RAISING INVESTMENT

NICK HAWKINS

COOPER PARRY

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Purpose

This session seeks to give an overview of the early stage equity investment landscape in the UK, based on our experience of working with hundreds of early stage companies in the UK looking to raise finance over the last 10 years.

We will cover the various forms of raising finance for early stage businesses, along with an overview of the process involving the documents required, valuations and dispelling some common myths.

Funding options

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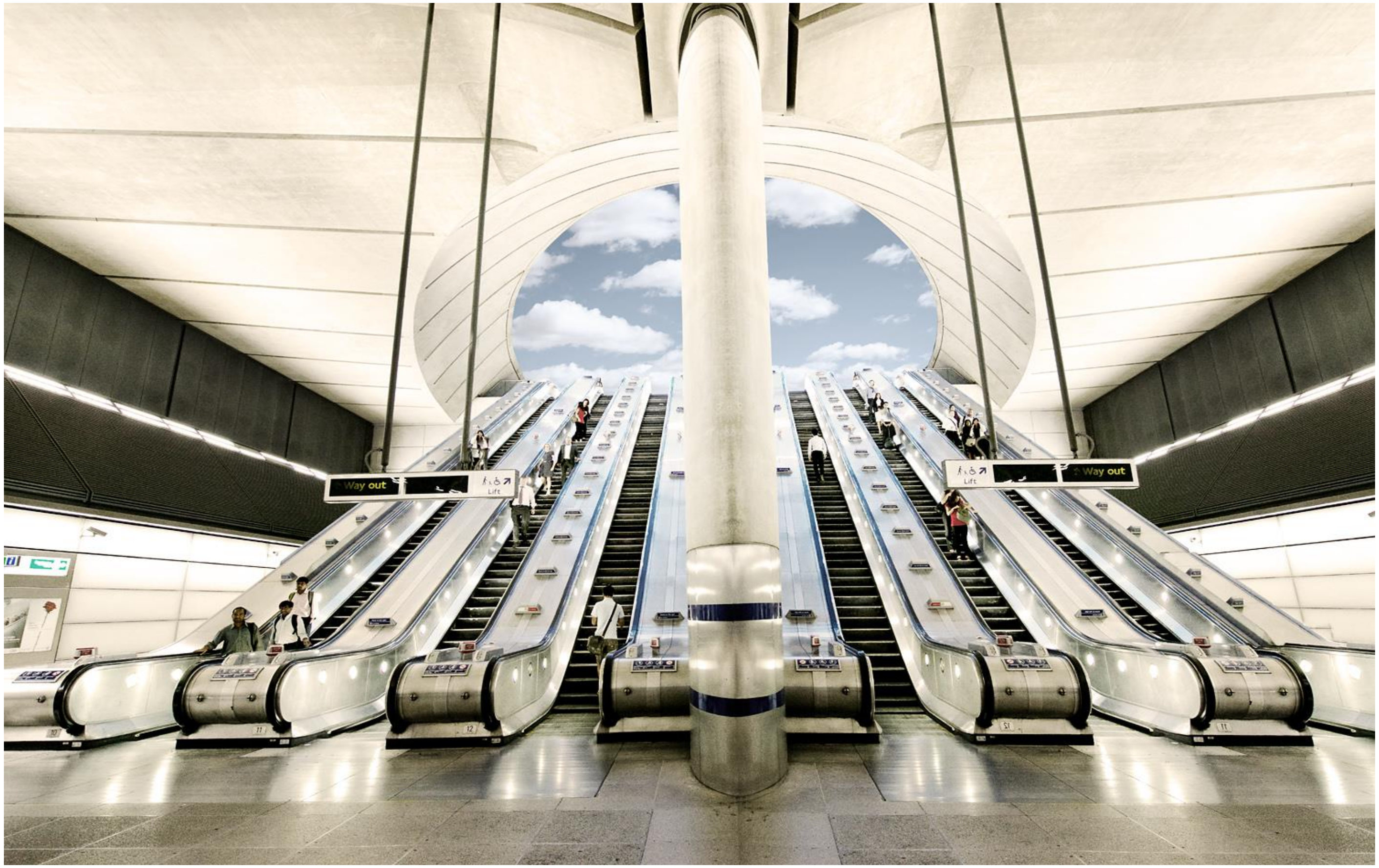
Funding escalator



The reality...

