Covid-19 – Business Support

Gambit Review

7th May 2020

Notice to reader – the contents of this circular are subject to frequent changes and interpretations by government and the private sector.

Business Support – The Reality

As the UK enters its sixth week of lockdown, the harsh effects that Covid-19 has had on the UK population and its economy is increasingly clear. This week, record low PMI data was released by IHS Markit/Cips illustrating the extent to which business activity has declined. Furthermore, over the next three months, small British manufacturers expect the biggest fall in output in more than thirty-years. The support schemes that have been put in place by both UK and Welsh government have helped to mitigate the effects of Covid-19 on the business community but as we shortly enter a period of 'reanimation' and the 'new normal', it is important to bear in mind the challenges that remain and which will require continued consideration from both Public and Private stakeholders. Below is a snapshot of the week's developments.

£4.1bn — **Total lending under CBILS by the 40 institutions**

Source: The Sunday Times (03/05/20)

22% Lower — **Average revenue fall in 2020 anticipated by CFOs due to Covid-19**

Source: Deloitte CFO Survey – Q1 2020

13.8 — **UK IHS Markit/Cips PMI data for April (the lowest on record)**

Source: Financial Times (05/05/20)

4 in 5 — **Businesses in the service sector experienced a drop in business activity during April**

Source: Financial Times (05/05/20)

40% — **Of start-ups have just three months worth of cash remaining**

Source: Financial Times (27/04/20)

13% — **Of firms who attempted to access CBILS were successful**

Source: British Chamber of Commerce (29/04/20)

REUTERS

BUSINESS NEWS MAY 5, 2020 / 12:05 AM / UPDATED 10 HOURS AGO

Small UK manufacturers gloomiest in over 30 years - CBI

The Guardian

Pandemic will 'vastly accelerate' decline of UK high street, MPs told

INDEPENDENT

UK economy set for deepest ever recession as businesses report record drop in activity

FINANCIAL TIMES

"UK business activity drops to lowest level on record"

sky news

Coronavirus: Nearly 100,000 applications for Bounce Back Loans to help small firms

Two business support schemes have been at the forefront of the UK's economic battle with Covid-19; the Job Retention Scheme and the Coronavirus Business Interruption Loan Scheme. Each has provided critical resource to eligible businesses that are in dire need of cash in a timely and efficient manner. As we enter a period of economic reanimation, these schemes need to bend and adjust in line with the rises and falls in economic activity. We have highlighted pertinent statistics around the utilisation of the schemes to date and provided our view on ways that these could move forward as the economy begins its reanimation phase.

Job Retention Scheme ("JRS")

6.3m — **UK jobs are being covered by the JRS**

Source: HMRC (03/05/20)

£8bn — **Total value of wages claimed by employers**

Source: HMRC (03/05/20)

27% — **Of UK employees had been furloughed by early April**

Source: Institute for Fiscal Studies

800k — **Employers had applied to use the scheme as of 3rd May**

Source: HMRC (03/05/20)

Gambit's View

Businesses have made good use of the JRS as a short-term fix. However, the Office for Budget Responsibility is forecasting that unemployment could soar by two million in Q2 of 2020. As detailed in our last report, there is a danger that furloughing may be delaying the inevitable. For this reason, it is important that the JRS is extended and tapered to avoid a 'W' shaped recovery. A staged winding down procedure which consists of a gradual reduction in the 80% government subsidy over time will serve to help businesses remove their reliance on the scheme, further helping the economy to rebound. These concepts will be explored in our next circular.

Coronavirus Business Interruption Loan Scheme ("CBILS")

Lending under CBILS from 'Big Four' UK banks

£1.6bn → NatWest

£835m → BARCLAYS

£765m → HSBC

£500m → LLOYDS BANK

Total lending under CBILS by the 40 accredited institutions at 30 April

=

£4.1bn

Source: The Sunday Times (03/05/2020)

Gambit's View

Despite initial issues, over 25,000 loans have now been approved under CBILS. The Bounce Back Loan Scheme also complements this initiative, providing much needed support for those unable to obtain CBILS funds. Focus should now shift to the statistics detailed above. £3.7bn (90.2%) in CBILS lending has been carried out by the 'big four' UK banks, despite the increase to 62 accredited scheme lenders. Greater transparency in the form of 'league tables' would be a welcome barometer for the speed and efficiently at which funds are being deployed. This is also in the interest of increasing the representation of FinTechs within CBILS, who can bring greater efficiencies to the lending delivery process.

