



OBN INVESTMENT & TAX ADVISORY GROUP (ITAG)

# From Seed to Unicorn

A guide to the sources of funding  
available to life science companies





## ABOUT OBN

OBN is a not-for-profit membership network that catalyses growth for the life sciences industry. Whether you're an emerging entrepreneur, R&D SME, investor, analyst, pharma company, science park, TTO or technology/professional services organisation, we are here to give you opportunities to meet, learn, and grow.

With over 530 members, the majority of them R&D SMEs, OBN works tirelessly to help the UK life sciences ecosystem to Create Connections, Save Time & Money and Secure Investment.

Our Vision at OBN is to be the member organisation where UK life science SMEs go to grow. This *From Seed to Unicorn* guide, (now in its 7th edition), is one of the many tangible examples that OBN delivers to support R&D SME growth and is one of our forthcoming *Go To* series of publications and services to the industry.

Our goal is to create and develop an environment that nurtures the emergence and growth of innovative and successful life sciences companies and new products / services and to create unrivalled opportunities to facilitate collaboration and new business generation.

To find out more visit [www.obn.org.uk](http://www.obn.org.uk)

Stuart Rose  
CEO, **OBN (UK) Ltd**

# OBN INVESTMENT & TAX ADVISORY GROUP (ITAG)

The OBN Investment & Tax Advisory Group (ITAG) brings together life sciences and investment industry experts to support R&D SMEs and optimise how those companies can access and manage finance.

ITAG also serves members' collective needs through advocacy based on consultation, and may do this through collaboration with other UK life sciences member organisations to gain a more powerful voice.

Established in 2014, the OBN Investment & Tax Advisory Group, formerly the Investment & Tax Special Interest Group (ITSIG), is chaired by **Dr Shawn Manning**, Managing Director, **Akesios Associates Limited**. Members of ITAG contributing to this Guide are:

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The objectives of the Group are to:

## 1. Develop Best Practice & Policy

Provide recommendations based on expert advice on investment, fiscal & corporate governance, grant funding, taxation and HMRC guidance affecting R&D SMEs.

## 2. Consult, Advocate & Inform

Liaise with members to canvass collective opinions and represent to Government and other relevant parties, often in collaboration with other life sciences member organisations. Feed back to membership on actions and progress.

# CONTENTS

2	<b>INTRODUCTION</b>
3	<b>OVERVIEW OF THE VARIOUS TYPES OF FUNDING</b>
5	<b>EQUITY: HOW MUCH DO I GIVE AWAY?</b>
19	<b>LOANS/CONVERTIBLE LOANS</b>
20	<b>GRANTS</b>
27	<b>INVESTMENTS WITH TAX RELIEF</b>
31	<b>MISCELLANEOUS SOURCES OF FINANCE</b>
37	<b>REFERENCES AND OTHER LINKS</b>
38	<b>ACKNOWLEDGEMENTS</b>
38	<b>DISCLAIMER</b>
39	<b>APPENDIX</b>





# INTRODUCTION

The overarching aim of this, the seventh edition of *From Seed to Unicorn*, is to provide OBN members with better insight into the multiple sources of funding, within the UK ecosystem, that will enable their growth from small, typically seed funded companies, into larger, properly funded companies, prepared for a liquidity event that will deliver shareholder return. In doing so we aim to draw attention not only to traditional equity-based approaches, but also non-dilutive, grant based, debt-based and more innovative methods of fundraising, including routes to maximise the value of existing cash resources through tax credits and matched-funding opportunities.

Much has changed since the sixth edition, not least the accession of a new Government, with the October 2024 Budget which it is expected will be followed by further clarity regarding Government support for the UK sector.

With a positive view to the ongoing maturation of the UK sector, this guide also examines the various routes to exit, including trade sale and IPO, together with our views on the pros and cons of these various approaches.

We anticipate, and hope, that our members and the wider life science community will find this a helpful reference and starting point. However, none of the options outlined are necessarily simple processes, and we have sought to include sufficiently credible information to enable interested SME's to seek the right advice from the right sources.

There is no one size fits all approach and we have endeavored to provide an introduction to as wide a selection of funding mechanisms as possible from equity to debt and non-dilutive to convertible instruments, and from private equity to public markets. However, in terms of markets our focus is primarily concerned with assisting smaller private companies plot a pathway to an exit point that may or may not include the public Equity Capital Markets.

Each approach has its merits and pitfalls and may play a part at various stages of an SME's evolution and journey to success. The content is not intended to be exhaustive, and we welcome ongoing feedback, input and updates from our members, including direct input to ITAG. Ultimately SMEs will need to undertake their own thorough due diligence to determine the best approach for them but we hope they may do so armed with sufficient information to do so in a more efficient, informed, and targeted manner.

**We sincerely hope that as an OBN member you find this guide useful, and moreover urge you to engage with OBN and the ITAG team, should it prompt any questions, or potential discussions, that you believe will be useful in your drive to accrete additional corporate or shareholder value for your company.**

# OVERVIEW OF THE VARIOUS TYPES OF FUNDING

## INTRODUCTION – THE BIG PICTURE

The comments in this guide generally assume a private limited company working through its lifecycle. Other legal forms of carrying on a business, for instance as a sole trader, partnership or trust, will all entail rather different considerations in terms of the most effective funding strategy.

