Covid-19 – Business Support

Solutions in Focus

27th April 2020

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

UK & Welsh Government Business Support

UK Government Support

UK Government Grants

UK government introduced a series of grants throughout March and April. Theses grants are administered through local authorities

Small Business Grant Fund or Rural Rates Relief

- Under these schemes, businesses in England in receipt of either small business rates relief or rural rates relief will be eligible for a payment of £10,000

Retail, Hospitality and Leisure Grant

- English businesses holding a property with a rateable value of less than £51,000 are eligible for a grant of up to £25,000

Coronavirus Business Interruption Loan Scheme ("CBILS")

- For UK businesses with up to £45m turnover
- The UK government will provide lenders with a guarantee of 80% on each loan and will cover the first 12 months of interest / arrangement fees
- The Coronavirus Large Business Interruption Loan Scheme ("CLBILS")has now been launched, offering 80% government backed facilities of up to £25m for those with turnover between £45m and £250m and up to £50m for those with turnover above £250m
- Under CLBILS, interest is payable by the lender from day one and the UK government will not cover arrangement fees

Future Fund

- An initial commitment of £250m of new government funding which will be unlocked by private instrument on a match funded basis and open until September 2020
- Innovative, pre-profit / pre-revenue businesses will be supported with convertible loans for working capital purposes. The bridge funding will automatically convert into equity at the next qualifying round with a minimum conversion discount of 20%

Welsh Government Support

Welsh Government Grants

Welsh government has introduced grants through two separate channels; the Non-Domestic Rates scheme and the £500m Economic Resilience Fund

ERF Grants

- Up to £10,000 to assist microbusinesses that have experienced a drop in turnover greater than 60%
- Between £25,000 and £100,000 available to SMEs with between 10 and 249 employees that have experienced a drop in turnover of over 40% since 1 March 2020
- Between £100,000 and £690,000 for non-SMEs who have experienced a more than 60% drop in turnover since 1 March 2020
- The anticipation within the business community is a significant number of redundancies will arise following the end of JRS on 30 June 2020. It has been mooted that these grant awards will assist funding the costs of business downsizing due to shrinkage and supply chain constraints, rather than assisting in the eventual "return"

Non Domestic Rates Grant

- £25,000 for retail, leisure and hospitality businesses occupying properties with a rateable value of between £12,001 and £51,000
- £10,000 to all businesses eligible for small business rates relief with a ratable value of £12,000 or less

Development Bank of Wales Loan Scheme

- £100 million scheme was launched on 30 March
- Businesses that have been trading for longer than two years have access to loans up to £250,000
- The scheme offers interest and capital repayment holidays for the first 12 months
- The scheme is currently fully subscribed after more than 1,500 applications were received
- It is expected that the scheme will receive further support, with demand set to be high given the issues surrounding CBILS distribution

Gambit's View

It is important that the schemes devised by both UK and Welsh government complement and dovetail across the spectrum of support. The introduction of a turnover deterioration mechanism by Welsh government via the Economic Resilience Fund inherently prioritises businesses with a high-degree of footfall such as leisure, retail and hospitality. The risk that Wales' industrial economy becomes under-represented and unwittingly excluded from these schemes is also significant, with prerequisites for indigenous ownership adding further complexities and messages to foreign direct investors. It is therefore increasingly important that policymakers engage with the business community when setting scheme criteria, ensuring there is no under-representation or over-complication by lack of awareness or evidence base.

Business Support – The Reality

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On a weekly basis, the impact that Covid-19 Is having on the economy becomes increasingly clear. In Wales, more than twice as many businesses failed in March 2020 as in March 2019. Analysis of this data is important and should consider the sector and size of businesses affected directly or indirectly by Covid-19. We maintain that the Public and Private sector's focus should remain the same; delivery of cashflow through an uncomplicated and efficient process. While steps have been taken to rectify the access to funds, a harsh reality has come into focus over the last four weeks. A change in mindset on behalf of the nominated financial partners which, as institutions, are prone to process and excessive collateral requests. Below is a snapshot of how the current mindset has brought to light another week of troubling statistics.