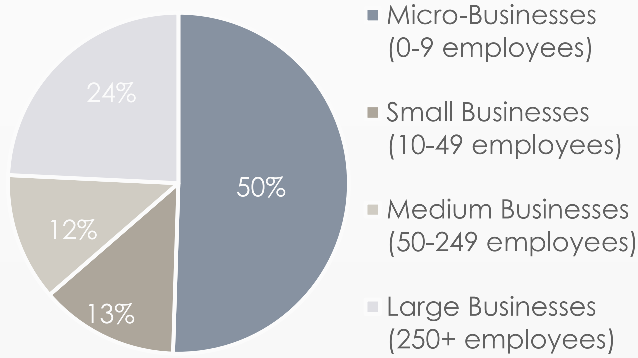
Solution in Focus – Bounce Back Loan Scheme

As thousands of businesses missed out on CBILS funding, it became clear that introducing an additional scheme for those that did not meet the criteria would be positively received by the small business community. The average loan size for CBILS stands at c.£165,000, which is more than many small businesses require or can afford. The Bounce Back Loan Scheme ("BBLS") fills an important gap in the Solutions Spectrum and offers a flexible and efficient solution to the UK's small business community. BBLS is unprecedented in its nature in many ways. We have detailed the key features of the scheme whilst providing our view on its wider significance.

Key Features

- **Up to £50,000 loan:** Loans from £2,000 up to 25% of a business' turnover or £50,000, whichever is lower
- **100% guarantee:** the lender benefits from a government-backed, full guarantee (100%) against the outstanding facility balance for both principal and interest
- **Interest rate:** The government has set the interest rate on BBLS facilities at 2.5% per annum, therefore, all eligible businesses will benefit from the same, low rate of interest
- **Interest paid by government for 12 months:** The government will make a Business Interruption Payment to the lenders to cover the first 12 months of interest payable, so businesses will benefit from no upfront costs
- **No principal repayments for first 12 months:** Borrowers will not have to begin principal repayments for the first 12 months, thereafter capital will be repaid on a straight-line basis
- **Finance terms:** The length of the loan is for six years but early repayment is allowed, without early repayment fees
- **No personal guarantees:** No personal guarantees are allowed

Proportion of UK Employment Growth 2009-2019



Source: Inter-Departmental Business Register

>110,000	**Applications for BBLS on the first day of opening**
£30,000	**Average size of BBLS first day applications**
£3.3bn	**Total amount of funds applied for on first day of BBLS**

Source: Financial Times (05/05/2020)

Gambit's View

This is a vitally important scheme for the large number of small businesses that fell outside of the scope of CBILS. Providing lenders with a 100% government-backed guarantee and standardising the application process has produced a far faster, more efficient process, with many BBLS loans already becoming available within days of application. As per the chart above, it is small and micro businesses that have led the previous ten years of employment growth. Providing these businesses with recourse to the generous BBLS injects vital liquidity to navigate short-term volatility and will underpin support for these businesses to lead us into the next era of economic prosperity. Furthermore, BBLS benefits from the key lessons learnt during the implementation phase of CBILS. The introduction of self-certification procedures within BBLS has already begun to highlight the benefits of self-onboarding. The reduced administrative burden on the lending institutions is already resulting in a streamlined lending process. While the scheme is unprecedented in its nature, we would urge stakeholders to view BBLS as a good example of how cashflow can be delivered through an uncomplicated and efficient process in these challenging times.

Solution in Focus – Future Fund

The Future Fund scheme was announced by the UK government on 20th April with the aim of supporting the vital UK start-up economy through Covid-19. Under the scheme, the UK government will issue convertible loans for working capital to unlisted, UK-based early stage innovative businesses that have raised at least £250,000 from private, third-party investors in the last five years. Loan values range from £125k-£5m and a mechanism exists for the UK government to convert its position to equity at a later stage. The Future Fund is due to open to applications this month and therefore, it is important that start-ups consider the eligibility criteria and process to be followed in order to access the funds. We have devised a flow chart to aid wider understanding of one of the more complex business support schemes.