Funding landscape

INVESTIGATION		COMMERCIALISATION	IN THE MARKET	
Concept	Feasibility	Planning	Market Entry	Growth

Own cash, friends and family

Grants

Equity

Alternative Finance (including Crowd-funding)

Debt

PRE-REVENUE PHASE **REVENUES**

This is a general representation only – industry sectors have differing characteristics

Quick note on COVID

COVID has disrupted the market with deal volumes down 40%, however various support schemes have been in place

Areas of government-led support

Lending/Investing		HMRC	Rates	People	
Coronavirus Business Interruption Loan Scheme	Coronavirus Large Business Interruption Loan Scheme	Time To Pay	Retail, Hospitality and Leisure	Coronavirus Job Retention Scheme	Statutory Sick Pay Rebate
Future Fund	Bounce Back Loans	VAT Deferral	Other cash grants	Deferral of Self-Assessment Payment	Self-employment Income Support Scheme

Friends and Family

•The very first tranche of external cash into a business, if not done properly, can create problems for the future.

- Loan or equity?

- Common pitfalls

- Developers working for ‘free’ in return for an equity stake…
- Family members that don’t understand how their share will likely be diluted…
- Complicated share capital structures…
- Disputes, different priorities… etc

•May only be small sums at this stage, but legal advice and shareholder/loan agreements are vital !

Main Sources of Equity Investment

- Business Angels
- Seed Funds (SEIS & EIS)
- Venture Capital
- Private Equity
- Equity Crowdfunding
- Family Offices
- Corporate Venturing

Business Angels

Business angels are private investors who invest their own money into early-stage businesses. They usually operate individually or as a group with a lead angel investor (often referred to as a syndicate). They often belong to member club organisations called 'Business Angel Networks' and can either be hands-on or arms-length investors. Business angels often use SEIS and EIS tax breaks as part of their investment.

Typical amount:

- £50k to £500k (although individuals may invest from £10k as part of a group).

UK Business Angels Association

Criteria often includes:

- Generating revenue, or on the cusp of commercialisation, but not yet generating a profit.
- Scalability and possible exit within three to five years.

UKBAA represents over 160 member organisations and around 18,000 investors. Business angels in the UK collectively invest an estimated £1.5 billion per annum and are therefore the UK's largest source of investment for start up and early stage businesses seeking to grow.

Seed Funds

Seed funds invest money in first or second round ‘seed’ investments and usually support companies with hands-on expertise. A criteria is often that companies must be eligible for the Seed Enterprise Investment Scheme (SEIS) or Enterprise Investment Scheme. Seed funds often look to co-invest alongside other funds and business angels, and may invest more in future rounds.

Amount

- Up to £1m

Criteria

- Generating revenue, or on the cusp of commercialisation but who are not yet generating a profit
- Scalability and possible exit route within 3-5 years

Since the launch of SEIS Fund 1 in 2013 we have invested in over 90 companies and have £15 million assets under management in our diverse portfolio.

Venture Capital

Venture Capitalists (VC) invest money from a fund (not their own) and are backed by both high net worth individuals and/or institutional money. They typically invest in series A or B rounds and often expect to re-invest in future funding rounds. Co-investment involving multiple venture capital funds is common.

Majority also manage EIS funds or Venture Capital Trusts (VCTs)

Typical amount:

- £750k to £10m (there are exceptions).

Criteria often includes:

- Generating revenue, or on the cusp of commercialisation, but who are not yet generating a profit.
- Scalability and possible exit route within three to five years.