Funding the company's development is, of course, much more than securing the necessary cash for working capital, R&D, other operating costs and fixed assets.

Funding also drives and reflects fundamental business strategy, in terms of ownership, commercial direction, progression of the 'equity narrative' and ultimately what the 'exit route', in terms of a liquidity event, is for the business owners. The *raison d'être* of most R&D SME companies is to successfully develop an innovation that ultimately improves human health. It is important to recognise, however, that for investors in those companies, the overarching objective is the creation of monetary value for shareholders. The application of skillful leadership to successfully develop scientific innovation can fulfill both of these drivers.

The different forms of finance sources briefly outlined in this booklet all have their own properties in terms of how they operate, how they can be sourced, and what the costs of servicing them are to the business. However, financing should be coordinated in the sense of optimally utilising and orchestrating the various sources of funding over the lifetime of the business.

## The importance of planning

A key requirement throughout a business's life cycle, from incorporation through to a liquidity event, is the generation of detailed and realistic financial forecasting and projections. If conducted in a suitably diligent, and as far as possible accurate manner, this should ensure that there is a clear understanding of the business's requirements over a projected period of time.

For example, if a company is capable of generating revenue and cash flow this could greatly reduce the requirement for additional funding. This in turn has implications in terms of the requirement to dilute existing equity via funding from additional shareholders, whether in the form of equity or debt, and will ultimately impact the return to existing shareholders in terms of the liquidity event.

However, no single plan, no matter how detailed or well thought through, will necessarily deliver a simple answer, in terms of strategy and potential execution. Rather, an ongoing planning process should be maintained, with a view to delivering optionality and empowering agility in order to ensure that opportunities may be fully exploited, and setbacks countered. In the words of Eisenhower 'plans are worthless, but planning is everything'.

## The necessity of a credible plan

However, many if not most technology companies (certainly in the life sciences sector) may take a long time to achieve significant revenue and will require significant funding and/or cashflow in order to transform themselves from loss making, through 'break even' to profitability.

In reality, very few life science companies actually continue long enough to achieve profitability. If their propositions are sufficiently compelling, and offensively positioned in terms of the competitive landscape, an acquisition represents the more probable outcome.

However, it would be an unwise management team that would seek to position a company for M&A without ensuring that a strong, self-fulfilling, growth strategy is planned and ready to be implemented. In the absence of an M&A-based transaction, an initial public offering (IPO) is the most likely liquidity event that will return value to shareholders. Whilst traditionally the UK markets, particularly AIM, has been looked upon as the public market of choice, an increasing number of companies, in the absence of a value accretive M&A based transaction, are now looking further afield.

As such, external sources of funding will be a necessary part of every company's ecosystem. Solid and credible financial projections will need to demonstrate future funding needs. It is beyond the scope of this particular guide to cover the necessity for realistic and, from an investor's point of view, believable forecasts. Suffice it to say that under promising and over delivering should be at the forefront of every management team's minds when constructing a forecast. Revenue forecasts that suddenly leap to a tenfold high one year after a forecast fundraising round do little to inspire confidence in a management team's grasp of reality from an investor's perspective. The goal of a good management team is to appear credible, rather than incredible.

## The essential role of good governance

In a sector renowned for the inherent risk of R&D, it is perhaps surprising that the major hurdle for success is poor management, rather than innovation risk *per se*. Investors invest in credible teams, and good corporate governance is an essential requirement for such credibility. Establishing an effective Board that, in addition to bringing additional scientific, industrial and financial skills to the team, may also be relied upon to offer regular positive, proactive contributions to the management team, is critical. This will take the form of mentoring, being a critical friend, offering a shoulder to cry on when failures occur and celebrating the successes that happen too. The strength of the Board is as critical as the strength of the management team and putting in place a good, proactive and supportive Board should be a vital component for all companies.

## Broad categories of funding

To categorise the types of funding set out in more detail below, there are three broad types:

- **Equity:** Share investment, where there is a balance between cash required by the company and the percentage of ownership which existing shareholders are prepared to give up for any given amount of funds invested;
- **Loan financing:** Which generally does not involve giving up any percentage ownership, but on the other hand brings in both a recurring cost to servicing debt (unlike, typically, equity) and of course implies a requirement to repay the underlying loan principal (which needs building into the financial projection); and
- **Non-dilutive capital:** Grant funding or similar types of 'free' funds – where 'free' does not usually imply the absence of any restrictions on either the use of the funds or conditions on the company's further operations, but at least does not imply dilution of shareholder ownership, or an ongoing cost or return of the funds.





# EQUITY: HOW MUCH DO I GIVE AWAY?

## INTRODUCTION

Equity is the term used to define the value of shares issued by a company, with 'equity funding' representing funds secured by the sale of new shares. Equity funding, i.e. the receipt of investment funds on the issue of share capital, is the core activity of most early stage life science companies' fundraising efforts.