Future Fund Flow Chart

- **Qualifying Round:** where the company raises an amount in equity capital equal to at least the last aggregate amount of the bridge funding
- **Non-qualifying Round:** where the company raises an amount in equity capital less than the amount required for a qualifying round

Pre-Future Fund
Round 0
Non-qualifying Round

>£250,000 has been received from private third-party investors in past 5 years (prior to 20 April 2020)

Future Fund
Round 1

- Access to convertible loans
- £125k-£5m government contribution, up to 50% of the funding round
- Matched by third-party private investors with no valuation cap unless agreed by matched investors

Future Equity Round

Future Sale/IPO

Future Sale/IPO

Post-Future Fund
Round 2

Is Round 2 Equity Raise >= Future Fund Round 1

Yes

Round 2
Qualifying Round

- Future Fund Round 1 to convert to equity at a minimum conversion discount of 20% to the funding round price (higher if higher rate agreed with matched investors)
- Loan principal converted
- Accrued interest to be paid, or converted with no discount, if not repaid

No

Round 2
Non-qualifying Round

- Future Fund Round 1 conversion at the election of the majority of the value held by matched investors

No Conversion

Future Fund Maturity
Non-qualifying Round 2 or Sale/IPO

- At the option of the majority of the value held by matched investors
- Repaid with a 100% premium to the principal of Future Fund Round 1
- Or, option to convert into equity at a minimum conversion discount of 20% to the Round 0 price (greater if higher rate agreed with matched investors), provided that the UK government's loan shall convert unless repayment requested
- Loan principal is converted
- Accrued interest is to be paid or converted with no discount, if not repaid

Post-Future Fund
Sale/IPO

Round 2 Equity Raised?

Yes

Sale/IPO
Round 0
Non-qualifying Round

- Future Fund Round 1 to convert to equity with no discount
- Or if greater, repaid with a 100% premium to the principal of Future Fund Round 1
- Loan principal converted
- Accrued interest to be paid, or converted with no discount if not repaid

No

Sale/IPO
Round 2
Non-qualifying Round

- Future Fund Round 1 to convert to equity at a minimum conversion discount of 20% to Round 2 price (higher if higher rate agreed with matched investors)
- Or if greater, repaid with a 100% premium to the principal of Future Fund Round 1
- Loan principal converted
- Accrued interest to be paid, or converted with no discount if not repaid