70% **Year-on-year increase in business failures in March**

Source: Financial Times (21/04/20)

25% **Of companies in the UK have been temporarily closed due to Covid-19 disruption**

Source: Financial Times (17/04/20)

12,000 **Small businesses have managed to obtain a loan through CBILS**

Source: The Chancellor (21/04/20)

£937m **Has been lent by NatWest (62% taxpayer owned), equating to roughly half of all loans through CBILS**

Source: City A.M. (21/04/20)

185,000 **Businesses applied for the Job Retention Scheme support on its first day**

Source: The Telegraph (21/04/20)

6/10 **UK firms have less than three months' cash in reserve**

Source: British Chamber of Commerce (22/04/20)

35% **Drop in UK economic activity forecast for Q2 2020**

Source: Office for Budget Responsibility (14/04/20)

509,000 **Businesses are in "significant distress"**

Source: Begbies Travnor (20/04/20)

c.7,600 **Of CBILS loans (63%) have been approved by just two lenders (NatWest and HSBC), despite the inclusion of over 40 accredited scheme lenders**

Source: City A.M.(21/04/20)

7/10 **UK firms have furloughed staff**

Source: British Chamber of Commerce (22/04/20)

£1.5bn **of state aid for furloughed workers applied for on first day**

Source: Financial Times (21/04/20)

The peak of Covid-19 in the UK is expected in June and July

Source: Imperial College London

Solutions in Focus - Adjusting Metrics

Solution Outline

- The vast majority of lenders' financial performance metrics have limited use in the current environment
- Increased collaboration between lenders to identify transparent, achievable KPIs to assess struggling businesses is vitally important
- Greater emphasis could be placed on averages or run rates of key measures such as EBITDA with Covid-19 impact to assess debt capacity (see below)
- In addition, multiples of variable expenses such as utility bills or wages could be used to gauge a clearer picture of funding requirements
- Added protections to lenders or grant providers could be introduced via quick review of overdrawn director's accounts, dividend strips, CCJs and HMRC liabilities on a self-certified basis

Examples of Metrics Used by Lenders

EBITDA

Earnings Quality

Debt to Equity Ratios

Interest Cover

Earnings Before Interest Tax Depreciation Amortisation and Covid-19 ("EBITDAC")

The implementation and institutional buy-in to new, relevant metrics such as EBITDAC would provide a mechanism for businesses to present the extraordinary financial impact of Covid-19 to their key stakeholders.

Rationale

- Financial covenants are likely to come under significant strain, with potential for widespread breaches in the short-term
- Many of these financial covenants are based on calculations of EBITDA, net income or other similar measures of earnings
- As borrowers face lower revenues and increased costs in dealing with the pandemic, traditional metrics will have limited relevance with the reality
- Asset based lending, often derived from accounts receivable and stockholding, is likely to reduce the amounts available to borrowers under existing lines of credit
- Covenant compliance is usually assessed at the end of the quarter and borrowers are likely to seek waivers or permanent amendments in Q2, giving time to implement new, relevant metrics such as EBITDAC

Assess Impact

Using EBITDAC as a lending metric could improve lending efficiency, assisting lenders' assessment of Covid-19's impact on viability

Promote Transparency

EBITDAC would also provide an increased degree of transparency around the impact that Covid-19 is having on business' earnings, providing a barometer for both private and public institutions to establish intervention strategies

Support Reporting

The metric provides a gauge of business disruption, thereby improving applications for debt funding and grants while also better informing internal strategy and Covid-19 mitigation practices

Solutions in Focus – Introduce Equity Stakes

Solution Outline

- By taking an equity stake in firms in distress, the government could shore up balance sheets over the current period of disruption and assist those with insufficient debt capacity
- An equity stake would add a layer of protection to the taxpayer, ensuring that there is an upside benefit upon economic recovery
- Equity stakes could also provide a convertible position to banks or government, which could subsequently be bought out or exited in a subsequent sale or fund raise round
- Locally, the Development Bank of Wales can assist by managing these cases within their investment portfolio team
- Upon an economic rebound, companies would have a sense of impetus to buy-out their position, returning shares to private ownership

Update

- Following the inclusion of this solution in our March circular, on 20th April, the Chancellor of the Exchequer announced the establishment of the ‘Future Fund’, designed to support the UK’s innovative businesses currently affected by Covid-19
- These businesses had been unable to access other government business support schemes due to their pre-revenue or pre-profit status and therefore typically rely on equity investment
- This is a positive step and evidences an encouraging sense of creativity in government solutions, but should be extended to companies funded by Universities and in the commercialistion phase of growth development
- Careful consideration must now be given to additional actions which should be taken to diversify and loosen the criteria on which the government’s equity stakes are based

Suggested Follow On Actions

The introduction of equity stakes into businesses through a downturn is a key tool to support the growth economy until more prosperous times arise. While the introduction of the Future Fund by the UK government is a welcome measure, there is a risk that access to funding is under-diversified from both a sectoral and geographical perspective. Below we have set out some follow-on actions to help to support current and future government investment through equity stakes.