### **Share Capital and the all-important, but often misunderstood, concept of 'ownership'**

The typical model here is of a company that is initially 100% owned by the founder(s), with 'dilution' of that ownership, and associated expansion of the 'share capital', as further rounds of shares are issued. In theory, assuming parity of shares, as each round of investors takes their equity, they are parting with their funds on a full risk basis (i.e. there is no obligation on the company, or any other party, to later refund or make good those funds), buying into an 'equitable hope' for the future growth of the whole company.

An important aspect of this model is that possession of share capital is directly proportional to ownership of the company. This concept is often forgotten, or pushed to the back of their minds, by many founders and management teams. It is certainly rarely appreciated at the operational level of most companies, whether they be privately owned or public listed behemoths. As such, distribution of new equity is not simply a distribution of potential future profits, but a redistribution of company ownership in the 'here and now'.



That means a company is owned by its shareholders with its interests being served by the CEO and management team. The latter are key to optimising the chances of the scientific innovation's success and therefore deliver value to the companies shareholders (investors). Whilst a company is required to consider all its stakeholders, major strategic decisions must be taken on behalf of, and with the consent of, shareholders.

Whilst founders are usually aware of this, management teams can often neglect this issue of ownership at their own cost. Amongst larger players this ignorance is, in part, bred by the relatively transient nature of investors in publicly listed companies, where shares may be traded at such a rate that to a large extent management is always playing catch up with the share register. However, investors in smaller companies are usually on board for a relatively prolonged period, and the company must acknowledge their right as owners to influence strategy, direction and eventual corporate goals. If a company's management does not wish to be subject to this level of involvement it could either seek to issue fewer shares to raise capital, or perhaps deliberately limit the number of shares that can be held by any single investor (and hope that alliances / cartels are not formed by groups of investors seeking more influence).

However, for an early-stage company, the prospect of balancing a large investor register is for many a nice problem to have. The immediate challenge is often finding willing investors in the first place. Seeking new capital has been described by some as a form of horse trading over equity value, as founders seek to give away as little equity, for as much cash as possible, in order to minimise dilution of their own holdings. In contrast, new investors seek to purchase as much equity, for as little cash as possible. In reality, enlightened investors ought to be aware of the risks of holding too dominant a position on the cap table - it may dissuade other

investors from syndicating, and can dis-incentivise founders who may well have critical roles in building future value.

### The Pre-Money Valuation

As such, some generalised rules of engagement have been developed in order to help smooth the process. The most important step, assuming some worth at least has been attributed to a company's initial endeavours, is to agree on a value for the company before any investment – referred to as the pre-money valuation. It is important to consider this from two perspectives; first, retrospective – what has been invested in the company to date, together with what has been achieved with that investment (the value created); and secondly, prospective – what is the size of the addressable market for the company, tempered by time required to reach market, the scale of future investment still required, and the risks along the way. More often than not, management and founders focus more on the rear view (*look at what we have achieved*) whilst investors focus on the forward view (*but look at the risks ahead*). A smart team will have prepared realistic plans to show that the forward journey has been appropriately considered.

**Ultimately, however, for early stage companies (not publicly traded), these valuations are often largely reliant on future commercial assumptions, and appropriate execution by management, that cannot be guaranteed at the time of the investment. If in funding mode, companies must remember that value will primarily be determined via discussion with investors. Whilst an internal valuation may be a useful discussion aid, the price will be ultimately determined by the investor, and what it believes the company can actually achieve, versus its ambitions *per se*.**

# EQUITY: HOW MUCH DO I GIVE AWAY?

One might expect existing shareholders to always argue that the pre-money valuation should be as high as possible in order to optimise the value of their existing investment. Of course, that depends upon their appetite to invest further: whether above their 'rights' (in which case a lower value might favour them), below their 'rights' (in which case a higher value would minimise their dilution), or at their 'rights' (which ought to make them value indifferent). In contrast, new investors may seek to deconstruct the perceived value emphasising future risks, and unanticipated requirements for further capital. Excluding initial investment, commonplace drivers of a pre-money valuation include non-dilutive funding (i.e. grant money), collaborations and/or validation by bigger industry partners and licensing or co-development deals with partners, or simply early engagement with potential customers or users to prove out assumptions about market potential.

Clearly the calculations and assumptions around a pre-money valuation may require many iterations and negotiations. Comparison with commercial peers and risk-adjusted discounted valuations may all play a role, and we would advise companies to seek reliable and experienced third-party counsel where appropriate.

## **The most important pre-money driver is data**

For a life science company the most important component of a pre-money valuation (which generally far outweighs any other factor) is good data, with

implications for successful product development, commercialisation, and a rapid pathway to a liquidity event. However, it is surprising how many companies attempt to relegate data to a secondary position, behind underlying scientific rationale, structural (assets, which may include patents) or funding achievements, when raising money. Sadly, in most of these cases this reflects a paucity of quality data rather than unawareness *per se* on behalf of the company. The perceived value of data to management teams is a noticeable difference between the US and European life sciences industry, being more highly valued in the case of the former.

