COVINGTON

UK Government’s Future Fund to Support Innovative Companies Facing Financial Difficulties Due to COVID-19

April 22, 2020

UK Corporate

On 20 April 2020, the UK Government announced the new Future Fund scheme under which the Government will offer funding to innovative UK registered companies facing financial difficulties due to the COVID-19 outbreak.

The Future Fund scheme forms part of a wider £1.25 billion COVID-19 package to protect businesses driving innovation in the UK. The remaining £750 million will be available through the UK's national innovation agency, Innovate UK, and is targeted at small and medium-sized businesses that are focused on research and development. Whilst existing customers of Innovate UK will receive the majority of this funding, in the form of grants and loans, the Government has announced that £175,000 of support will be offered to each of around 1,200 customers that do not currently receive Innovate UK funding, equating to just under 30% of the total funding. The first payments will be made by mid-May and more details are expected to follow in due course.

This briefing focuses on the Future Fund only.

Future Fund

The Government has committed an initial £250 million to the Future Fund, with this amount subject to review. The scheme is due to be launched in May 2020 and will initially be open until the end of September 2020. It will be delivered via the British Business Bank.

Eligible companies will be offered convertible loans of between £125,000 and £5 million, provided that this amount is matched by private investors such that the funding from the Government is no more than 50% of the aggregate funding. The convertible loans will have a maximum term of three years.

Eligibility

The full eligibility requirements have not yet been published, but under the headline terms released on 20 April 2020, companies would need to meet the following criteria to access the loan:

1. be an unlisted UK registered company;
2. have a substantive economic presence in the UK;
3. have previously raised at least £250,000 in equity investment from third-party investors in the last five years; and
4. crucially, must obtain at least equal match funding from third-party private investors and institutions.

Key Terms

The headline terms (which are available here) set out the key expected terms for the convertible loan notes. The most important of these terms are summarised below.

Conversion/Repayment

Conversion: On a conversion, the principal amount of the loan will convert into the most senior class of shares issued by the company at a minimum discount rate of 20% to the price per share paid by investors in that funding round (the **Discount Rate**) (the Discount Rate being higher if the matched investor(s) agree a higher rate than 20% with the company). On a "qualifying funding round"—being a round at which proceeds raised equal at least the aggregate amount of the bridge funding provided—that conversion will occur automatically. On any other funding round, the matched investor(s) can elect to (but do not have to) convert. If companies issue a further senior class of shares in the six months following conversion, the lenders will be able to convert their shares into that senior class.

Exit events: On a sale or IPO of the company, based on whichever provides the higher return for the lenders, the loan will either:

(i) convert into equity at the Discount Rate to the price set at the most recent non-qualifying funding round; or

(ii) be repaid with a redemption premium equal to 100% of the principal of the bridge funding (the **Redemption Premium**).

Maturity: On maturity (being after a maximum of 36 months), the matched investor(s) can choose to either:

(i) be repaid with the Redemption Premium; or

(ii) convert into equity at the Discount Rate.

The Government's portion of the loan will convert, unless it requests repayment.

Interest: The Government's loan will accrue a minimum non-compounding interest of 8% per annum, or any higher rate agreed by the matched investor(s). Accrued interest is payable on maturity of the loan. If the loan is converted into shares, at the option of the company the interest will either (i) convert into shares without the Discount Rate applying or (ii) be repaid in cash.

<u>Other key terms</u>

Government rights: The Government will be entitled to various matched terms and entitlements as may be given to the other investor(s), including the following:

(i) valuation cap: the Government will be entitled to the same cap if any is agreed by the matched investor(s); and

(ii) most-favoured nation: while the loan is outstanding, the Government will benefit from any favourable terms contained in convertible loan note instruments issued subsequently to any investor(s). Companies should be mindful of this provision when seeking additional bridge financing during the term of the loan.

Government restrictions: The Government will have limited corporate governance rights during the term of the loan.

Transferability: The Government will be entitled (without restriction) to transfer the loan and, following conversion, shares to an institutional investor that is acquiring a portfolio of the Government's interest in at least ten companies owned in respect of the Future Fund.

Conclusions and Considerations

While the headline terms provide helpful detail on the key terms of the loans that will be offered under the scheme, full details are yet to be published, leaving a number of important points unclear. We have the following thoughts on the guidance provided so far.

- *Applicant eligibility*: The scheme has been pitched in certain media as support for start-ups—but the requirements to have already raised £250,000 and have investors willing to put in at least £125,000 more means that it is targeted at the more established companies along the emerging company chain, including those that have received backing from venture capital investors. Usual venture capital deal terms will mean that the company will need buy in and support from those investors before applying for the scheme. It is also worth noting that while the scheme is only open to UK-registered companies, there is no requirement for the existing shareholders to be based in the UK.
- *EIS funding*: If the "matched funding" needs to be provided on the same terms as the loan notes that are issued to the Government then this is going to restrict the type of investor that a company will be able to attract. In particular, the subscription for a convertible loan note will not permit an investor to claim EIS tax relief under current rules. A lack of such relief risks significantly narrowing the pool of potential matched investor(s) and we wonder whether the full terms will include further details that will enable the "matched funding" to be on different terms to the Government funding or whether the "matched funding" may be able to be brought within the EIS remit.

- *Funding allocation*: There will be challenges with allocating the loans between applicants. Theoretically, 50 companies could claim the entire pot, although based on the minimum deal terms there could be up to 2,000 loans. Our assumption is that the Government's final proposal will include measures to distribute the allocation across the differing levels of funding requests from applicants.
- *Simultaneous funding*: It is unclear as to whether the funding from the matched investor(s) needs to be provided simultaneously with or after the Government's funding, or whether the matched investor(s) can invest now with the confidence that the Government will invest from May 2020 (or whether there will be a look-back for companies that executed funding rounds on qualifying terms prior to the announcement of the scheme). Caution is to be taken until the final particulars of the scheme are issued.
- *Decision-making*: The nature and extent of rights of the Government following conversion of the loan are unclear based on the headline terms. It is also unclear how the Government will make decisions—and with a potential portfolio of 2,000 companies, this process may not be fast.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our UK Corporate practice:

Simon Amies	+44 20 7067 2002	samies@cov.com
Paul Claydon	+44 20 7067 2060	pclaydon@cov.com
Gregor Frizzell	+44 20 7067 2055	gfrizzell@cov.com
James Gubbins	+44 20 7067 2065	jgubbins@cov.com
James Halstead	+44 20 7067 2052	jhalstead@cov.com
Kat Kingsbury	+44 20 7067 2041	kkingsbury@cov.com
Louise Nash	+44 20 7067 2028	lnash@cov.com