offering, but it demonstrates a commitment to establish itself as a regional manager, as well as to achieve its strategic target of managing £1 billion by 2022;
- Mercia has a well-designed online Investor Centre, offering a range of downloadable Fund and personal portfolio valuation information, online application, reports, newsletters, Investment and Advisory Committee papers, tax certificates, and other communications;
- The Manager remains profitable, and can call upon the support of the PLC if required;
- The top-level management team is stable, and has low levels of turnover;
- The Mercia EIS Funds have an external Advisory Committee, which according to the Manager represents the interests of the investors and holds the Manager accountable to adhering to its mandate, as set out in the IM;
- Mercia's parent, Mercia Asset Management plc is a listed company, and it is therefore subject to certain regulatory and reporting requirements, which may make Mercia more transparent than many of its peers;
- Although the manager of the EIS Mercia Fund has a limited exit record, its parent Mercia Asset Management Ltd, and by extension the same team executing the EIS strategy, can point to a number of notable exits.

AT THE PRODUCT LEVEL:

- Mercia's team are technology sector specialists, in particular the four subsector leads – each of whom have overseen business growth in those industries. This sector expertise may also help Mercia to attract quality investee companies, given the level of support which Mercia can provide;
- The strategy brings together several considerable strengths, such as the regional focus and sector expertise, in a well-thought-out manner;

- The Fund provides investors with the option of incorporating some exposure to SEIS-qualifying companies in their portfolio, as well as EIS;
- The regional presence and strong university links across the UK may enhance deal flow, allowing Mercia access to and line-of-sight on quality deals that managers based in the South East may not have;
- There appears to be a strong pipeline of deals which should facilitate rapid deployment of capital, and Mercia can point to an historical rate of EIS deployment of seven months;
- The drip-feeding process means that investee companies must meet certain milestones before it receives further funding; as such Mercia will have better visibility on company progression, mitigating risks for later rounds of funding into the same company. Although we note this does give rise to conflicts of interest between different investors with respect to the valuation at each funding round;
- In some cases, it may be possible for investors to sell their investments to the parent PLC, which is a potential additional source of liquidity. Investors should bear in mind, however, that the terms offered for this liquidity involve accepting a significant discount to fair value, and it is left to their own judgment to decide whether to utilise this option;
- The Fund aims to allocate investors across a portfolio of up to 15 investee companies, providing a level of portfolio diversification not usually afforded by many other EIS funds in the market although sector diversification remains minimal;
- The current portfolio and pipeline are in-line with the proposed strategy and the investee companies are relatively diversified in terms of sub-sector and funding stage.

Issues to consider

AT THE MANAGER LEVEL:

- Mercia Asset Management PLC is listed on AIM, which means its ownership is less stable than many of its peers and if a takeover were to occur the regulated business may no longer receive the support it currently does;
- For every opportunity that Mercia encounters, the team are required to consider which of its third-party funds are most appropriate to be involved. There are scenarios where non-EIS Funds could take priority over the Mercia EIS, for example for deals in certain regions that are covered by Government-backed regional development funds;
- In managing so many funds, in addition to PLC investments, there will be conflicts between the funds themselves or between the PLC and the funds. Such conflicts include negotiating pricing of funding rounds and investment allocations;
- The variety of mandates that Mercia manages results in a range of conflicts which are complex for an investor to fully appreciate;
- In keeping with Mercia’s expansion plan, a substantial recruitment campaign has been under way, along with regional office expansion. As with any swift large-scale expansion, it is important that management remain conscious of integration in terms of culture and systems.

AT THE PRODUCT LEVEL:

- There is a considerable amount of key person risk associated with the four head-of-sector Investment Directors, as each has a high level of knowledge and experience in their respective area. However, one of these directors did leave in September 2017, and was rapidly replaced in December 2017;
- Junior members of the team are responsible for filtering new investment opportunities, and there is a risk that they omit strong companies due to inexperience;
- While the existence of the performance fee helps partly align the investment team's interests with those of the investors, there is no hurdle rate, and the team is not permitted to invest into the Fund alongside investors, which means the investment team has limited alignment with investors;
- It should be noted that the initial fee and at least three years of annual management fees (plus VAT) will be deducted from gross subscriptions before any portfolio investments are made. Therefore, tax reliefs will be on 92% of their subscription by default;
- Individual realisations may take significantly longer than the stated target of five to seven years. The team acknowledges that in some cases it could feasibly take up to 15 years for eventual complete realisation of businesses that perform well and have been backed since seed-stage, but the Manager notes this could lead to a high multiple return on invested capital;
- While the previous iterations of the funds are showing positive uplifts in portfolio valuation, it remains too early to judge performance, and investors may wish to see a longer track record of successful exits;
- The PLC's involvement in later stage funding creates a potential conflict of interest in that investor interests could be diluted if the PLC invests at too low a valuation;
- While the breadth of sub-sector exposure does mean that there are different value drivers, all the opportunities are coming from the technology sector, which means that investor will have to find a level of comfort with the sector concentration.

Manager Quality

Manager Profile

Mercia began as WM Enterprise Limited ("WME"), which was established in 1982 as a venture capital provider. WME began forming partnerships with universities in 2000, with the creation of a seed fund for spin-outs from the Universities of Warwick and Birmingham. A management buy-out led by Mark Payton in 2010 led to the creation of Mercia Fund Management Ltd ("Mercia" or "the Manager"). Mercia Fund Management Limited ("Mercia") is a wholly-owned subsidiary of Mercia Asset Management plc (the "PLC"), formally Mercia Technologies plc, having been renamed in July 2019 in order to "reflect the evolution of the Group's core competencies as a proactive, regionally focused specialist asset manager".

Between 2010 and 2014, Mercia's main activity was managing the evergreen seed vehicle Mercia Fund 1 (MF1) and Mercia Fund 2 (MF2). After delivering cash returns equal to the initial cost of MF1, the fund is currently being reinvested into a new set of companies, but MF2 was acquired by the successor PLC, Mercia Technologies, in 2014.

In February 2014, Martin Glanfield and Susan Searle joined the business and helped bring about a transformational change, with the formation of Mercia Technologies in September 2018. Following an IPO listing on AIM in December 2014, the PLC raised £70 million from the market, with a further £40 million raised in 2017. The PLC's new model was to upscale its investment in early-stage technology businesses across the regions and have the capacity to use its balance sheet to provide later-stage support to successful business investments. The PLC used a portion of its newly raised capital to acquire Enterprise Ventures Ltd (a manager of regional development funds) in March 2016. Mercia Asset Management's headcount has grown to 84, AUM of £508 million, and now currently has nine offices in operation across the UK as at October 2019.

Via its subsidiaries, Mercia Asset Management manages multiple different third-party funds in addition to the EIS products. Previously, the Mercia EIS Funds were known as Mercia Growth Fund 1, Mercia Growth Fund 2, and so on; the new name reflects that while each Growth Fund is a closed-ended fund, it effectively aggregates to an evergreen EIS product, the Mercia EIS Fund, which is always open to new investment, with tranche closures in March, June and December each year.

Mercia Fund Management Ltd has involvement in the following funds:

- Mercia EIS Funds[1];
- Mercia Digital Fund (EIS/SEIS focused on digital technologies);
- Mercia University Growth Fund (EIS/SEIS focused on university spinout companies);
- Mercia Fund 1 (Evergreen Fund– providing proof of concept, including non-commercial and seed investments into university spinouts based in the West Midlands).
- WM AHSN SME Innovation Fund;

Meanwhile, Enterprise Ventures Ltd bears responsibility for multiple Regional Development LP Equity & Loan Funds:

- Northern Powerhouse Equity Fund and Debt Fund (Yorkshire, Humber and Tees Valley focused);
- Coalfields Enterprise Fund & Growth Fund;
- Enterprise Ventures Growth Fund & SME Loan Fund;

[1] Formerly Mercia Growth Funds. The 8th tranche closed to new subscriptions in Q2 2018.

[2] Mercia has changed the way it reports Client Money and Assets Return ("CMAR") because Mercia Investment Properties and Mercia Investment Limited are not Alternative Investment Funds (AIFs); their assets are no longer shown in Mercia's CMAR. The current CMAR has only Mercia's EIS funds, Mercia Fund 1 and WM fund.

- Finance Yorkshire Seedcorn Fund & Small Loan Fund;
- Lancashire Rosebud Fund;
- NW VCLF HF;
- NWF Development Capital Fund & Mezzanine Fund;
- NWF (Venture Cap);
- RSGF MPF;
- Rising Stars Growth Funds 1 & 2;
- SYIF Seedcorn Fund;
- Proof-of-Concept and Early Stage Equity Fund (Midlands Engine);
- North East Venture Fund.