Consider the Risk

Given the nature of the Future Fund’s, support for pre-profit / pre-revenue businesses, investments under the scheme should be fully considered, engaging with the investment community to minimise the risk of undertaking poor/ill-advised investments

Private Investment Criteria

The mechanism around the Future Fund’s investment being ‘unlocked’ by private investors should be reconsidered, to improve the diversity of investment and provide further support to the early stage economy that are often without sponsorship or owned by higher education institutions

Ensure Diversity

Arguably, the Future Fund holds a bias to London based technology businesses who have proximity to the Venture Capital lending community. It is vitally important that existing and future equity schemes channel investment into the regional economies of the UK

Increased Transparency

In line with the widespread criticism of CBILS with regards to transparency of lending under the scheme, weekly reporting around the companies/sectors that are securing investment from the Future Fund should be released, helping to shape and improve its reach gamBIT CORPORATE FINANCE

Solution Outline

- The UK is the leading global FinTech hub with a thriving ecosystem and international talent pool spanning the whole country
- Mainstream lenders are struggling to process the large number of applications for CBILS, potentially jeopardising the financial security of SMEs
- FinTechs are already working with the UK government to diversify the source of funding to SMEs and they want to continue to help
- A taskforce has been established which includes FinTechs 'Wisefunding', 'Nimbla' and 'NorthRow'
- Even before the Covid-19 crisis, SMEs were struggling to access enough credit, with over £59bn in unmet lending needs (*Source: The Fintech Times*)
- FinTechs should be used to facilitate improved access to the schemes through turnkey lending platforms, risk assessment support and KYC checks to expedite the allocation of funding

Update

- Following the inclusion of this solution in our March circular, the UK FinTech community has become a growing part of the discussions surrounding the UK's Covid-19 economic response
- Nick Ogden, founder of Worldpay, is lobbying the UK government to save small businesses that are failing due to the lack of funding available to them to manage the Covid-19 crisis
- Ogden estimates that over 50,000 small businesses in the UK are at risk due to a lack of cashflow caused by issues of inefficiency in the delivery of crisis funds
- Increasingly, non-banks are being considered to open up appropriate lending to small businesses, with Funding Circle recently winning government approval to lend via CBILS
- Despite NatWest's majority ownership by the UK taxpayer, lenders appear to be struggling significantly with the delivery of funds to businesses in need

Suggested Follow On Actions

While significant steps have been taken to include the UK's FinTechs in the UK's Covid-19 economic response, we have highlighted several areas of focus which policy makers should consider to maximise engagement with the community.

Call to Action

As banks are criticised for the slow delivery of funds through CBILS, further encouragement of the FinTech community is required, offering a chance to prove their worth, increasing engagement while obtaining vital operational improvement advice

Widen Scope

Limitations on accredited lenders will serve to hurt the small business community, which relies heavily on online based lenders, who often provide a 'catch-all' mechanism for good businesses that have been dismissed by mainstream lenders

Increase Competition

Introducing FinTechs in the roll out of government schemes will serve to increase competition at a time in which CBILS lending transparency is becoming less opaque. Lenders that do not hit a certain approval rate should be ranked against their peers and held to account

Use Central Platforms

An increasing number of lending platforms have been developed, allowing the quick and simple deployment of funds through an automated and simple process, taking the processing strain away from banks in their processing of CBILS applications

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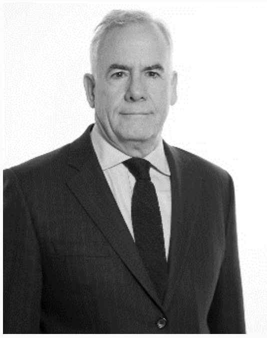

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Gambit Corporate Finance

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