Enterprise Investment Scheme mandates

EIS landscape commentary

April 2023

As ever when looking back at the year before there is an inevitability of doing it through lenses tinted with hindsight. Since March 2020, our global society and economy, underpinned by its interconnectivity, experienced several shocks in an unprecedented and cumulative fashion. As the pandemic was beginning to subside in 2021, the global network of trade, and consequently supply, struggled to reorientate itself at the same pace as demand. Inflationary sparks began to increase. As we headed into the second calendar quarter of 2022, Russia and its brutal invasion of Ukraine poured fuel onto these sparks leading to wartime-like interventions by major economies, such as the US releasing its Strategic Petroleum Reserve, the nationalisation of French energy company EDF and the UK's Energy Price Act. We will pass on the opportunity to comment on the UK's attempted 'mini-budget' in September 2022, but we mustn't forget to mention the significant COVID-related lockdowns imposed in China in the final quarter of the year and the impact of their subsequent relaxation.

Why we have recalled these events and noted their cumulative effect is that they are reactions to the runaway global inflation, just like the rapid hikes to interest rates by US Federal Reserve (followed by the Bank of England and European Central Bank) where Chair Jerome Powell increased rates from 0.25% in March 2022, reaching 5.00% a year later. In historical context, an increase in relative terms not seen before or since legendary inflation-fighting former Fed Chair Paul Volcker's administration in the late 1970s and early 1980s.

These big changes in the rates of interest have had significant impacts on global and UK equity markets, which have flowed through to our EIS mandate. The Numis Large Cap Ex-IT (Excluding Investment Companies) index produced a return of +3.7% in the calendar year 2022, outperforming its smaller peers in the Numis Mid Cap (Ex-IT) which was down 18.8%. Our investable universe lies largely within the Numis Alternative Markets index (FTSE AIM stocks) which fell a significant -31.1%. Every year Paul Marsh and Scott Evans at Numis provide a masterly yearly review which provides additional insight into the UK markets' machinations. Interesting anecdotes include that the UK large-cap outperformance was led by the largest 10 companies providing an average gain of 25.1% versus the remaining 90, which declined by 10.4%. In terms of UK smaller companies (lowest decile by market capitalisation) this was the worst performing year since 2008, worse than 2000 and any year prior (as defined by Numis). Alongside this the venture asset class also suffered, with the total number of global deals falling from its high of 14,000 in the first quarter of 2022 down to 8,000 in Q4 2022, with the total deal value falling from $200 billion in Q4 2021 to $75.6bn in Q4 2022. The impacts on growth capital were broad and deep.

However, equally importantly our companies and their funding environments continue to progress with encouragement. While AIM welcomed only 13 IPOs in 2022, since August we were introduced to 17 EIS transactions attempting to raise a combined £88.6 million, of which they raised £69.4m. We participated in six of these (35%) of which two were new investments (one IPO) with the remaining four supporting our existing businesses. We will detail more on these later.

In relation to companies in which we have holdings which were not EIS eligible, they raised a combined £35.6m compared to their target of £38.2m across four transactions. Since the turn of the year, the fundraising environment has materially improved with three companies raising £18.8m versus their £14.7m target. We participated in two of them, one of which was a new business to our mandate. This is without including our growing confidence across our pipeline. Smaller companies need investors' support to develop their products and services, so we're encouraged by the bipartisan support of the UK's leading parties in the invaluable EIS scheme.

For the year ahead we are reluctant to make any forecasts without our lenses of hindsight. What we can say with confidence is that the recently passed US Inflation Reduction Act, US CHIPS and Science Act and its namesake the European CHIPS Act, will have profound effects on the life science, green energy and semiconductor industries. These commitments by major economic blocs should increase confidence in R&D cycles and, ultimately, the products and services arising from them. However, we must be mindful of tensions between China and the US - and even the EU and US - and remember the conflict in Ukraine, which complicates both geopolitics and markets for metals, energy and food.

Many of our companies are beginning to monetise their technologies in ways which we did not envisage when we first invested. Despite the well-documented pressures in capital markets and economies, it's important to remember ingenuity endures. In 2008, as the financial system was disintegrating, wife and husband team Özlem Türeci and Uğur Şahin, both children of Turkish immigrants, founded a little company called BioNTech in Germany. Focusing on a relatively unheard technology called mRNA, their companies' work now underpins one of the world's largest-selling COVID-19 vaccines. Way back in 1973, when UK RPI hit 10.6% and the nation was crippled by strikes, shortages and blackouts, Sir David McMurtry and John Deer co-founded a small UK company called Renishaw, now a world leader in metrology (measurement tools and devices).

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Important information