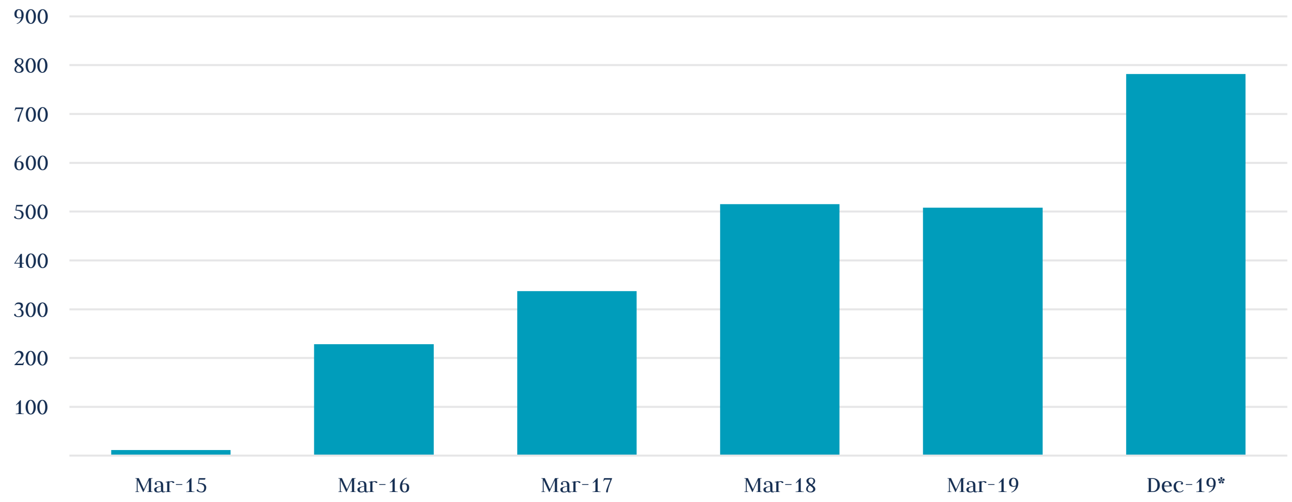
Mercia was awarded a mandate for the latter two funds, with a combined value of £51 million, in early 2018. The North East Venture Fund prompted the opening of the ninth office in Newcastle.

Mercia Asset Management has announced its intention to acquire the three Northern Venture Capital Trusts fund management contracts from NVM Private Equity LLP. From this acquisition it will add approximately £278 million AUM to Mercia Asset Management. This not only serves to demonstrate Mercia's commitment to become an established regional investment manager, but it also drives the firm well toward its goal of attaining £1 billion in assets under management.

Mercia Asset Management plc also makes direct investments from its own balance sheet but is not itself an authorised entity by the FCA. As the designated third-party fund managers, both Mercia Fund Management and Enterprise Ventures are independently FCA regulated and authorised. At the beginning of 2018, Mercia Asset Management obtained retail permissions from the FCA and appointed The Share Centre as custodian.

As an EIS/SEIS Fund manager, the Manager has a slightly unusual structure. While Mercia Fund Management Ltd is a distinct legal entity, it is a subsidiary of Mercia Asset Management plc. Ultimately, the underlying equity investment team is integrated - one can draw little distinction between the two, investing and managing money on behalf of both Mercia Fund Management and its parent company. The entities view themselves as emerging technology investors as well as asset managers (hence the name change from Mercia Technologies to Mercia Asset Management), not purely as an EIS/SEIS manager.

CHART 1: MERCIA ASSET MANAGEMENT AUM AS AT DECEMBER 2019 (£ MILLIONS)

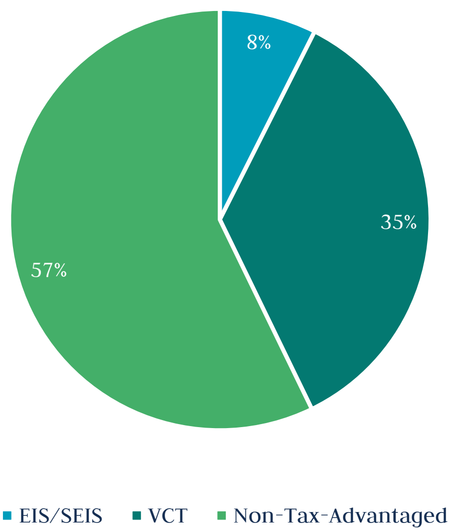


Source: Mercia; AdvantageIQ

*Note the figures above include the Northern VCT assets

Following strong growth between 2015 and 2017, funds under management for Mercia Asset Management remained largely unchanged since early 2018 at around £500 million. However, this changed in December 2019 where it acquired the Northern VCT's, which added £278 million to the Manager's AUM. As can be seen in Chart 3 below, the PLC benefitted from healthy fundraising levels through 2016 and 2017, owing to the acquisition of Enterprise Ventures Ltd, and again in December 2019 due to the acquisition of the Northern VCT's.

CHART 2: MERCIA ASSET MANAGEMENT ASSETS UNDER MANAGEMENT BREAKDOWN AS AT DECEMBER 2019*

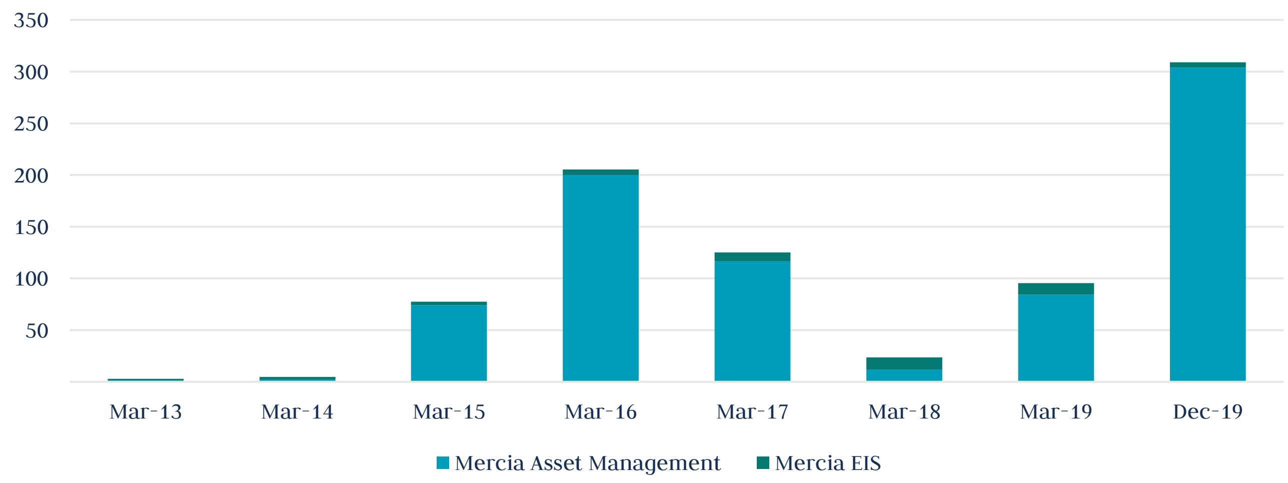


Source: Mercia; AdvantageIQ

*Note the figures above include the Northern VCT assets

As can be seen from the chart above, the significant majority of the PLC's assets are accounted for by non-tax-advantaged, institutional funds, with its EIS and SEIS investments accounting for 8%. Unlike many other managers within this space, this means that the PLC is less exposed to any potential legislative changes. However, it is similarly acknowledged that given the nature of investments made into EIS and SEIS qualifying companies, Mercia's investment strategy has been less impacted by the most recent changes brought about by the Patient Capital Review.

CHART 3: MERCIA FUNDRAISING TRACK RECORD AS AT OCTOBER 2019 (£ MILLIONS)



Source: Mercia; AdvantageIQ

From levels around £3.5 million in 2015, the Mercia EIS Fund has managed to increase the level of funds raised each tax year to levels in excess of £11 million in both the 2017/18 and 2018/19 tax years. For the current tax year, Mercia has raised just over £5.7 million, and this is likely to ramp up significantly as we near the end of the tax year in April 2020.

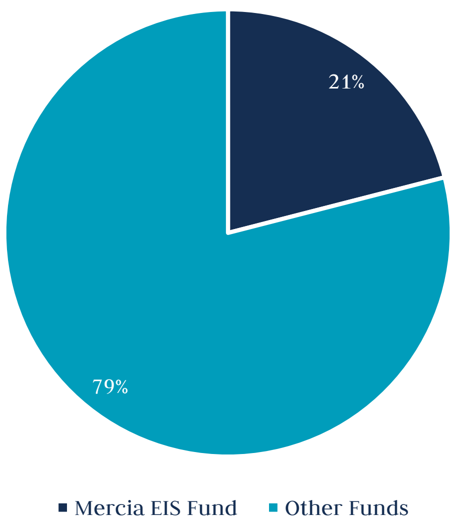
With regards to client services, the majority of its communications are made through Mercia's online Investor Centre portal, the "Investor Centre", although we understand that hard copy communications can be requested if desired. The Investor Centre is a bespoke platform developed specifically for Mercia by a third-party company. Investors are able to log-in and download a range of documents specific to their holdings: fund valuations and reports (available quarterly); personal investment specific valuations on a six-monthly basis; quarterly Advisory Committee reports; newsletters every couple of months; EIS tax certificates, Information Memorandums; and appropriately redacted Investment Panel papers for each investment completed. Existing investors can also make further applications online.

The Investor Centre is also used to conduct the firm's Share Exchange programme – whereby temporary offers may be made by the PLC balance sheet to acquire EIS shareholdings (typically at a discount to the prevailing funding round valuation pricing). Individuals can log-in, view the offer from the PLC, and choose to accept (or not) an offer. The programme operates on a first-come, first-served basis – investors can request to sell just a proportion of a shareholding or the whole amount, although the PLC will usually need to make special approval for aggregate purchases in excess of £250,000. Individuals can make their own judgement whether such offers are reasonable, but the key benefit would be an early partial or full realisation of an illiquid investment, along with its potential use from a tax planning perspective vis-à-vis deferred capital gains. Having seen Mercia's system, it appears functional and well-designed, providing investors with straightforward access to a range of key information and supporting documentation.

