GUIDE FOR INVESTORS

The investment market is evolving. Get involved.

InvestingZone.com

What is InvestingZone?

InvestingZone is a web-based platform for buying shares in early stage, unlisted companies – often known as equity crowdfunding. Through InvestingZone you can invest in some of the UK's best start ups, expansion companies and SME's. You can also benefit from generous SEIS and EIS tax incentives. It's an economical way to invest in great new ideas and technology at a low price.

What is equity crowdfunding?

An equity fund-raising is when a company sells shares in its business in return for cash. The investor becomes the shareholder in the company with all the legal rights associated with buying shares in a private company.

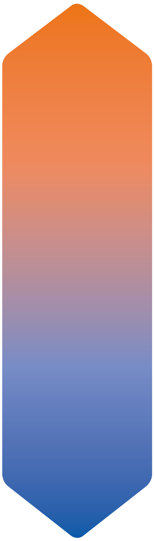
How is this different to other investments I might have?

In legal terms, buying such shares in a start-up company is very similar to buying shares in any private company. You become a shareholder in that company and in the case of InvestingZone, you enjoy the right to receive dividends, the right to make follow-on investments and the right to vote. You also get the opportunity to have direct dialogue with the founders before deciding to make an investment.

To buy shares in a listed company on the stock market you would normally need to go through a stockbroker. InvestingZone acts in a similar way to a broker, facilitating the deal but without you having to pay any fees.

All investment is a balance between risk and reward. There is very rarely an opportunity for reward without taking some degree of risk and, as has been shown over recent years, even bank deposits carry some degree of risk!

Basic risk/reward spectrum:



Spread betting

Derivatives (options, futures etc)

Early stage unlisted shares (InvestingZone)

Listed growth shares (e.g AIM)

Blue chip shares

Property

Index funds

High grade bonds

Cash deposits

This spectrum isn't exhaustive and you should consult an investment advisor for a complete picture. However, the message in respect of the kind of early stage investments found on InvestingZone is clear – they may offer significantly higher rewards but are also significantly riskier than shares listed on the stock market and are more risky than those listed on AIM.

What exactly are the risks?

There are five principle risks to think about when considering making investments in early stage companies:

1. LOSS OF CAPITAL

Most start-ups and early stage businesses fail, and if you invest in a business through InvestingZone, it is significantly more likely that you will lose all of your invested capital than that you will see a return of capital or a profit. You should not invest more money through the platform than you can afford to lose without altering your standard of living.

2. ILLIQUIDITY

Any investment you make through the platform will be highly illiquid. This means that you are unlikely to be able to sell your shares until and unless the investee company floats on a securities exchange or is bought by another company. Even for a successful business, a flotation or purchase is unlikely to occur for a number a years from the time you make your investment.

3. DIVIDENDS

Start-ups and early stage businesses rarely pay dividends. This means that if you invest in a business through the platform, even if it is successful you are unlikely to see any return of capital or profit until you are able to sell your shares in the investee company. Even for a successful business, this is unlikely to occur for a number of years from the time you make your investment. Profits are typically re-invested into the business to fuel growth and build shareholder value. Businesses have no obligation to pay shareholders dividends.

4. DILUTION

Any investment you make through the InvestingZone platform is likely to be subject to dilution. This means that if the business raises additional capital at a later date, it will issue new shares of the investee company to the new investors, and the percentage of the investee company that you own will be reduced. These new shares may also have certain preferential rights to dividends, sale proceeds and other matters, and the exercise of these rights may work to your disadvantage. Your investment may also be subject to dilution as a result of the grant of options (or similar rights to acquire shares) to employees of the investee company or to service providers and other parties connected closely with the business.

5. DIVERSIFICATION

Investing in start-ups should only be done as part of a diversified portfolio. This means that you should invest relatively small amounts in multiple businesses rather than a lot in one or two businesses. This helps to spread your risks. It also means that you should invest only a small proportion of your investable capital in start-ups as an asset class, with the majority of your investable capital invested in safer, more liquid assets.

This risk warning may seem stark however InvestingZone is committed to making sure that investors using the platform fully understand the risks to which they are exposed. If you are in any doubt about these risks you should consult a professional investment advisor. Read on to find out how these risks can be mitigated and why we think early stage investing is worthwhile…

Can the rewards really make the risk worthwhile?