Private Equity

Similar to a VC but invest in later stage profitable businesses. Usually backed by institutional money, pension funds and family wealth. Can provide follow-on funding

Take a majority equity stake in the business and work alongside management. May want to replace key members of management

Amount

- Invest between £2m to £20m, sometimes higher

Criteria

- Strong revenues and profitable
- Main aim of raising finance is to reduce inefficiencies, increase profit margins and/or unlock new sources of revenue
- Global scalability
- High capital returns, possible exit in short timescale
- Will want to put debt into the business

PIPER PRIVATE EQUITY

OAKFIELD CAPITAL PARTNERS

LDC BACKING AMBITION

LIVINGBRIDGE

Other equity funds

Regional Funds

- Structured funds that exist to support particular regions. Smaller amounts of equity finance up to £2m
- Example: Northern Powerhouse Investment Fund – supports SMEs with an existing/potential base in the North of England, Mayor of London Fund

Enterprise Capital Funds

- Bring together private and public money to make equity investments
- Public funding provided by the British Business Bank
- Examples: Panoramic Growth Equity; Passion Capital ECF; Notion Capital Fund

Growth Capital

- Long-term, patient equity funding
- Invest in revenue generating, profitable businesses for expansion and strategic growth plans
- Different from Private Equity as they don't want a majority stake
- Example: Business Growth Fund invests between £2m and £10m in return for a 10-40% stake and a seat on the board. They invest in companies that can demonstrate a strong growth trajectory and have a turnover between £5m and £100m

Equity Crowdfunding

Equity crowdfunding involves a large amount of people each providing a little amount of funding to make up an investment round for a start-up or early-stage business. Investors can download investment documents online and decide if they want to invest.

About crowdfunding:

- A group of individuals (a crowd) collectively providing finance.
- Business ideas are showcased via various online platforms.
- Marketing is an important part of the fund raise and involves a lot of proactive work by the business.
- SEIS/EIS eligibility seen as a big incentive for investors.
- You need to bring your own crowd too

crowdcube

KICKSTARTER

SEEDRS

BREWDOG

monzo

Family Offices

The managed private wealth of high-net-worth and ultra-high-net-worth individuals. They provide an outsourced solution to managing the financial and investment side of an affluent individual, family or collection of individuals or families.

Typical amount:

- £1m+ (occasionally a blurred line between Family Offices and Angel Investors)

Criteria often includes:

- Often similar criteria to a fund but with a less formal process.
- Generating revenue, or on the cusp of commercialisation, but who are not yet generating a profit.
- Scalability and possible exit route within three to five years.
- May be more erratic than a fund in their investments as depends on wider needs.

PERSCITUS

BRAN INVESTMENTS

KM CAPITAL

Jam Jar Investments

Corporate Venturing

Large, often multinational, corporates who make investments into earlier stage businesses for strategic reasons. This may be to acquire new brands or to acquire new technologies which may be disruptive in their industry. Corporates do not typically expect the same returns as a traditional venture capital investor; often the longer term objective will be to eventually acquire the whole entity.

Corporates can have formal venturing arms and/or funds e.g. Yeo Valley Ventures, Google Ventures or Distil Ventures.

Alternatively, corporates may take a more informal, opportunistic approach to investments. E.g. Duvvel Moortgat who acquired a majority stake in kombucha brand, JARR Kombucha.

Social Enterprise Finance

mustard seed

BRIDGES Fund Management

THE BIG ISSUE INVEST

unity trust bank

SASC SOCIAL and SUSTAINABLE CAPITAL

Key Fund Growing Enterprise in Communities

ClearlySo

Triodos Bank

Seed Enterprise Investment Scheme (SEIS)

WHAT:

A tax efficient scheme to drive investment into small businesses

The tax benefit is to the investor, but companies indirectly benefit as if you qualify it makes you a more attractive investment opportunity.