Financial & Business Stability

Mercia Fund Management Ltd was loss-making in its first few years, as a result of the business investing to scale-up its operations. The PLC has indicated it will continue to support Mercia Fund Management until it generates a more substantial profit. Enterprise Ventures has reported profits historically, and the PLC has made profits in the last three years; in addition, it has £30.3 million of cash on the balance sheet.

CHART 4: REVENUE BREAKDOWN FOR MERCIA ASSET MANAGEMENT PLC



Source: Mercia

The Manager's revenue is comprised of fund management fees, initial management fees from new investments, investment director monitoring fees, and sundry business services income. As illustrated above, while the EIS and SEIS investments account for 7% of overall AUM, the Mercia EIS Fund generates over 20% of the PLC's revenue. Its main costs are its administrative expenses which have increased over the last year, as can be seen the tables below, as Mercia Asset Management continues to scale up operations, with the aim to grow the total AUM to £1 billion by 2022. The acquisition of the Northern VCT's aid the Manager's growth plans as detailed above.

TABLE 1: KEY FINANCIAL METRICS SUMMARY OF MERCIA ASSET MANAGEMENT PLC

£'000	2015	2016	2017	2018	2019	5 YR. CAGR
Revenues	508	1,755	6,660	10,197	10,675	83.9%
Revenue Growth		*245.5%*	*279.5%*	*53.1%*	*4.7%*	
Net Expenses	(1,460)	5,531	4,732	8,173	8,671	-242.8%
Cost to Income Ratio	*(2.9)*	*3.2*	*0.7*	*0.8*	*0.8*	
Operating Profit	1,968	(3,776)	1,928	2,460	2,004	
Net Profit	1,968	(1,697)	1,043	1,663	2,620	
Net Profit Margin (%)	*387.4%*	*-96.7%*	*15.7%*	*16.3%*	*24.5%*	
Net Assets	80,839	80,041	121,400	123,500	126,100	

Source: Companies House, financial reports for the financial year ended 31 March 2019

TABLE 2: KEY FINANCIAL METRICS SUMMARY OF MERCIA FUND MANAGEMENT LIMITED

£'000	2015	2016	2017	2018	2019	5 YR. CAGR
Revenues	829	946	1,517	2,122	2,383	23.5%
Revenue Growth	*18.3%*	*14.2%*	*60.3%*	*39.9%*	*12.3%*	
Net Expenses	981	1,070	1,187	1,363	2,096	16.4%
Cost to Income Ratio	*1.2*	*1.1*	*0.8*	*0.6*	*0.9*	
Operating Profit	(152)	(123)	330	758	288	
Net Profit	(152)	(123)	330	758	288	
Net Profit Margin (%)	*-18.4%*	*-13.0%*	*21.8%*	*35.7%*	*12.1%*	
Net Assets	330	207	537	1,292	1,387	

Source: Companies House, financial reports for the financial year ended 31 March 2019

The accounts show that currently the profitability of Mercia Asset Management can be significantly influenced by valuation changes within its direct investment portfolio; as such, the PLC stresses that its cross-business valuations policy is applied in accordance with the international private equity and venture capital valuation guidelines. Deloitte LLP prepares the PLC's accounts and audits its portfolio valuations annually. At the time of writing, we understand that the portfolio contains over 23 holdings. Continual fundraising and associated portfolio valuation increases should enable Mercia to become more predictively profitable than it has been in the past. Following the Enterprise Ventures acquisition, all key investment staff were retained and that the investment committees were effectively integrated. Overall, both Mercia Fund Management and its parent Mercia Asset Management plc have demonstrated positive progression in their financial performance, and both remain profitable and well capitalised.

Mercia Fund Management Ltd and Enterprise Ventures Ltd are wholly-owned subsidiaries of Mercia Asset Management plc, which is listed on AIM and has a market capitalisation of approximately £74.6 million at the time of writing. The firm's largest shareholders as at 10 December 2019 included Invesco Perpetual (19.5%), Forward Innovation Fund (11.2%), Link Fund Solutions Limited (11.0%), Forward Nominees Limited (5.4%), NFU (4.6%), and Baillie Gifford (3.9%). Please note, these shareholdings will be modified after the £30 million placement which is due to complete in December 2019. The Forward Innovation Fund is a private equity fund managed by Forward Group PLC (founded by Ray Chamberlain who also co-founded Mercia Fund Management Ltd alongside Mark Payton). The shareholders may be offered opportunities to invest alongside Mercia Asset Management PLC into portfolio companies. In July 2019, Woodford Investment Management's Chairman, Susan Jane Searle, who was a non-executive director of Mercia Asset Management, resigned from Mercia to focus on the Woodford funds (subsequently managed by Link Fund Solutions Limited). Owing to recent, and well publicised events at Woodford Investment Management (now Link Fund Solutions Limited), had decreased its shareholdings to 20% in July 2019 and further to 11.0% in December 2019. When queried on whether events at Woodford would have any impact on the PLC, it stated that there may be an impact on Mercia Asset Management PLC share price, but it was noted that this will not affect the operations of the Manager.

Mercia has nine offices throughout the UK, with Mercia Asset Management's head office in Henley-in-Arden, Warwickshire. It rents, occupying one floor of a building owned by PLC non-exec board member Ray Chamberlain and his Forward Group PLC.

Quality of Governance and Management Team

Mercia Fund Management Ltd and Enterprise Ventures Ltd ("EV") are two separate fund management businesses operating under Mercia Asset Management. The Manager and EV are both FCA regulated and authorised. It also each has its own external audits, with Rosie Bhattacharjee joining Mercia as Group Compliance Officer, and oversees compliance across both businesses and report into CFO, Martin Glanfield. Rosie is supported by Alice Grieve.

To oversee and mitigate potential conflicts of interests, Mercia has separate investment committees. Previously, the EIS funds investment decisions were made by an external, independent Investment Panel, but this function has now been brought in-house in order to bring the Manager in line with the rest of the group. The Board of the PLC has authority over direct investments from the PLC's balance sheet.

In many cases, Mercia Asset Management's management team, acting on behalf of all funds and the PLC's own portfolio, may seek to invest capital using more than one fund. The different EIS cohorts may co-invest with one another, other EIS funds, similar funds such as Mercia Fund 1, or alongside one or more Regional Development Funds. The PLC Balance Sheet may also invest later-stage funds to existing portfolio companies. Conflict of interest are inevitable, and as such each fund has its own board to act in the interests of its investors, most of the funds have independent non-executives. Additionally, the Manager's and the PLC's Board review all the conflicts quarterly.

A separate, external Advisory Committee also exists, which acts on behalf of Mercia's EIS Fund. It provides oversight, ensuring that Mercia adheres to the investment mandate set out in the Information Memorandum and has the power to replace the Fund Manager should it have reason to do so. It can also act as an additional point of advice and resolution in the event of conflicts of interest, as mentioned above, though the committee is not fully independent from the Manager.

As a PLC, Mercia Asset Management has increased regulatory reporting and transparency requirements than unquoted companies. As mentioned above, it has a formal conflict of interest process when a conflict arises. Compliance is also discussed at monthly PLC Board meetings. The firm also has an Audit Committee which has oversight over the PLC's regulatory reporting, accounting, and internal controls.

While there is a level of concern regarding the number of funds managed by the PLC and the conflicts it generates, we recognise that the Manager has established appropriate reporting chains and separate committees as necessary to ensure that the sometimes-competing interests (in terms of pricing and allocation) of its various funds are represented. We also note that under current policy, no Mercia employee is allowed to invest into the funds in order to avoid any potential conflicts of interest that may arise, although this also limits the possibility of greater alignment between investment team and investors that this would achieve. However, the Manager has noted that the compensation of the investment team is linked to the performance of their respective funds. Additionally, the investment directors share in the carry, which aids employee retention.

TABLE 3: OVERSIGHT COMMITTEES/WORKING GROUPS

COMMITTEE	DETAILS
EIS Funds Advisory Committee (External)	**Mandate:** Ensures the Manager follows the mandate as described in the IM. Provides independent perspective on Fund progress, timing of returns and corporate governance. Has the power to replace the Manager in event of negligence. **Members:** Michael Cumming, Dr James Wilkie, Peter Dicks, David Plump, Stuart Palmer, Quintin Compton-Bishop **Frequency:** Quarterly
Mercia Asset Management PLC Board	**Mandate:** Exercising responsibilities as a PLC Board, including investment decisions, and conflict resolution **Members:** Mark Payton, Martin Glanfield, Julian Viggars, Ian Metcalfe, Ray Chamberlain, Jonathan Pell, Caroline Plumb **Frequency:** Monthly
Investment Panel	**Mandate:** Makes decisions on fund investments, including Mercia EIS fund. **Members:** John Simpson, Julian Viggars, Peter Dines, Jonathan Diggines **Frequency:** Twice weekly
Audit Committee	**Mandate:** Oversight of processes, monitoring integrity of financial statements, reviewing internal controls, and overseeing the relationship with external auditors. **Members:** Non-executive directors, CFO, Executive Directors by invitation **Frequency:** Three times a year

Source: Mercia; Advantage IQ

At the beginning of 2018, Mercia appointed The Share Centre as custodian, with permissions to hold client money. As such, The Share Centre will hold investor subscriptions.