## **Some important observations regarding valuation**

In addition to providing the basis for investment, a regularly updated valuation should provide management with a better three dimensional understanding of its business, and as such valuation metrics can greatly assist with internal decision making. The short-comings of any static equity-based valuation is that it is always subjective with respect to representing 'Fair Value' under a particular set of criteria (e.g. discount rate, risk adjustment, speed of execution etc.), and as such represents a snapshot at best. As such regular updates, using a consistent and comparable methodology are essential if valuation is to be properly employed as a decision-making tool.

However, we note that one time valuations may be effectively employed to assess new opportunities (e.g. licensing deals or portfolio management challenges).

Moreover, management teams should expect that investors buying equity will nearly always discount internal valuations, as they will likely be biased by factors such as minimum stakes, desire to drive returns and/or management of fund cycles.

### What do investors want?

Whilst it is usually very obvious what companies seek from investors, a surprising number of companies are unaware what investors are actually seeking from companies. It is sometimes surprising for a management team when they meet a well-qualified, well connected, technology enthusiast, perhaps with extensive operational experience, representing an investment fund, who buys into the underlying proposition and seems willing, excited even, at the prospect of helping the company achieve its goals. That this individual is willing to lead the effort to invest cash into the company can be a thrilling proposition.

Investors will want to be viewed as partners in the company's journey, working with management that is open and honest about challenges in a timely manner. This is always a one of the great challenges for a CEO – articulating an ambitious plan that gets an investor excited, but demonstrates a realistic understanding of the risks and uncertainties.

Investors will almost certainly be looking for evidence of this transparency during due diligence, and should ultimately see it as risk reducing – which in turn will strengthen the value of the opportunity.

However, it should never be forgotten that, first and foremost, investors need a return on their investment. On becoming owners of the company, investors expect the management team to deliver that return and any considerations around the technology, or the personal ambitions of the team, is very much secondary.

### Management alignment with investors

Ideally company management will be aligned with this concept, although they're often not. The principal purpose of all commercial ventures is to deliver shareholder return. Amongst listed companies, this is typically manifested by an increase in equity value, driven by positive news flow, value accretive transactions (particularly acquisitions at a share price premium) or dividend payments. Whilst listed life science companies conform to this established model, for smaller, privately-owned companies a liquidity event in the form of an Initial Public Offering (IPO) or value accretive acquisition is the most common route to shareholder return. Most investors will seek to exit at this liquidity stage, taking cash from either a large corporate in the event of an acquisition, or cash from larger institutional investors in the case of an IPO.





## EQUITY: HOW MUCH DO I GIVE AWAY?

However, some management and employees are inappropriately motivated by factors other than return on investment. Even senior members of management may view their role principally as an opportunity to pursue research interests or career progression as a stepping-stone to greater things. At best, this may manifest itself as ambivalence regarding the timeliness of converting equity to cash, and at worse, an inclination to take a healthy compensation package and senior job title role without delivering growth in equity value. Such an approach is often, but worryingly not always, coupled with an ignorance of shareholder's expectations pertaining to return on capital and risk. A further consideration often ignored is the idea of the right management team for the right stage of a company's development. It is very unusual to see founding, usually scientific executives remaining in the same roles throughout a successful company from seed to sale, IPO or commercialisation. Painful conversations will need to be had at critical points in a successful company's development, usually around further financing rounds and a high degree of self-awareness is needed.

The situation may be exacerbated in situations where an executive's fear of failure, and associated concerns regarding future employment, may act as a barrier to company progress, particularly if shareholder value is dependent on a positive outcome associated with a risky binary event. In contrast, we note that more dynamic management are often keener to embrace risk, with

the intention of either (i) capitalising on equity return, (ii) moving on within a company to a NED or advisory position or leaving entirely on a voluntary or involuntary basis or (iii) failing in as capital efficient a manner as possible, learning valuable lessons, and moving onto the next, and more likely successful, venture. In the US, where management failure may be viewed more positively (i.e. 'what did you learn?' rather than 'you're a failure'), there are more opportunities and a relative veneration of entrepreneurialism, risk aversion may be much lower.

From a personal tax point of view, a key concern of the founders will be the amount by which successive investments dilute their shareholding. In the UK, Business Asset Disposal Relief (formerly Entrepreneur's Relief, a lower capital gains tax rate for the first £1m of lifetime gains) is only available to individuals who have owned the shares for more than 2 years and who own at least 5% of the ordinary share capital of the company (which must entitle them to 5% or more of the voting rights and either: (i) 5% of the profits available for distribution and 5% of the assets on winding up the company or (ii) 5% of the disposal proceeds if the company is sold). There is now a provision to 'bank' Business Asset Disposal Relief where a funding round which completes after the 2nd year holding period dilutes the shareholding below 5%. From 6 April 2025 the capital gains rate for Business Asset Disposal Relief will increase from 10% to 14%. It will increase further on 6 April 2026 to 18%.