The short answer is yes – provided that you take some simple steps to mitigate the risks involved, early stage investing can prove very rewarding indeed and can involve you in exciting new businesses.

In 2009, NESTA (National Endowment for Science, Technology and Arts) and the BBAA (British Business Angels Association) published a report entitled "Siding with the Angels" which analysed 1,080 business angel investments made between 1998 and 2008. These investments are the type of deals you'll see listed on InvestingZone. You can access the report here.

The report found that over the period studied angel investors received an average of 2.2 times their money back over an average investment period of 3.6 years. This equates to an internal rate of return of 22% – effectively meaning that an average investment increased in value by 22% each year. Compare that to the average deposit account or index tracker fund.

It is important to remember that most start-ups fail so an angel investor's success depends more on the winners than on making up for the failures. The NESTA report supports this – it found that returns from angel investing were not neatly distributed around the averages given above – 9% of the deals which had exited returned more than 10 times the money invested and provided 80% of the total cash returned to investors.

Besides the financial returns, there are other benefits to investing in early stage companies. You'll be helping to fund the next generation of successful British businesses, creating jobs and engaging with some fascinating companies and entrepreneurs. In short, it's fun with a purpose.

The NESTA report is well worth reading if you are considering making investment in early stage companies. You should consult a professional investment advisor if you are unclear as to the risks involved.

Read the report here.

I can see the potential rewards, but how can I mitigate the risks?

There are a number of steps you can take to mitigate the risks involved in early stage investing. These include:

Build a portfolio

If, as the NESTA report found, a small proportion of early stage deals are responsible for the vast majority of profitable returns then early stage investing is essentially about hunting for those winning deals.

Clearly, an investor will think every deal he/she does is great at the outset, but the data shows that most will in fact fail. Therefore, the best way of maximising the chance of investing in a winning company is to build a portfolio of several investments.

True, if you build a large portfolio then you will also have a large number of failures, and that will dilute the returns from your winners. However, you will also have reduced the impact of the companies which fail, and will stand a much better chance of enjoying profitable returns overall.

InvestingZone therefore recommends that the amount you decide to invest in early stage companies should be spread across several different companies rather than focused into just a few.

For maximum diversification you should also consider spreading your investments across different industry sectors (so as not to be too exposed to industry-specific problems like the dotcom crash in 2000) and across different stages (seed, early stage, expansion) so that your investments are likely to come to exit at different times.

Of course, portfolio theory extends beyond investments you make through InvestingZone. You should consider the risk/reward spectrum shown earlier in this brochure and make sure that your assets are allocated in a way which mirrors your attitude to risk. InvestingZone suggests that you invest a maximum of 20% (and probably less) of the cash you have set aside for investment, in early stage companies. The rest should be in safer, more liquid assets. Again, you should consult a professional investment advisor for formal advice.

Take advantage of tax reliefs

Seed Enterprise Investment Scheme (SEIS) and Enterprise Investment Scheme (EIS) tax reliefs can help to skew the risk/reward equation in your favour.

Take EIS as an example. Depending on your personal tax position, if you invest in an eligible company, the cost of your investment is immediately reduced by 30%. Furthermore, if the company fails, then your losses can be set against your income tax bill for the year. These reliefs mean that the capital which is actually at risk is dramatically reduced.

On the reward side, if the company goes on to be successful, and as long as it remains EIS eligible, any gain on disposal of your investment will be tax free (provided you have held the shares for the minimum period of 3 years) – meaning your effective rewards are increased.

The effects of the SEIS reliefs on the risk/reward balance is even more pronounced.

InvestingZone allows you to easily see which investments are SEIS and EIS eligible.

Conduct due diligence

It is important that you take the time to fully understand each investment you make though InvestingZone. Companies' pitches will include the following:

- Business description – a basic summary of what the company does.
- Market – a description of the market the company intends to address.
- Current achievements – progress the company has made to date.
- Exit strategy – the company's plans for realising a return for investors.
- Intellectual property – details of patents that the company possesses.
- Team information – brief details of the key members of the management team.
- Summary financials – high level financial forecasts.

A full business plan will also be available as a download. This will contain much more detail on the proposition. It is important that you read this as well as the main pitch.