Julian Viggars, CIO, bears responsibility for ensuring that the investment team is delivering to the mandates of Mercia's various third-party Equity Funds, and Peter Dines, COO, heads up the life sciences and bio-science-focused team, has individual responsibility for ensuring that the EIS Funds are properly deployed and managed.

The corporate structure may appear somewhat complicated, with a number of distinct entities involved in the management and oversight of a number of funds, along with the inherent conflicts which this may give rise to. However, Mercia has acknowledged these conflicts, and has made active measures to mitigate these risks, and the external EIS Funds Advisory Committee which will provide an additional level of oversight should provide investors with a degree of comfort.

Product Quality Assessment

Investment Team

The investment team (across the PLC) has grown significantly and is currently comprised of 35 individuals (excluding the debt team), with Julian Viggars as the Chief Investment Officer. Julian Viggars replaced Matt Mead in April 2018, and has primary responsibility for all investments made across the various funds managed, as well as those made from the PLC's own balance sheet. Julian Viggars has worked in early-stage venture capital for around 20 years, including 13 years at Enterprise Venture (before it was acquired), where he managed multiple funds, which included successful listed businesses such as Blue Prism (£1.3 billion), Xeros (£68 million), and Optibiotix (£62.3 million). The Manager states that there are plans to continue expanding the team as the AUM grows towards its target of £1 billion by 2022.

In addition to Julian, there are four key Investment Directors, each of whom is highly experienced in their respective sectors. While Mercia emphasises that having such knowledge and experience in each area is a key strength of its philosophy, it is important to note that such an approach incorporates a degree of key man risk. However, Mercia has stated the team below the directors is capable enough to carry out the strategy. One of the four did, in fact, leave the firm in September 2017; however, the Manager was able to replace Rob Johnson, the Investment Director for software and Internet, with Alistair Forbes, who joined in December 2017. Although the short-term impact seems limited, it remains to be seen if this change will have any negative long-term impact on the Fund.

The four current sector heads are:

- **Peter Dines:** Head of Life Sciences & Biosciences. Peter has 20 years of healthcare experience and has worked as an entrepreneur and investor involving various turnarounds and realisations. He also has overall responsibility for ensuring that the Growth Funds are properly deployed and managed.
- **Mike Hayes:** Head of Digital. Mike was formerly CEO at SEGA Games Europe and America, with over 23 years' experience in interactive businesses.
- **Dr Mark Volanthen:** Head of Engineering and Materials. Mark's experience is in growing various companies across sectors including oil & gas, energy, defence, instrumentation, and materials.
- **Alistair Forbes:** Head of Software and Internet. Alistair has created, built, and sold start-up software businesses and has held general management roles in large companies.

Underneath the four lead Investment Directors there are other Investment Directors and Managers that will help in all aspects of the investment process, sourcing, performing due diligence, executing deals, and managing the portfolio. We are informed that at least one of the four lead directors will be directly involved in every deal that the EIS Funds complete. As such Investment Directors have view of all deals and can then allocate deals to investments based on expertise and geographic location, leveraging Mercia's footprint across the UK. At which point, the respective investment team will conduct due diligence over a period of time and present the details to the Fund for an investment committee decision.

Mercia maintains relationships with 19 universities, with Edinburgh University the most recent addition, with Dr Nicola Broughton acting as Head of Universities to help support the commercialisation of spinouts.

Owing to a rule within Mercia, employees are unable to invest into the Fund and therefore lack the traditional alignment. However, every employee is a shareholder or option holder and therefore partially align with the Fund through the success of the business as a whole. Only the investment directors share in the carry from the Funds, thus illustrating some top-end alignment.

Overall, the structure of the investment team, with sector experts overseeing investment into specific sectors, and assisted by a broader team to assist with due diligence and deal execution creates a strong, well-experienced team. Further, the team enjoys the benefit of a broader geographic spread, with offices across the UK, assisting with engagement of investee companies. Given the specific sector expertise offered by the four lead Investment Directors, there is an element of key person risk should any one of them leave the business; however, Mercia are confident that this would be mitigated by the size and depth of the broader investment team.

We have included key individuals' bios in the Appendix.

Investment Strategy & Philosophy

The Mercia EIS Fund aims to deliver capital growth from a portfolio of early-stage, high-growth technology businesses, with a focus on four subsectors: Digital & Digital Entertainment; Software and the Internet; Life Sciences & Bio-Sciences; and Electronics, Materials & Manufacturing/Engineering. Within these subsectors there are areas which Mercia avoids, such as software business-to-consumer internet companies (due to potential cash burn), or therapeutics/drug discovery (for the same reason), preferring to focus on companies developing devices, diagnostics, and synthetic biology advancements etc. The strategy targets a multiple of 2.5x and above (not including tax reliefs) in five to seven years, although it is acknowledged that the holding period may be much longer.

Mercia aims to be a long-term provider of funding for investee companies, an approach it describes as the "Complete Capital Solution". This involves drip-feeding funding to early-stage companies that meet their performance targets over time through multiple funding rounds. In addition, Mercia will take an active role in the investee companies, offering assistance with strategic planning, tax credits, intellectual property, accounting, and access to contacts.

As has been mentioned, the Fund will operate under tranche closures, and the previous cohorts under this strategy (formally known as Mercia Growth Fund 1, Mercia Growth Fund 2 etc.) have typically invested into around 20 companies, including EIS and SEIS. Similarly, the latest iteration is expected to invest into 12 to 15 EIS companies and 2 to 4 SEIS companies. Mercia will aim to diversify holdings across technological subsectors and geographic location. Mercia has stated that no more than 30% of the portfolio will be invested in any one company, and any company which is likely to be over 20% of the portfolio will attract additional scrutiny. The level of diversification should help to mitigate, although not completely eliminate the risks associated with early-stage investments.

The Manager focuses on those regions of the UK outside of London and the South East, which it believes are underserved in terms of funding, and therefore offer more competitive valuations. In addition, Mercia has partnerships with 19 universities in the UK, and works closely with their technology transfer offices. The Manager states that its strong relationships with these universities are a key source of dealflow (although there are no exclusivity arrangements in place which might limit competition to this dealflow in the future). Edinburgh University was the latest addition to the network (19^{th}), and the Manager plans to focus future funding into this area. However, from our conversations with the Manager, it was mentioned that it is witnessing less viable opportunities due to universities demanding a higher equity stake in potential investee companies, which as the Manager puts, disadvantages the founders and therefore disincentivises them.

In screening prospective investments at their initial funding stage, key selection criteria will vary depending on the subsector and business stage of development – for example, having patents in place in a life sciences or engineering business. Generally, Mercia will seek a credible management team, consider the market opportunity, and determine whether it has faith in the team being able to execute its business plan. While most companies are likely to be pre-profit at the point of initial investment, many will either be expected to have revenues (usually the case in digital and software sectors where the team will seek validation through customer adoption) or typically be no more than two to three years away from revenues.

The 'Complete Capital Solution' means being able to provide funding throughout a company's developmental journey - from start-up/university spinout/seed-stage through to Series B and C funding of several million pounds (the PLC can invest up to £10 million and potentially syndicate for more) and eventual trade sale or IPO market listing. Mercia can provide capital from its various EIS/SEIS Funds, its Regional Development Funds and its own PLC Balance Sheet; this capital can be in the form of direct equity or loan investments. The PLC, however, has no obligation to provide follow-on investment to existing third-party portfolio holdings. The Board of the PLC makes its own investment decisions, as does the Investment Panel serving the EIS Funds. It is also worth noting that whilst drip-feeding funding does reduce risk, it also results in the initial investors becoming increasingly diluted, and in the absence of third-party investors, the price of any subsequent funding round could be considered to be subjective (and is therefore kept at cost). The above, though beneficial to increase check sizes as a whole, can create a series of conflict of interests, however, the Manager has stated that each fund has its own investment committee to act on behalf of its investors and there exists a Valuations Conflict committee where each fund represents its own investors to discuss valuations of investee companies.

Deal size can vary from £100,000 to £2 million, with an average of £500,000 across all funds. Earlier-stage funding rounds will typically involve smaller deal sizes. Mercia typically expects to receive between 10% and 35% of the equity of each business in which it invests, although this could be spread across more than one fund. It also seeks pre-emption rights to ensure it has the right to participate in future funding rounds at the same shareholding percentage (these rights are not necessarily enforceable by individual investors however). Post-investment Mercia should have some degree of influence through its engagement and a seat on the Board, but its main influence is exerted through the provision of follow-on funding and this is dependent upon performance against set milestones.

Realisation timeframes are expected to be in the region of five to seven years. However, Mercia acknowledges that investment durations from seed-stage through to eventual realisation can sometimes take up to 15 years. It says its experience has shown that digital and software investments are likely to be realised earlier, as the companies are often demonstrating revenue growth and it is therefore easier to take a view on it. Life science and IP-based engineering businesses may be expected to take longer as it proves commercial viability. The majority of realisations will be in the form of trade sales; secondary sales and IPOs may also be considered.