It would be advisable to consider introducing some form of share incentive arrangement, which will help to align the interests of investor and senior managers. The most popular UK share scheme is the **Enterprise Management Incentive (EMI)** scheme. This is a tax approved share option scheme. The key benefits are that the growth in value of the shares will not be taxed on exercise of the option (instead they will be taxed to the more favourable capital gains tax on a sale of the shares acquired by a third party). The conditions for qualifying for Business Asset Disposal Relief on a disposal are also relaxed for shares acquired through an EMI scheme so that the individual does not need to hold 5% of the fully diluted share capital to qualify and the 2-year ownership period starts from the date the option is granted and not the date that the shares are issued.

An EMI scheme will only be available if a number of conditions relating to the company, the employee to whom options are to be granted, and the option documentation are met.

Where tax efficient incentives are offered, poor documentation or failures in implementation (including failures to notify HMRC) may result in the intended tax relief being unavailable. A buyer will typically require indemnities from the sellers for any tax liability arising from the option scheme and will typically refuse to recover these from existing employees even where the option agreement permits the company to recover from the option holder. The box below highlights the importance of getting documentation correct. It should be noted that the numbers are often higher than this.

TYPE OF OPTION	OPTION GRANTED	EXERCISE PRICE	SALE PRICE	TAX ON EXERCISE	TAX ON SALE	TOTAL COST
<b>EMI</b>	10 ordinary shares	£5 per share x 10 = £50	£2,500 per share x 10 = £25,000	£0 (assuming that £5 was the market value at the date of grant)	Gain = £24,950 Less CGT annual allowance (2025/26 rate = £3,000) = £21,950 chargeable gain. Taxed @ 14% (assuming option holder is still an employee and granted the option 2 years prior to sale) = £3,073	Total Tax = £3,073 Total exercise price = £50 = £3,123
<b>UNAPPROVED</b>	10 ordinary shares	£5 per shares x 10 = £50	£2,500 per share x 10 = £25,000	Income gain on exercise: £25,000 - £50 = £24,950 • Employer's NICs £3,742.50 (payable by employee @15%) • Employee NICs £499 Net gain (assuming employee to pay Employer NICs) = £21,207.50 • Income Tax £9,543.38 (assuming 45% rate) Total tax/NICs = £13,784.88	£0 (as all taxed on exercise)	Total Tax/NICs = £13,784.88 Total exercise price = £50 = £13,834.88

# EQUITY: HOW MUCH DO I GIVE AWAY?

## FUNDING ROUNDS – A BRIEF INTRODUCTION

The stages of a typical life sciences company's share issue lifecycle vary immensely from company to company. In addition, the descriptions of each stage may vary by geography (e.g. the concept of Series A, B and C rounds etc. has traditionally been religiously followed in the US, but historically ignored in the UK). However, there is a general pattern that applies for the vast majority of early stage companies:

- 1. Incorporation/initial share issue:** Shares are typically issued at the shares' 'nominal value' (i.e. their face value), simply to get the company incorporated and initial ownership established. The number of shares issued is generally quite low, but sufficient that all founders feel that they have an appropriate piece of the action. For many UK companies spun out of universities or larger companies, a proportion of the incorporation shares may be held by the originating university or company.
- 2. Founder or 'pre-seed' rounds:** these may introduce initial funds into the company, from founders, and family and friends. This round may attract privately wealthy individuals, often described as 'High Net Worths'. It has become fashionable, particularly in the technology industries, for privately wealthy investors to be described as 'Angels'. The term originated on Broadway, where wealthy individuals would literally keep the show on the road, but in the late 1970s was used to describe wealthy patrons of entrepreneurial businesses. Many of these Angels may operate within a confined geographic space (e.g. Cambridge only). High Net Worths may also invest via a family office.
- 3. Seed investment:** If the first investment is made only by founders, the earlier round may be designated (or even re-designated) as pre-seed and a further seed round may seek to widen the circle of existing investors. This round may also include private investors, groups of private investor networks (so called Angel networks), crowdfunding platforms and even niche investment funds. The latter may include, in the UK and Europe, state-backed business banks. The latter tend to invest alongside privately wealthy investors in order to spur on and incentivise their behaviour and encourage investment into industries viewed as being of strategic and national importance. Moreover, state-backed business banks may have a broader investment remit, versus just purely a return on capital invested.
- 4. Series A:** This usually represents the first major round of funding, where investment is typically earmarked for a specific task, such as proof of concept. A number of factors may be included in the valuation that are indicators of success to date, whilst additional factors may be taken into account such as the quality of the board and management team. At this level of investment, a 'lead' or 'cornerstone' investor may account for 25-40% of the investment round (depending on the number of other participants), with other investors following this lead. Some of these may have frequently invested alongside the lead on previous occasions, and it is possible that some previously syndicated investors, that know each other well from previous deals, may share the weight of some of the



required due diligence. The ability and willingness of investors to syndicate may be a key factor in ensuring that a round is successfully executed.