Does not need to be a UK company (but it helps!)

HOW:

A company can raise a maximum of **£150k**

Investors can invest up to £100k a year under the scheme

Investors receive **50% tax relief** in year of investment

Exempt from Capital Gains Tax on sale of company (after 3 years)

CRITERIA:

No previous SEIS or EIS investment. Less than **2 years trading.** Less than **£200k** trading history. Less than **25** employees. Less than **£200,000** in gross assets. Active in a **"qualifying trade"** as defined by HMRC

Enterprise Investment Scheme (EIS)

WHAT:

A tax efficient scheme to drive investment into small businesses
The tax benefit is to the investor, but companies indirectly benefit as if you qualify it makes you a more attractive investment opportunity.
Does not need to be a UK company (but it helps!)

HOW:

A company can raise a maximum of **£5m a year,** lifetime limit of £12m
Investors can invest up to £2m a year under the scheme
Investors receive **30% tax relief** in year of investment
Exempt from Capital Gains Tax on sale of company (after 3 years)

CRITERIA:

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No previous SEIS Less than **7 years trading**
Less than **250** employees. Less than **£15m** in gross assets.
Active in a **"qualifying trade"** as defined by HMRC
Different rules for “knowledge intensive” companies

Grants

The good things:

It's money & you don't have to give it back (except in default)

You don't have to surrender equity

The not so good things:

Strict suitability (majority are focused on R&D and particular sectors and/or capital expenditure and job creation)

Applying takes time and effort (and money!)

Only available for future activities, not past ones so apply early and before starting any project

Usually linked to local/regional or national economic benefits – job creation, GVA increase

Grant contribution only likely to be a low percentage of the funding requirement

Some grants:

- Horizon 2020
- Innovate UK
- Regional Angel Investment Programme

The funding process

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Valuation

- Valuation is an art not a science
- Don't overcomplicate things
- The valuations you read about are the exception not the norm
- Convertible notes are less common due to EIS
- Wide variations by sector
- Investors invest on traction, referencing potential returns and sector multiples

$$\cancel{WACC = \frac{E}{E+D} * R_E + \frac{D}{E+D} * R_D * (1-T)}$$

Investment Documents

What do investors want to see?

•Executive Summary
•Investment Memorandum
•Pitch/Presentation Deck
•Forecast financial information
•Historic financial information

Be careful!

The distribution of financial promotions is a regulated activity as defined by the Financial Conduct Authority (FCA) . More information can be found on the FCA website https://www.fca.org.uk/

An effective executive summary

An executive summary is usually the first opportunity to grab a potential funder's interest.

Know your audience

- Good sources of funds receive up to 100 plans a week.
- Make sure you don't underestimate the importance of the opening statements and flow of information.