The Manager targets an individual investment to return multiples of invested capital 10 times-plus for first time investments. For later-stage, follow-on funding rounds these targets soften to perhaps 3-5 times depending on a company's stage of development. Mercia also concedes that a proportion (perhaps 25% to 30% or more) of its early-stage deals can be expected to fail. A 'Fail Fast' policy is in place to try to cut-off failing investments quickly - this policy is used when an investee company is falling well short of agreed milestones and in the Manager's view it has turned into a lost cause. In this situation the company's management team will be notified that no further funding will be given. Mercia says that usually it has a good indication within five to seven months whether a business is on track. If a company hits their pre-agreed milestone targets, Mercia would expect to provide follow-on investment, either from one of the funds that it manages, or from its own balance sheet. The 'Fail Fast' policy should also help to provide reassurance that, while some investments may have a much longer holding period than the target, these are likely to be among the best performing.

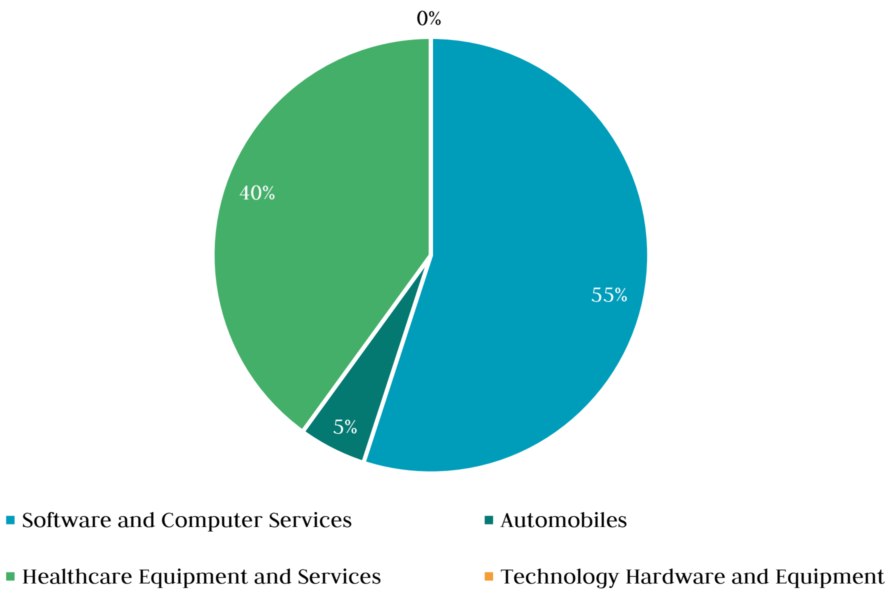
Overall, we consider the strategy employed by the fund to be coherent and well-thought-out. Mercia offers a combination of the following: a team of experts, the ability to offer follow-on funding through the "Complete Capital Solution", a focus on underserved regions of the UK and its partnerships with 19 British universities. While none of these factors in itself is a unique feature in the market, together they make a compelling proposition. Lastly, the approach to diversify investors across up to 15 companies, at varying stages of development should help to mitigate some of the risks associated with the strategy.

Pipeline/Prospects and Current Portfolio

Overall, Mercia has invested into 87 companies under the current strategy, both under the current fund structure, and through the previous closed end funds.

On average, spinouts from its non-exclusive university partnerships have been responsible for around 20% of dealflow, but from our conversation with the Manager, this is likely to decrease as mentioned above. The breakdown between the four key sectors of interest is driven largely by the number of good deals the Manager can see in each category; as such, Mercia expects there to be more investment into biosciences, due in part to the scarcity of high-quality opportunities in the digital and media sectors. The current sector breakdown for the Mercia EIS Fund (excluding the previous iterations of the fund) is as follows:

CHART 5: MERCIA EIS FUND SECTOR SPLIT AS AT NOVEMBER 2019



Source: Mercia; AdvantageIQ

The chart above shows the sector split for the Mercia EIS Fund. Note, the portfolio for all the previous Mercia EIS funds (Mercia Growth Fund 1, Mercia Growth Fund 2 etc.) differs, and the above is purely for the Fund currently under review. Though the chart above shows concentration in Software and Computer Services, each company within this sector operate its software services in multiple other sectors and there is no clear overlap. Therefore, the current composition of the Fund is relatively diverse.

We understand that the intention going forward is for around 40% to 60% of investments made within the Mercia EIS Funds to comprise follow-on funding rounds of existing portfolio investments. An investor's portfolio is likely to contain a mix of companies in terms of its stage of development.

TABLE 4: MERCIA EIS FUND CURRENT PORTFOLIO COMPANIES AS AT DECEMEBER 2019

COMPANY	SECTOR	DATE OF INVESTMENT	AMOUNT INVESTED	PROPORTION OF THE PORTFOLIO	BRIEF DESCRIPTION
CAM Solutions Ltd	Software & Computer Services	Jul-18	£100,000	1%	Online video sharing/analysis for team sports
Expandly Limited	Software & Computer Services	Aug-18	£250,000	3%	Ecommerce Sales Software
Cyan Forensics Limited	Software & Computer Services	Sep-18	£234,997	3%	Forensic Science Software
Arc Vehicle Limited[1]	Automobiles	Oct-18	£350,000	5%	Electric Motorcycle

Kumulos Limited	Software & Computer Services	Oct-18	£399,967	5%	Mobile App Controller Software
CAM Solutions Ltd*	Software & Computer Services	Nov-18	£200,000	3%	Online video sharing/analysis for team sports
Living Map Assets Limited	Software & Computer Services	Jan-19	£249,997	3%	Digital Mapping
Manchester Imaging Ltd	Healthcare Equipment & Services	Feb-19	£116,250	2%	Dental Diagnostics Software
Pharmaseal International Limited	Healthcare Equipment & Services	Feb-19	£374,992	5%	Clinical Trial Management Software
Rinicare Limited	Healthcare Equipment & Services	Feb-19	£250,000	3%	Health-Tech Solutions
Snapdragon Monitoring Ltd	Software & Computer Services	Feb-19	£350,000	5%	Online IP Protection for Businesses
Pertinax Pharma Limited	Healthcare Equipment & Services	Mar-19	£199,999	3%	Antimicrobial protection for medical devices
Clinspec Diagnostics Limited	Healthcare Equipment & Services	Mar-19	£259,001	3%	AI Brain Cancer Detection
Blackcurve Solutions Limited	Software & Computer Services	Mar-19	£270,990	4%	Ecommerce Pricing Software
Axis Spine Technologies Ltd	Healthcare Equipment & Services	Apr-19	£499,978	7%	Bespoke Surgical Solutions
Snapdragon Monitoring Ltd*	Software & Computer Services	May-19	£74,995	1%	Online IP Protection for Businesses
Living Map Assets Limited	Software & Computer Services	May-19	£249,997	3%	Customised Mapping Technology
Gecko Labs Limited	Software & Computer Services	Jun-19	£799,991	11%	Higher Education Chatbot
Nuvision Biotherapies Ltd	Healthcare Equipment & Services	Jul-19	£249,986	3%	Regenerative Medicine Company
e-bate Limited	Software & Computer Services	Aug-19	£299,958	4%	Bespoke Rebate Solutions
Axis Spine Technologies Ltd*	Healthcare Equipment & Services	Aug-19	£499,872	7%	Bespoke Surgical Solutions
Rinicare Limited*	Healthcare Equipment & Services	Aug-19	£125,000	2%	Health-Tech Solutions

Snappy Shopper Ltd	Software & Computer Services	Sep-19	£249,935	3%	Online Shopping Delivery App
Covatic Limited	Software & Computer Services	Sep-19	£450,000	6%	Media App Software
Invizius Limited	Healthcare Equipment & Services	Sep-19	£500,000	7%	Aiding side effects of Extra-Corporeal treatments
Totals			**£7,605,906**	**100%**	

Source: Mercia

* Follow-on Investment

[1] We note that Arc Vehicle Limited went into administration in September 2019

In terms of likely investor portfolio, it is advisable for investors to check that they are comfortable with the sectors and investment checklist followed by Mercia, as this is followed consistently in the types of companies into which it invests into. In recent times, the Fund has invested into the above listed companies, such as, CAM Solutions Limited, Snapdragon Monitoring Ltd, and Pharmaseal International Limited. All the companies in the above portfolio are B2B companies, and hence not particularly vulnerable to individual consumer patterns. Majority of the companies in the portfolio are also post-revenues/pre-profits. Half of the companies above are follow-on investments from the previous close-ended Mercia EIS funds, according to the Manager, this can be expected going forward. The Manager states that the valuations above are all externally set.