- 5. Series B and Series C:** There is such variability in progression rates of life science companies that all that can be said with any accuracy regarding Series B, C, D or E rounds are that if they occur they will essentially be providing capital, that builds on the previous company investments, to assist it in its path to liquidity. In the UK markets there are some life science companies that have listed on the public market via IPO after just two or three private investment rounds, whilst there are others that have secured upwards of eight investment rounds and are still many years away from a liquidity event.
- 6. Investment round prior to Initial Public Offering (IPO):** In an ideal world, historically at least, this may be what could be termed a Series C investment. At this point any long-term investors are likely to be keen to exit with a significant return on capital. As such they are unlikely to

be keen to dilute their shareholdings, and if they are capable of doing so (i.e. they have sufficient funding themselves) they are likely to wish to participate in the round prior to IPO. If additional and very substantial investment is required ahead of the event (e.g. to commence an expensive Phase-III trial), additional investors may be sought who fulfil the criteria of supplying capital, but also offer the prospect of some share register stability through the listing process, via a 'crossover' or 'mezzanine' round (or private equity investors that finance both private and public equity). In the early 2020s there was a, predominantly US, trend towards SPACs (Special Purpose Acquisition Companies). These consisted primarily of mainly US listing vehicles that were effectively shell companies that merge or acquire promising privately held companies. This was not a success. Although more operationally demanding, and costly, the more traditional entry route to public capital markets is generally preferable.

Companies should pay close attention to their advisors but, at the same time, do their best to ensure that the interests of both the company and the advisor are aligned and not conflicted. We are aware of an example whereby an advisor informed a listed life science client that it had extensively 'reached out' to the market and reported that there was limited appetite for shares priced at a particular level. However, this was not case, it had spoken to only a limited number of (favoured) investors with a view to providing equity to the company at a discounted share price. By the time the company was aware of this, it had very limited time and cash resources, to seek an alternative advisor. Whilst the company secured investment, it was at an insufficient level of funding to successfully execute the value enhancing project that had been planned. Nevertheless, the advisor was rewarded, under the initial contract, for completing its fund raising mandate.

Another example is an advisor that, whilst committing to an extensive fundraising 'investor

roadshow', for a fee, was secretly advising investors not to invest as it was simultaneously running a roadshow for another company.

Trust between a company and its advisor(s) is key. However, trust should be demonstrated and earned rather than assumed. It is perhaps wise never to automatically assume that an advisor will act in the best interests of a client company but do your own due diligence to validate what an advisor may be saying. Advisors may have their own reasons for the way they act that are not aligned with those of the corporate client.

For instance, it is not unheard of for advisors to place the interests of key investor clients (with which they do a lot of business across the sector, and other, sectors), above those of a corporate client seeking, for instance, to raise funds. It is possible for the latter to become a pawn in a relatively complex strategy, the prime objective of which is to generate more business from the former. As such, discounted valuations may come into play.

# EQUITY: HOW MUCH DO I GIVE AWAY?

## TYPE OF SHARE

The simplest model is for a company to have only a single class of share. However, in the life science sector, multiple classes of share are not unusual as a way of flexing the needs and demands of investors seeking to secure their proportion of share capital by protecting against downside risk, or increase their influence in certain situations. Whilst this may attract or secure some investors, it can result in potential hurdles as potential new, additional, shareholders compete for increasingly preferential classes of share.

### Preference shares

The most well-known distinction in classes of share is between 'ordinary' and 'preference' shares, where preference may relate to particular features such as dividends and/or votes. In practice, even ordinary shares can have gradations of preference between them, including preferred returns on exit (for example either earlier or later round investors may demand the first tranche of return on a sale of capital).

Related to different classes of share, there may be other features of individual rounds of investment such as 'anti-dilution', whereby earlier investors may insist on the protection that if later rounds are issued at a lower price than earlier rounds (which in theory ought to be rare), they should be allowed to invest again at that same lower price, or at an even lower price such that their average price of investment is reduced to that of the later round.

## As simple as possible for as long as possible

Not surprisingly, dealing with different classes of shares can constitute a real headache for management. Therefore, many companies adhere to the principal of a single share class, so as to ensure equivalent capital amongst all investors. If this is acceptable to the incoming investors, all well and good. However, adopting an 'investor friendly' structure early might avoid having a more egregious structure imposed on the company at a later date. For example, a simple 1x liquidation preference with non-participating shares protects the downside for investors but has no impact on upside returns to other share classes. In this case, investors get their money back first in the event of an exit that only returns the invested capital, but if the exit yields substantially more, all shares 'catch up' as if the preference had never existed. Otherwise, investors might argue from the outset for participating preference shares with a 2x liquidation preference which is far unfriendlier, taking a top slice of returns equal to twice the invested capital, before any other share class receives a penny.

A company issuing shares with any form of preferred returns can potentially have unexpected tax implications, including compromising the availability of Business Asset Disposal Relief or SEIS and EIS tax reliefs (see below). Careful structuring can mitigate these effects and advice should be sought (there are structures which can potentially satisfy both tax efficient schemes and institutional investor demands).