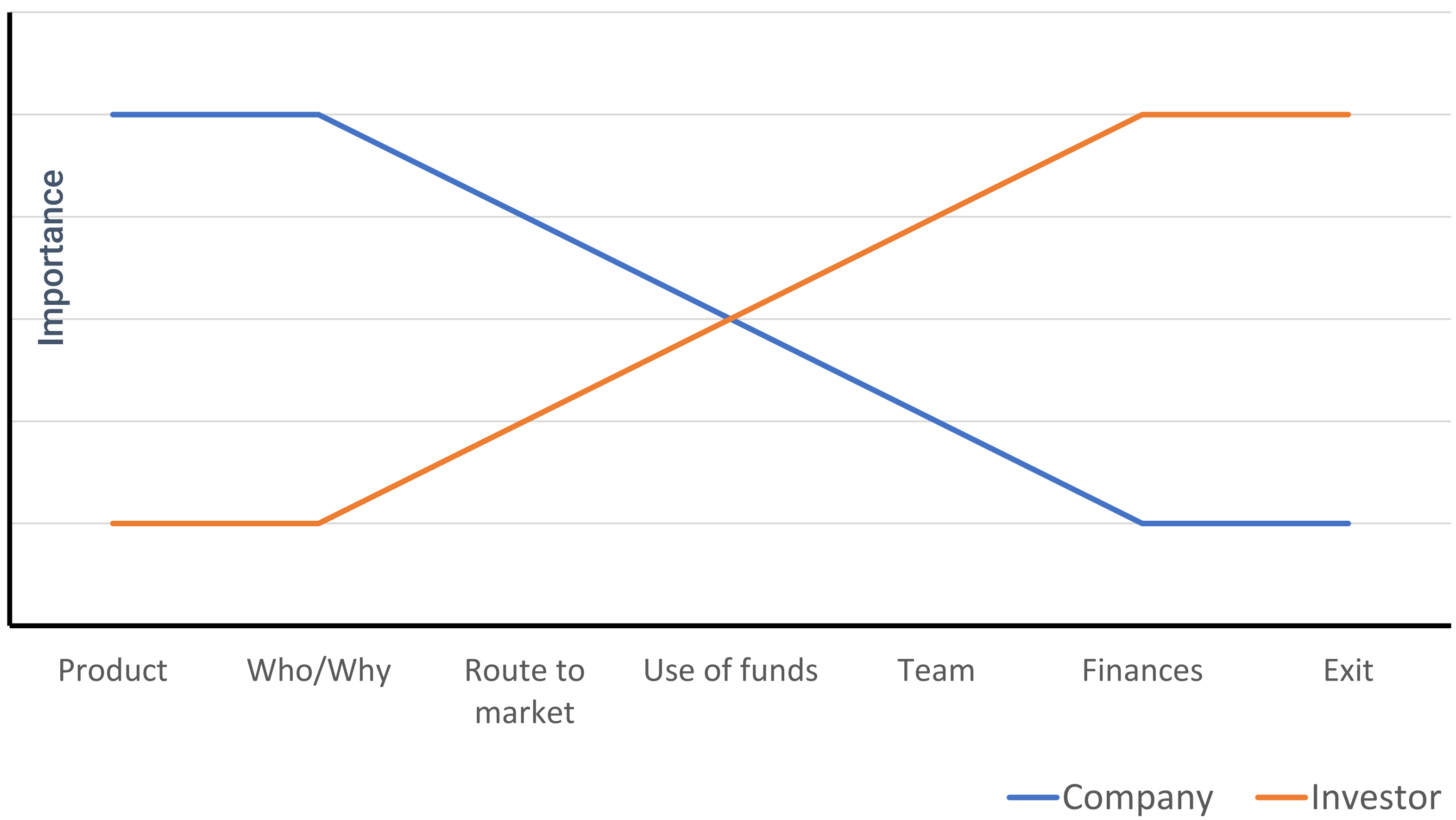
Top tips

- Don't disclose the full details at this stage. This is a summary document.
- Get straight to the point – done well the note should act as an effective tool for explaining your business to others.
- Its your chance to stand apart from your competition.
- It is for the benefit of the funder – they have a limited attention span so you need to spark initial interest.
- 2 pages maximum.

What are investors looking for?

- Ownership but not always control
- Growth ambition
- A return (most important)
- Investment ready
- Valuation and future rounds

Entrepreneur and investor priorities



Why do investors reject proposals?

- Lack of skills in management team
- Non credible financial projections
- No track record or proof of concept
- Inadequate financial returns
- Too complex
- Not scalable
- Lack of trust
- Lack of market awareness
- No clear exit route (trade sale, IPO, etc.)
- Inability of entrepreneur to sell

Myths of raising finance

1. My bank is my first port of call
2. I need an NDA in place before sharing information
3. I shouldn't have to give up equity
4. I'll lose control of my business
5. Investors value a company based on future potential
6. Investors like to hear that you have no competition
7. They do it to give something back / buy into my vision
8. The time is takes to raise money
9. Crowdfunding is a last resort