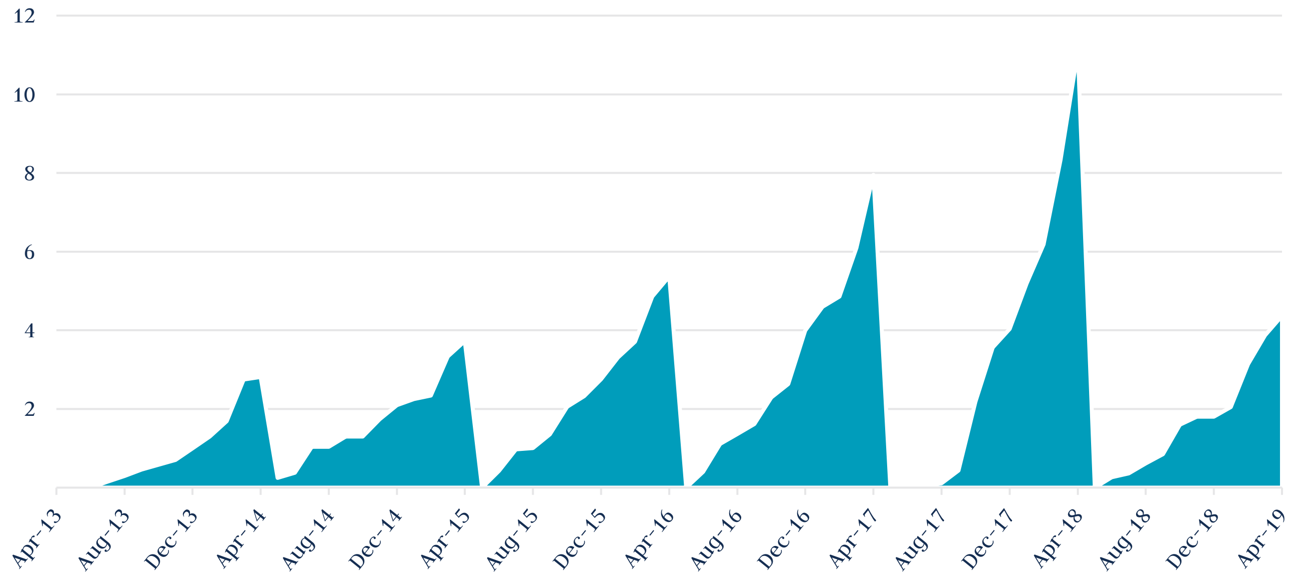
The table below shows the portfolio standings of the previous close-ended Mercia EIS funds.

TABLE 5: MERCIA FUND'S CURRENT PORTFOLIO POSITIONS AS AT OCTOBER 2019

FUND	YEAR OPENED	YEAR CLOSED	NO. OF INVESTMENTS	AMOUNT INVESTED
Mercia Growth Fund 1	2012	2014	20	£1,470,000
Mercia Growth Fund 2	2013	2014	28	£2,389,000
Mercia Growth Fund 3	2014	2015	30	£2,592,000
Mercia Digital Fund	2014	2015	13	£896,000
Mercia Growth Fund 4	2015	2016	35	£3,693,000
University Growth Fund	2015	2016	16	£1,744,000
Mercia Growth Fund 5	2016	2017	28	£4,994,000
Mercia Growth Fund 6	2016	2017	16	£3,086,000
Mercia Growth Fund 7	2017	2018	25	£5,950,000
Mercia Growth Fund 8	2018	2018	20	£5,195,000
Mercia EIS Fund	2018	-	16	£4,106,000
Totals			**247**	**£36,115,000**

Source: Mercia

CHART 6: CUMULATIVE TAX YEAR DEPLOYMENT AS AT APRIL 2019 (£MILLIONS)



Source: Mercia

The chart above shows the timeline of cumulative deployment of all of the Mercia funds. As can be seen the rate of deployment, as expected, increases as the fund reaches tax-year end. The Manager deployed £11.8 million in the 2017/18 tax year, but only deployed approximately £4.4 million in the 2018/19 tax year. This according to Mercia was partly due to the move to retail permissions, as one of the three funds in the 2018/2019 tax year closed at the end of March 2019, and so there was no opportunity to deploy this capital. Mercia has added to this point but noting that it is seeing valuation inflation in London and Edinburgh, as excessive capital is chasing few high-quality investment opportunities.

The table below outlines the current pipeline, only those in "Detailed Appraisal" have been included, however, there are several companies currently going through other stages of the Manager's investment process. As can be seen, majority of the pipeline is to be deployed into new investee companies, with a total of £6.2 million to be potentially deployed within the next six months. Mercia has indicated that historically, it has managed full deployment for each tranche within seven months. As per the strategy, the companies in the pipeline are all B2B companies, and range from Seed to Series A within the three of the four sectors: Software and the Internet; Life Sciences & Bio-Sciences; and Electronics, Materials & Manufacturing/Engineering, no Digital & Digital Entertainment deals are currently in this stage of the investment process.

As mentioned in *Investment Strategy*, the primary deal sourcing is through the Investment Teams local and personal networks. Another key source of deal flow is from its partnerships with universities, where it can find promising university spin-outs.

TABLE 6: NEW INVESTMENTS PIPELINE AS AT NOVEMBER 2019

COMPANY	NEW/ FOLLOW-ON	TRANCHE TO BE INVESTED	SECTOR	CAPACITY	STAGE OF COMPANY
Company 1	New	2019 Q4	Software & Telecoms	£1,000,000	Post-Revenue/Pre-Profits
Company 2	Follow-on	2020 Q1	Lifesciences and Biosciences	£250,000	Post-Revenue/Pre-Profits
Company 3	New	2020 Q1	Lifesciences and Biosciences	£1,000,000	Post-Revenue/Pre-Profits

Company 4	New	2020 Q4	Software & Telecoms	£400,000	Post-Revenue/Pre-Profits
Company 5	Follow-on	2019 Q2	Lifesciences and Biosciences	£340,000	Pre-Revenue
Company 6	New	2019 Q4	Software & Telecoms	£750,000	Post-Revenue/Pre-Profits
Company 7	New	2019 Q4	Software & Telecoms	£250,000	Post-Revenue/Pre-Profits
Company 8	New	2019 Q4	Electronics, Engineering & Manufacturing	£250,000	Pre-Revenue
Company 9	New	2018 Q4	Lifesciences and Biosciences	£350,000	Pre-Revenue
Company 10	New	2019 Q2	Electronics, Engineering & Manufacturing	£250,000	Post-Revenue/Pre-Profits
Company 11	New	2020 Q1	Lifesciences & Healthcare	£350,000	Post-Revenue/Pre-Profits
Company 12	New	2019 Q4	Lifesciences & Healthcare	£500,000	Post-Revenue/Pre-Profits
Company 13	New	2019 Q4	Software & Telecoms	£500,000	Post-Revenue/Pre-Profits
Totals				**£6,190,000**	

Source: Mercia

* Mercia EIS Fund's contribution of the £1.5 million investment round is to be confirmed

** Mercia EIS Fund's contribution of the £150k investment round is to be confirmed

Investment Process

The Manager has described its investment process as follows in AdvantageIQ:

TABLE 7: INVESTMENT PROCESS

INVESTMENT PROCESS	DETAILS
Deal sourcing/ origination	In 2018/19 Mercia saw 3000 opportunities and invested in around 2% of these opportunities. 80% of these deals were sourced from our investment teams' networks, whereas 20% are sourced from our 19 university partners. We believe that we have the best early stage dealflow in the country. Since MJ Hudson Allenbridge's last review in June 2017, Mercia has added Edinburgh University to its list of University partners, taking the number to 19. Edinburgh is notable as it is one of the top 25 universities in the world for R&D, and hence there are a large number of spin outs, which Mercia has the option to fund. The R&D spend of our 19 university partners is larger than that of Oxford, Cambridge and Imperial, and the pricing is much better value in these regional universities.

Deal filtering and selection	Prior to making investments, we will apply investment criteria including some or all of the following: • a pre-identified strong market potential and high opportunity for growth; • the identification of likely exit opportunities, such as trade sales, flotation or partnerships; • the technology team should be recognised as leaders in their field; • there should typically be an underlying enabling and scalable technology, capable of addressing multiple applications. • there should be defensible intellectual property and ideally comprehensive patent protection, with the ability to enhance this position as the investee company develops; and • the technology is typically no more than 2 to 3 years away from demonstrating incremental value to third party investors or trade buyers or being capable of generating revenue streams for the business. • The total capital required to fund the business through to sustainable breakeven should be no more than £15m Given the time frame to fully maximise the value of an investment, we expect that investments will be held for the medium to long term, although short-term disposals of assets cannot be ruled out in exceptional or opportunistic circumstances.
Due diligence process	Due diligence involves the rigorous testing of the assumptions that form the basis of a company's business plan. It provides a framework for the efficient gathering, analysis and verification of material facts and expert opinions, in the form of written reports, interviews and third-party verification in order to be able to determine the potential risks and returns from an investment and whether these meet the Client Fund's criteria *Further information on the Fund's due diligence can be found in the Mercia EIS Fund Information Memorandum, specifically, from clause 1.2 to 2.15*
Deal approval	Investment Committee: All investment will be approved by the Investment Committee, which meets twice a week. This ensures that every portfolio company within the fund is subjected to the same criteria and is assessed objectively. The Advisory Committee was established to oversee adherence to the Information Memorandum by the Fund Manager. It provides an independent perspective on the progress of the funds, corporate governance and the timing of investment returns. It meets on a quarterly basis and convenes additional meetings if necessary and is also able to remove and replace the Fund Manager in cases of negligence. Full advisory committee reports are available via the Investor Centre

Source: Mercia; AdvantageIQ

According to Mercia, it receives circa 3000 business plans per annum and makes approximately 20 new investments a year in the EIS. Deals are primarily sourced from a combination of the Manager's partnerships with universities, and the investment team's personal and local networks. However, we note that more junior members of the team play a large role in filtering out opportunities in the early stages of the process, which may lead to good deals being passed over due to the lack of experience. Though Mercia's juniors do often come with past professional experience which gives comfort on this score.