## Sources for Equity Funding

These include:

- Founders, family and friends
- High net worth individuals (Angels) & Family Offices
- Private equity (PE) investors
- Angel investor networks
- Venture Capital Trusts (VCTs)
- Crowdfunding platforms
- Enterprise Capital Funds (a combination of private and public funding)
- Enterprise Investment Scheme (EIS) funds
- Sovereign wealth funds (state-owned investment funds, eg Singapore's GIC)
- Philanthropic Investors (e.g. The Bill and Melinda Gates Foundation)

Some of these are described in further detail below.

## THE CURRENT FUNDING ENVIRONMENT – SUPPRESSED PUBLIC MARKETS BUT BUOYANT ENVIRONMENT FOR UNLISTED COMPANIES

As of December 2024, the UK funding environment for life sciences SMEs is in relatively rude health, led by investments primarily focused on private companies. The public market in the UK has faded to the extent where it represents only a small fraction of funds raised for the UK life science sector (approximately 10% in 2024, versus approximately 12% in 2023, 57%, 34% and 24% in 2020, 2021 and 2022 respectively). Over 2024 approximately £2.3bn was raised by UK-based life science companies, representing the highest amount of investment recorded to date, excluding 2021. Investment over 2021 was abnormally high due to an upsurge in new investment in life sciences following the easing of COVID-19. Similarly, although less funds were raised in the UK than 2024, 2020 saw a shift of capital into the 'defensive' life sciences sector).

In the UK, regardless of the public equity markets (see below) and the appetite of institutional investors in public equity, the life science sector has continued to grow. The commonly heard cry by many life science companies that 'there is no money' reflects an increase in the number of companies seeking funding, rather than the overall quantum of funding. The latter has undoubtedly continued to increase, led by expert and committed PE and VC investors. These now represent the core repository of sector knowledge and expertise, which a decade or so ago was, in the UK, represented by sell-side and buy-side experts in the public capital markets.

As such, the UK industry has continued to mature, with growth, and eventual sale, of privately listed companies setting a good example for their earlier stage peers. Globally, deal volume has been relatively low over the past 18 months, at least in terms of whole company acquisitions. However, the market is optimistic that following the US election results, deal sizes will pick up. Over 2024 there have, at time of writing, been two key acquisitions of UK companies (see Table below). As elsewhere, we expect to see an increase in M&A activity, amongst UK companies, over the next 18 months, barring the precipitation of UK-specific macroeconomic barriers.

TARGET	LOCATION	ACQUIRER	DEAL VALUE (\$M)	DATE ANNOUNCED
<b>Kymbab</b>	Cambridge	Sanofi	\$1,500	Jan, 2021
<b>GW Pharma</b>	Cambridge	Jazz Pharmaceuticals	\$6,700	Feb, 2021
<b>Inivata</b>	Cambridge	Neogenomics	\$415	May, 2021
<b>Mirobio</b>	Oxford	Gilead	\$405	Aug, 2022
<b>Diurnal</b>	London	Neurocrine	\$57	Aug, 2022
<b>DJS Antibodies</b>	Oxford	AbbVie	\$255	Oct, 2022
<b>Amryt Pharma</b>	London/Dublin	Chiesi Farmaceutici	\$1,480	Jan, 2023
<b>Dedra Pharmaceuticals</b>	Northwich	Freya Bidco	\$6,089	Jun, 2023
<b>Abcam</b>	Cambridge	Danaher	\$5,700	Aug, 2023
<b>Circle Health Group</b>	London	Pure Health	\$1,200	Aug, 2023
<b>PetMedix</b>	Cambridge	Zoetis	Not disclosed	Sep, 2023
<b>Eyebiotech</b>	London	Merck	\$3,000	May, 2024
<b>Exscientia</b>	Oxford	Recursion	\$688	Aug, 2024

Source: Company data; Akesios Associates



# EQUITY: HOW MUCH DO I GIVE AWAY?

## Public equity markets in the UK and US

The future of AIM is increasingly a subject for debate within the City of London, and we note that 2023 was characterised by a number de-listings from the exchange. In contrast, although in a period of IPO recovery over 2023, NASDAQ has historically proven a market of choice for companies with sufficient critical mass to demand appropriate pre- and post-money valuations (see below). Over 2023 public listing opportunities have been obstructed by relatively low interest rates. Higher Bond yield rates, as demonstrated by UK Gilts and US-T Bonds, have restricted investments into perceived higher risk equities such as life sciences. Initial sentiment at the end of 2023 was that equities were set for a recovery in the US, with GDP growth and reduced interest rates. In contrast, in the UK, the jury is still out with respect to the likely macroeconomic picture over 2025. Structurally, the UK decline in 'buy-side' specialist investors, and commercially aware 'sell-side' analysts has come home to roost, and whilst advisors will readily publish (very often biased) research supporting their corporate clients ('Buy' notes) there is little incentive to raise awareness of less successful companies ('Sell' notes), further antagonising investor sentiment for the sector when setbacks (i.e. critical late stage development failures) arise. We must hope that further over-brokered and overvalued listings (i.e. Circassia or Oxford Nanopore) followed by subsequent share price crashes, do not erode the goodwill that has been built up with life sciences investors over the past few years. We believe that the lack of reliable, non-subjective (i.e. independent of broking

relationship) equity research has adversely impacted those funds that invest across the sector (i.e. both listed and private companies), potentially assisting to 'wrong-foot' portfolio valuations (see above). As such trading volumes of publicly listed companies have continued to decline, whilst UK IPOs have generally (with the exception of perhaps Oxford Nanopore – see below) offered access to increasingly limited pools of capital, whilst share placings have attracted decreasing levels of interest.