Gambit's View

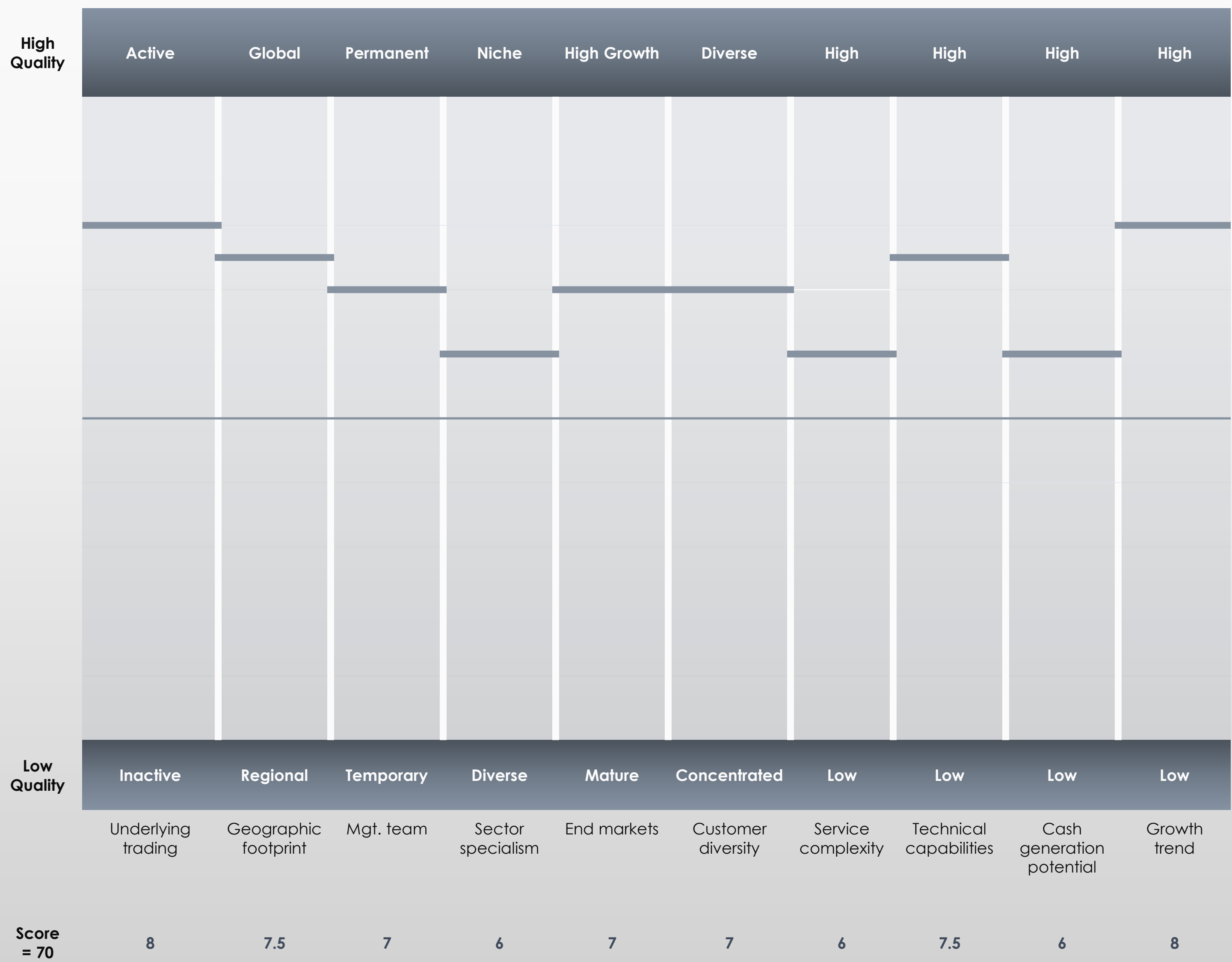
The Future Fund presents the ideal entry point for third-party investors that wish to follow strategic growth opportunities. To augment what could be a cumbersome approval process, we would advocate a scoring system that eases Future Fund onboarding procedures. To this end, we have devised a question-based-system that would help to assess and onboard potential Future Fund beneficiaries. Through self-certification and the population of an underlying scoring system, a simple but effective evaluation of requests under the scheme could be performed. The appendix within this circular shows the dashboard outputs of a prospective Future Fund applicant's self-certification. We would be happy to discuss this further with both public and private sector bodies.

Appendix – Key Future Fund Value Drivers

Gambit's View

Set out below is an illustrative representation of a dashboard summary which could be used to assess a prospective Future Fund candidate's self-certified application. The 'Key Future Fund Value Drivers' system is question-based and from the respective responses, it can be used to score whether a business would be deemed a 'high-quality' or 'low-quality' Future Fund investment. Consideration is also given to the candidate's balance sheet and we have built in investment protections through quick review of criteria such as overdrawn director's accounts, CCJs and HMRC liabilities. Our model also factors in the extent to which the candidate's business could assist with the UK's Covid-19 mitigation planning strategy, enhancing the visibility of innovative businesses that could greatly help in this regard. Concepts such as this could greatly assist the disbursement of convertible bridging loans through the Future Fund in an effective and efficient manner, invoking simple onboarding and self-certification as has already been observed with BBLS. We would welcome a discussion with private and public sector bodies to discuss our proposal and scoring system in more detail.

Key Future Fund Value Drivers



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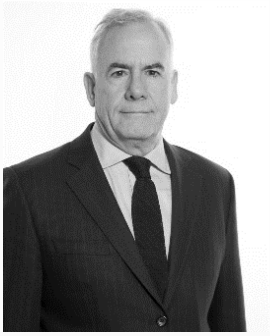

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Gambit Corporate Finance

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