As mention in *Manager Profile*, the Manager has recently acquired the Northern VCT's, which should aid with additional deal flow to the EIS. However, in our meeting the Northern VCT manager it was mentioned that it has agreed with Mercia that it will have first refusal on all venture deals above £2 million. This may limit some of the higher ticket venture deal flow being supplied to the Mercia EIS.

The more in-depth due diligence occurs after term sheets have been signed. The Investment Panel is only involved in the process near its conclusion, when it is required to approve the investment. The panel may reject deals which have passed through the other stages; 95% of deals pass this final stage, and all decisions made by the Investment Panel are unanimous. During the due diligence process experts within the Manager's network are consulted to weigh in during the research phase.

Valuations of investee companies are set at the external market price when a third-party investor purchases 20% or more of the company, as it is assumed that the appropriate market price has been set by the significant participation of that third-party. When there has not been a 20% or more investment by a third-party, the valuations are set internally based on the IPEV guidelines.

In terms of documentation there is a one-pager and a deep-dive due diligence pack, which goes to the Investment Committee ("IC"), where final investment approval is given. MJ Hudson Allenbridge were allowed to view examples of both of these documents, which were of a high standard. The document contained in-depth due diligence collected from liaising directly with the investee company, references from Mercia network, third-party due diligence (if applicable), and forecasts for the business.

The Fund is expected to co-invest alongside other Manager-run vehicles that operate under similar strategies. By co-investing alongside other Mercia Funds, the EIS fund gains access to some higher valued companies requiring larger ticket sizes that would be difficult to compete for alone. However, this does cause a conflict of interest between the funds, which the Manager states is managed on a case-by-case basis, each fund is represented by its own investment team, and the independent Advisory committee have oversight of the whole process.

We regard the investment process as standard for a manager of Mercia's size and stature. Mercia's brand recognition, the networks of the investment team, and relationships with universities indicate a good flow of opportunities and the investment process is sufficiently thorough and repeatable to explore opportunities to the requisite level of detail.

Risk Management

Mercia's investments into early-stage tech companies means that it models for a few large successes to more than compensate for the inevitable write-offs and write-downs that a higher-risk strategy inevitably brings with it. However, to manage these risks Mercia pointed to a range of ways that it hopes to manage risk on behalf of investors, from portfolio construction to policies around oversight of investee companies.

In terms of portfolio construction there is some level of idiosyncratic risk mitigation through diversification, as an investor will be exposed to around 15 companies, which is more than many other EIS products on the market. The holdings will also be spread across their main investment subsectors and investee companies tend to have been based across Britain regionally. While the technology sector can be subject to some secular trends in terms of valuations, Mercia should not be overly exposed to any one particular trend or technology within the sector which might overly concentrate risk. It should also be noted that there are a number of sub-sectors and verticals within the broader technology sector.

The first layer of risk management for Mercia is their due diligence, an example of which MJ Hudson Allenbridge reviewed. Most of the due diligence, such as visiting the business or supplier and customer references, is carried out internally, although external parties will be used occasionally, especially for legal matters. The Manager mentioned that the most common failing in their investee companies so far was the management team not delivering. To this end Mercia conduct background search on management teams, meet key individuals several times, and collect references, although it stresses the imperfect nature of any attempt to systematically assess individuals.

Once an investment has been made, Mercia stresses the collection of key performance indicators and management information, a proactive approach with partnering with management teams in order to add value, and the leverage afforded by a drip-feed, follow-on funding model.

Mercia regards it as essential that agreement is reached on the mode of operating and frequency of financial reporting prior to investment and that this is incorporated in the legal agreements. This is then re-confirmed at the post-completion meeting. Management accounts are also required from investee companies to a common format and to an agreed timetable. Annual budgets and the principal assumptions on which they are based are submitted to the investee company's contact at Mercia for approval before the start of the financial year to which they refer. To this end, responsibility for each investment is allocated to a named executive in the Venture Capital Team, who also serves as a board member on said investee company. This is standard practice for the Manager's investment team to take board seats on its investee companies. This individual completes a monitoring report after receiving the management accounts. These reports are discussed at a monthly review meeting and, in the cases where companies are encountering difficulties, an action plan is agreed. The late submission of management accounts is seen as a potential red flag, as it is often the first sign that there is trading, financial, or other problems.

Any unexpected or noteworthy event, at the discretion of the CIO, such as the company winning or losing a major contract, can serve as a review trigger. The strength of the management team is monitored by Mercia, so an unexpected resignation from the board or by senior management would be of concern and would prompt a review of the investment as well as Mercia's ongoing strategy.

On top of the actions outlined above, Mercia also address strategic issues by appointing one of their senior executives and/or an experience business contact to the board of the investee company. This also allows for greater monitoring for potential risk issues.

In terms of follow-on funding Mercia assigns investee companies into its stars, good fund investments, and underperforming assets. If an investee company falls into the former category Mercia can award more funding for the company from its own balance sheet, while the second group of companies will be helped to find syndicate partners for follow-on funding. The drip-feeding of EIS funding, as well as the possibility of follow-on funding from Mercia's own funds, provides considerable incentives for investee companies to hit agreed milestones.

Mercia's hands-on approach, as well as line-of-sight of key manager information, means that most avoidable risks should be managed appropriately, while technical due diligence questions should be answerable by the in-house investment team or external consultants as required. However the main risk of an early-stage tech investment remains the ability of a management team to drive forward the company to scale successfully, which will always be the hardest part of any due diligence process.

Key Features

The following table outlines the headline fees charged by Mercia EIS Fund. The 2% initial fee, 1.75% annual management charge ("AMC"), and 0.25% custodian fee is paid by investors, where the latter two are paid for a maximum of six years. The initial fee is reduced to 1% for existing Mercia EIS Fund investors. Three years of annual fees as listed above, by default, will be withheld from the initial subscription, fees after the first three years will be invoiced accordingly. The fees to the investee companies vary according to the negotiations between the Manager had the company, and factors such as: stage of investee company, amount invested, and number/type of co-investors are taken into account when agreeing fees. Additionally, as mentioned above, the Manager takes a board seat on all investee companies and as such, at a fee, which ranges between 2%-4% depending on the level of directorial involvement from the Manager's team.

While MJ Hudson Allenbridge normally decries deal-by-deal performance fees, the provision that an investor has to get 100% of their subscription back before this applies, limits the normal downside of such an arrangement that sees some managers charge for performance while losing investors' money. The Performance fee of 20% is taken without a hurdle, meaning all returns above £1.00 for every £1 subscribed are subject to the fee. This may not incentivise the growth of the portfolio, however, it could limit the riskier behaviour from the principals to achieve higher returns if a high hurdle were to be set.

With all the above taken into account it leaves Mercia EIS Fund qualifying for 92% (excluding VAT) EIS eligibility for advised clients who have invested previously with Mercia.

TABLE 8: FEES PAID BY INVESTOR AND INVESTEE COMPANY

FEE (*EXCLUDING VAT*)	CHARGED TO:	
	INVESTOR	INVESTEE COMPANY
Initial Fee	2.0%[1]	-
Custodian Fee	0.25%[2]	-
Arrangement Fee	-	3.0%[3]
Annual Management Fee	1.75%[2]	-
Annual Service Fee	-	-
Director's Fee	-	2%-4%[3]
Exit Performance Fee	20.0%	-
Exit Performance Fee Hurdle	1.0x	-
Execution Only Fees	-	-
Direct Application Fees	-	-

Source: Mercia; AdvantageIQ

[1] Reduced to 1% for existing Mercia EIS Fund Investors

[2] For a maximum of 6 years

[3] The investee company fees are negotiated on a deal-by-deal basis, and are variable according to stage, quantum of investment and co-investors.

* 3 years of annual fees are taken upfront by the Manager from the Investors initial subscription

Performance

Due to the long-running nature of the fund, and a continuity of strategy, it is possible to look at the past performance of the Fund's strategy when put into action. Below is the performance of each of the first five iterations of the Service, which have each had at least on exit.

In aggregate, the Mercia EIS Funds have invested into 87 companies, of which 15 have failed and three have exited successfully: LM Technologies Limited, Oxford Genetics Limited, and Impression Technologies Limited.

The existing SEIS & EIS portfolios remain in the relatively early stages. However, we are informed that by way of share sale after IPO and sale on the Share Exchange, cash has been returned to the first two EIS Funds' shareholders shortly after the three-year holding period (24% and 17% of subscription). Mercia provided the following performance data for its funds which have completed their investment programmes:

TABLE 9: MERCIA FUND MANAGEMENT PORTFOLIO'S AS AT OCTOBER 2019

FUND	NO. OF INVESTMENTS	AMOUNT INVESTED (£'000)	CURRENT VALUATION (£'000)	MULTIPLE
Mercia Growth Fund 1	20	1,470	1,506	1.02
Mercia Growth Fund 2	28	2,389	4,219	1.77
Mercia Growth Fund 3	30	2,592	3,744	1.44
Mercia Digital Fund	13	896	1,601	1.79
Mercia Growth Fund 4	35	3,693	3,692	1.00
University Growth Fund	16	1,744	2,460	1.41
Mercia Growth Fund 5	28	4,994	5,110	1.02
Mercia Growth Fund 6	16	3,086	2,717	0.88
Mercia Growth Fund 7	25	5,950	6,091	1.02
Mercia Growth Fund 8	20	5,195	5,650	1.09
Mercia EIS Fund	16	4,106	4,106	1.00
Totals/Average	**247**	**36,116**	**40,896**	**1.22 (Average)**

Source: Mercia

* Excludes Tax and Loss Relief

These figures are, on the whole, encouraging, although we note that Mercia Growth Fund 6 is currently valued below cost. The average portfolio NAV multiple is 1.22x. It should be noted that the above performance figures include SEIS, which were the majority of the fund in the first few funds, and Mercia has stated that due to varied performance it now focuses on investing EIS capital.