THANK YOU

Nick Hawkins
nickha@cooperparry.com

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Further thoughts

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Summary - differences between business angel and Venture Capital

	Business Angel	Venture Capital
Personal characteristics	Entrepreneurs	Financial managers
Funding characteristics	Own money	Invested funds money
Investee companies	Start-up, early-stage, high-growth potential	Medium to large growth businesses
Due diligence	Experience based, lower cost	More formal, expensive
Geographical proximity	Important	Not important
Legals	Simple deal structures, focus on fairness	Complex and demanding
Post-investment monitoring	Active, hands-on	Strategic
Involvement in management	Important	Important
Exit route	Important	Very important
Return on investment	Important but flexible	Very important

Equity v Debt

	Equity	Debt
RETURN	Expectations of high growth and future rewards from a sale of the business.	Make a return by way of interest and need to see capital repaid over time.
RISK	Prepared to accept greater risk in exchange for higher returns.	Lenders take minimal risk on their money – low risk, low returns.
REPAYMENT/EXIT	Rewards generally come from capital appreciation when business is sold.	Clearly defined payment schedule for capital and interest.
SECURITY	No guarantee of a return and no security. All capital may be lost.	Generally requires business or personal security.
OWNERSHIP/CONTROL	You are selling a stake in your business and investors will be co-owners. Investors likely to have a much closer involvement especially in strategic matters.	No commitment after loan is repaid. Lenders do not take a stake in your business. Unlikely to get involved in either management or strategic decisions.
UNIQUE	Can take much longer to complete process – no certainty until completion.	Financing decisions often made quickly against standard criteria.

Executive Summary

- [ ] Business overview
  - [ ] Market pain
  - [ ] Solution to market pain
  - [ ] Product/service
  - [ ] Stage
  - [ ] Route to market
  - [ ] Sales model
  - [ ] Scalability
  - [ ] Basic financial table
- [ ] Market overview
- [ ] Team
- [ ] Key achievements - a summary of your main strengths
- [ ] Investment requirement
- [ ] Exit strategy

Executive Summary

- [ ] Business overview
- [ ] Market overview
  - [ ] Market size
  - [ ] Trends
  - [ ] Competition
  - [ ] USPs
  - [ ] Pilot studies
- [ ] Team
- [ ] Key achievements - a summary of your main strengths
- [ ] Investment requirement
- [ ] Exit strategy

Executive Summary

- [ ] Business overview
- [ ] Market overview
- [ ] Team overview
  - [ ] Team members name's and roles (including advisors)
  - [ ] Members experience, education, recognition and skill
  - [ ] Skills gaps and plans to cover them
- [ ] Key achievements - a summary of your main strengths
- [ ] Investment requirement
- [ ] Exit strategy

Executive Summary

- [ ] Business overview
- [ ] Market overview
- [ ] Team overview
- [ ] Key achievements - a summary of your main strengths
    - [ ] Awards won
    - [ ] Notable press coverage
    - [ ] Prestigious client wins
    - [ ] Grants
    - [ ] Key sales milestones
- [ ] Investment requirement
- [ ] Exit strategy

Executive Summary

- [ ] Business overview
- [ ] Market overview
- [ ] Team overview
- [ ] Key achievements - a summary of your main strengths
- [ ] Investment requirement
  - [ ] Amount needed
  - [ ] Purpose
  - [ ] EIS/SEIS assurance
  - [ ] Previous funds raised
  - [ ] Anticipated future rounds
- [ ] Exit strategy

Executive Summary

- [ ] Business overview
- [ ] Market overview
- [ ] Team overview
- [ ] Key achievements - a summary of your main strengths
- [ ] Investment requirement
- [ ] Exit strategy
  - [ ] Anticipated exit route
  - [ ] Who would buy you
  - [ ] Timescales
  - [ ] Similar M&A activity overview

1-2 sentences