It is very difficult to forecast financial performance accurately for early stage companies, and actual performance will almost certainly differ from the forecasts you'll see in a pitch and in the company's business plan. However, such forecasts can give a good indication of what will drive the business and what the entrepreneur thinks its potential could be. They also demonstrate that a management team has thought through the long- term plan for the company and has a clear idea of what will lead to success.

NB – If you see a pitch with no financial data, this is likely to mean that either the company hasn't prepared a financial model (in which case it can have no clear idea of what its business drivers will be or if/when it will need further funding – unacceptable!) or it has but does not want

InvestingZone provides tools to help you dig deeper into a pitch:

- LinkedIn profile – the 'Team' tab of each pitch contains links to the LinkedIn profiles of key members of the team. You can view these profiles and choose to connect if you have a LinkedIn account.

- Forum – you can use the forum tool to post questions to the company's management team and they can respond. Questions and answers are visible to all investors so investors, can pool their knowledge and experience.

- Skype calls – a pitching company can schedule times when its management will be available on Skype for discussions with potential investors. If no times are scheduled you can use the forum to request one. These calls are designed to allow investors to get straight to the individuals they are considering backing and to ask questions that haven't been covered elsewhere.

Anticipate follow-on investments

Most companies that raise money on InvestingZone will need to raise further funding in future. You may have some warning of this if you have reviewed the financial projections in the business plan, but such follow-on funding can often be unforeseen if a business does not perform according to plan. If an existing investor does not participate in future funding rounds then his/her percentage ownership of the company will be reduced.

This is not always a problem. If the business is progressing well and subsequent funding is raised at a much higher valuation, then although your percentage holding may be reduced, the actual value of your shares may still increase – e.g. owning 1% of a company worth £10million is better than owning 10% of a company worth £500k.

At flat or reduced valuations, if you want to protect your percentage holding from dilution, you will need to invest further funds. For this reason, an investor should hold some funds in reserve to fund follow-on investments where appropriate.

NB – companies listed on InvestingZone will issue shares with pre-emption rights. This means you will have the right to participate in follow-on funding rounds if you want to (pro-rata to your existing percentage ownership). Beware of companies and platforms that exclude these rights as you could be left unable to protect against

Be an active investor

There are limits to how involved an investor can become in a company unless he/she has invested a great deal of money and has taken a seat on the board for example, but you should be sure to monitor your investments by keeping in touch with the company, by making sure it has your up-to-date contact details and by exercising your right to vote on significant matters.

The precise matters that require a shareholder vote vary from company to company, but whatever the issue, as a shareholder you have the right to a vote and you should make sure you understand the issue at hand.

NB – all companies pitching on InvestingZone will offer voting shares. Beware of companies and platforms offering non-voting shares. If you invest in these shares, although the economic benefits of the shares may be unaffected, your right to have a say in the company's affairs will have been removed and you will be a 'passenger' while someone else makes the decisions.

Similarly, you should be wary of arrangements by which you retain the beneficial ownership of the shares but another party (a nominee) has the right to vote on your behalf. Unless you are sure that the nominee will consult you as to how your voting rights should be exercised or that they will always vote according to your wishes, this could mean that you are not properly represented.

Who can participate in equity crowdfunding?

Anyone can apply to invest through InvestingZone. However, the risks involved and the need to fully understand the investment opportunities available mean that it is not suitable for everyone and so some applicants sadly have to be rejected.

There are three routes to investor membership:

- Self-certified high-net worth individuals
- Self-certified sophisticated investors
- Experienced/professional investors

Each of these routes is fully explained in the registration process but broadly speaking the first two categories are for those with sufficient financial assets or business experience to be able to participate in existing business angel networks.

The third is for those who would not automatically qualify for existing business angel networks, but who can clearly demonstrate that they have sufficient financial resources to make small investments in unlisted equity and that they understand the risks involved. Although this registration route takes slightly longer to complete but we hope it will enable people who could not currently access the world of early stage private equity to participate in this exciting asset class.

How can I find out more?

You can access more information on the specific opportunities available on InvestingZone by clicking on a company's logo in the pitch listings.
You can also use the discussion forums to ask entrepreneurs questions.

If you have any further questions about InvestingZone and how it works, please read our FAQs. If they don't answer your questions, please email help@investingzone.com

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