The table below provides information on the three successful realisations. The average multiple of 2.8x is above the targeted 2.5x. Although it should be remembered there have similarly been 15 failures, and the three realisations are unlikely to be representative, and past performance does not guarantee future success.

TABLE 10: DETAILS OF SUCCESSFUL REALISATIONS AS AT OCTOBER 2019

REALISATION DATE	INVESTEE COMPANY	PORTFOLIO NAV MULTIPLE*
July 2016	LM Technologies	4.8
November 2016	Oxford Genetics	1.7
January 2017	Impression Technologies Limited	1.9
Average		2.8

Source: Mercia

* Excludes Tax and Loss Relief

Within the wider investment portfolios of Mercia Technologies Group there have been a number of profitable realisations, including from the portfolio of Enterprise Ventures, with the majority in the form on an IPO on AIM. Notable IPOs include:

- Robotic process automation firm, Blue Prism plc in March 2016, which returned 104x invested capital for the Rising Stars Growth Fund. £0.9m was invested in the company, which is believed to have been EIS qualifying at the time, and in total £95m was returned to the investors, with the last shares in Blue Prism plc were sold in March 2019;
- Women's health diagnostics business, Concepta plc – listed in July 2016.

There is less of a track record in terms of trade sales (which is anticipated to be the most likely exit route for most of the EIS Fund's investments). However, one notable example was the Mercia Fund 1 holding Allinea Software Ltd, which was successfully sold to ARM Ltd for 26x initial funds invested.

On balance we are encouraged by the growth in portfolio valuations across the Manager's EIS and SEIS portfolios, as we are by the record of successful IPOs. However, this is tempered somewhat by the lack of profitable trade sale realisations, although this is in part due to the immaturity of the Growth Funds. As the earlier funds approach maturity, we expect to see more exits in the next 12 months.

Appendix 1: Key Personnel

Key Investment Professionals

NAME	JOB TITLE	DATE STARTED	BIOGRAPHY
Mike Hayes	Investment Director	09/2013	Mike brings over 23 years' experience in interactive businesses and at multinational games company SEGA, he was CEO for Europe and America presiding over a turnover in excess of £400 million. He was responsible for the re-birth of SEGA as a multi-platform software company and managed the acquisition of several development studios including Sports Interactive, (maker of the Football Manager series) and Creative Assembly, (maker of the Total War series). Mike led the team that transferred Sonic successfully onto digital platforms and launched one of the first ever games for the iPhone – Super Monkey Ball.
Alistair Forbes	Investment Director	12/2017	Alistair brings extensive technical and business leadership experience in software businesses to the team. He has created, built and sold start up software businesses and held general management roles in larger companies that have attained global leadership positions in their industry sector. He has extensive connections in the software industry in the UK and internationally, extending from the start-up space through scale-up businesses and into larger corporate organisations. As a private investor and advisor, he has worked both formally and informally with numerous software businesses in the UK and internationally, helping them to develop and execute their growth strategies.
Peter Dines	Chief Operating Officer, and Investment Director	01/2015	Peter has been involved with a number of high-profile turnarounds and exits within the sector, including the acquisition of Surgicraft's loss making business where, as Managing Director, sales quadrupled within three years and the business was subsequently sold to ISIS Equity Partners. Other key healthcare positions held, both previously and currently, include Bridges Ventures, Cisiv, Diagnostic World, Spring Active and Newtech Ortho.
Julian Viggars	Chief Investment Officer	01/2003	Julian joined the Group in 2003 with over 20 years' venture capital experience. He now heads all third-party tech fund activities, and works closely with the COO, supporting the Investment Teams and managing Mercia's proprietary funnel of Emerging Stars as they progress. He is also a Fund Manager for NPIF - Mercia Equity Finance, the RisingStars Growth Funds, and the Finance Yorkshire Seedcorn Fund, which include successful listed businesses Blue Prism, Xeros, and Optibiotix PLC. In addition, Julian has been a non-executive director of Xeros PLC since 2009 and is a member of the BVCA's membership committee. Julian has experience across all tech sectors and was previously an investment director and COO of BioProjects International PLC, an AIM-listed early-stage technology fund, which he cofounded with private investor, Jim Slater. Prior to that, he was with accountancy firm Smith & Williamson in London and spent time with Barclays Ventures working on small PE buyout transactions.

Mark Volanthen	Investment Director	11/2015	Mark is a veteran telecoms specialist with over 15 years spent in leadership roles within venture backed businesses whereby he has been instrumental in increasing shareholder value. Building his career at Kymata, backed by 3i and Kleiner Perkins, the business achieved rapid growth during Mark's tenure, increasing its staff count from 5 to 550 and subsequently being sold to Alcatel for $160m in 2001. Following a directorship role with Silecs, Mark held various leadership roles with another 3i backed business, Insensys, whereby notable achievements included the sale of the oil and gas division to Schlumberger in 2007 and the sale of the wind energy and aerospace and defence business to Moog in 2009. More recently, Mark was CEO of WFS Technologies and MD Oil & Gas at Guralp Systems, a PE backed supplier of seismic instrumentation.
Paul Mattick	Head of Sales and Investor Relations	07/2016	Dr Paul Mattick heads the Sales and Investor Relations team for the Mercia Growth Funds (EIS). He works directly with private clients and advisors to build the EIS fund raising capacity of Mercia. Paul oversees the administration and development of the EIS funds and ensures that investors receive a high level of service, much of which is delivered through Mercia's award-winning Investor Centre. Paul has a variety of experience in early-stage businesses (including being a founder), and formerly worked at another leading EIS fund manager, where he built close relationships with top tier clients, and significantly grew both fund and single company assets under management. Paul has a PhD and Post-Doctorate from the University of Oxford and a 1st Class Bachelor of Science from the University of Leeds.

Source: Mercia; AdvantageIQ

Senior Management Team

MARK PAYTON – CHIEF EXECUTIVE OFFICER

Mark is CEO of Mercia Technologies PLC, having led the flotation in December 2014 and before that the management buyout of its precursor Mercia Fund Management in 2010. Latterly he led the acquisition in 2016 of Enterprise Ventures. Mark chairs the executive committee and the boards of Mercia's fund management businesses (Mercia Fund Management, Enterprise Ventures and EV Business Loans). In addition, he sits on the board of portfolio company Oxford Genetics and has portfolio responsibility for PsiOxus Therapeutics. Prior to Mercia, Mark was at the Department of Pharmacology, University of Oxford, and then afterwards played leading roles within Oxford University Innovation (OUI, formerly Isis Innovation, the technology transfer operation of the University of Oxford), facilitating the spin out of BioAnalab, Oxford Immunotec, Oxitec and Natural Motion. Three of these companies were sold and one other was listed on NASDAQ. After OUI Mark was vice president corporate development at Oxxon Therapeutics Inc prior to its sale to Oxford BioMedica plc. Mark gained his PhD jointly between the University of Oxford (Worcester College) and the University of London (King's College). He also has an MBA from the University of Warwick, has IMC parts I and II, is a Royal Academy of Engineering Sainsbury's Management Fellow (Life Sciences) and is FCA accredited.

PETER DINES – CHIEF OPERATING OFFICER

As above

ROSIE BHATTACHERJEE – GROUP COMPLIANCE DIRECTOR

Rosie joined the Group in 2017 and has responsibility for group-wide compliance. Her initial focus is on Mercia Fund Management Limited, where she is responsible for compliance, client assets operational oversight and anti-money laundering and financial crime controls. She reports to the Chief Financial Officer and works closely with the Finance Directors across the varying divisions.

Rosie has a background in FCA regulation and compliance, having joined the regulator following graduation from Sheffield where she studied Law. Rosie worked for the regulator for 10 years, followed by a period in consultancy, working with a range of regulated firms, including private equity and venture capital firms. She then spent five years as head of compliance at AJ Bell, before undertaking a couple of roles in specialist client assets compliance, most recently for Lloyds Banking Group.

JOHN SIMPSON – FINANCE DIRECTOR

John joined the Group as Finance Director in 2006 and has over 30 years' experience in managing all aspects of private equity as an investor, portfolio director and in fundraising. He is responsible for all of the financial aspects of the business and a member of the Fund Investment Committees.

A Chartered Accountant, John spent eleven years with Murray Johnstone Private Equity, followed by four years with Aberdeen Murray Johnstone Private Equity as portfolio director and a member of the executive management team. John has held a number of non-executive director appointments on behalf of institutional investors and client funds and has advised private equity investors and fund investors, in the private and public sectors, in the UK and overseas, on due diligence and investment management. He is a former member of the British Venture Capital Association Hi-tech Committee and the VCT Fund Managers' Forum.

NOTE: Please be aware that the Manager mentioned in this report purchased the rights to distribute this single report only (no payment was taken to undertake the research which is carried out fully independently and in accordance with MJ Hudson Allenbridge's governance process).

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