UK IPO activity has been almost non-existent, albeit punctuated by rare listings such as ProBiotix Health, Shortwave Life Sciences and EDX Medical on the UK AQUIS exchange in 2022 (raising just £2.5m, £0.8m and £1.2m respectively). Whilst this specialist market does provide some liquidity, volumes are relatively small, even compared to AIM. In the Chancellor's Mansion House speech in November 2024, Rachel Reeves committed the Government to establishing the Private Intermittent Securities and Capital Exchange System (PISCES), pitched as 'an innovative new stock market' in the UK, by May 2025. PISCES marks a step in the UK Government's efforts to rejuvenate its capital markets, revive its flagging IPO pipeline and compete amongst global financial ecosystems (and against, for example, the NASDAQ Private Market (NPM)). It is too early to say whether PISCES will move the needle, although initial reaction has been somewhat muted.

Despite the ongoing malaise in the UK public equity market, we reiterate our view that well-informed (and well managed) life science companies still have cause for

a degree of optimism. That said, the impact of the recent budget (increased personal and corporate tax burden) certainly represents a headwind for the sector.

**Listing on non-UK exchanges:** Historically, the US NASDAQ exchange has offered clear potential for a liquidity event for both UK and European companies seeking an IPO, dual listing or relisting. A large number of (i) publicly traded life sciences companies, (ii) specialist, knowledgeable investors, and (iii) knowledgeable and commercially astute analysts, and (iv) investors with significantly larger pockets than their UK peers, have created an equity capital market environment characterised by mostly buoyant stock prices, relatively large volumes of traded shares and access to significantly larger pools of accessible capital. Moreover, a US listing may offer a potentially more impressive longer-term return to patient companies. We note that the largest UK biotechnology acquisition price to date was achieved subsequent to a listing on NASDAQ (GW Pharma).

However, of late the US has also been impacted by poor performance of historically listed stocks. The warning lights were flashing in 2020, a record-breaking year for NASDAQ, with 102 healthcare IPOs raising approximately \$23.6bn and representing the sector's best ever year. The newly listed companies included 82 biotechnology companies, raising \$15bn (2019 saw 55 biotech IPOs raising just \$5.6bn, slightly down on 2018, which saw 72 listings raising \$6.7bn). However, nearly 30% of these listings were companies with only preclinical pipelines, and it was noted that whilst these flotations undoubtedly generated a return for exiting early-stage investors, and significant fees for bankers and lawyers (as in the case of more high profile UK listings), there remained a tangible risk of these relatively unvalidated pipelines failing to deliver value to public shareholders. Much of the same continued into 2021, with 109 biopharmaceutical IPOs, raising \$14.1bn, with closer of 40% of these listings constituted by companies with relatively early stage pipelines.



## EQUITY: HOW MUCH DO I GIVE AWAY?

As predicted, market confidence finally failed, and from September '21 through 2022 the NASDAQ biotech index continued to fall. Over the course of 2022 there were just 22 IPOs (an 80% decline versus 2021) and just 20 IPOs in 2023. Following the IPO frenzy of 2020-2021 many US companies have relatively strong balance sheets, whilst maturing US mid-cap companies, many of which are still continuing to hire new employees, continue to demonstrate the growth opportunities available to their earlier-stage peers. However, as a consequence we believe that US public market investors have now become far more discerning.

Importantly, despite (in many cases warranted) market discounts to IPO valuations, structurally the US life science market remained in relatively good shape. Over 2022/2023 there were expectations, based on two year historical recovery periods, that the public markets would recover by H2 2023, and this indeed seems to have been the case. Over this period it was also expected that the NASDAQ IPO window would transition from 'barely open' (recently) to 'open' by 2025.

The sector has an inherent resilience, arising principally from critical mass and recognition by many specialist US investors that the sector could continue to offer significant returns, (it facilitated 23 IPOs over 2024 at the time of writing). Given the positive mood music coming from the US equities market since the 2024 election results, we anticipate a continuing stream of US IPOs over 2025, notwithstanding

macro-economic and geopolitical turmoil that sadly appears to be all too common at this point in time.

Traditionally, UK and European life science sentiment tracks that of the US although, historically, by the time positive sentiment filters through (typically 12-24 months – see comments above on UK equity markets), US sentiment is on the wane. Given that bad news in the sector tends to travel faster than good news, this has historically resulted in at best stunted European and UK equity market performances versus that of their US counterpart. Whilst the positive US market over 2020-21 undoubtedly supported investment sentiment for the IPO of Oxford Nanopore, the transaction was so late in the global (i.e. US) cycle, that even allowing for an ambitious (and some might say overbrokered) valuation at IPO, there has been only limited equity market support (its share price and market capitalisation – £1.4bn versus £4.8bn - is currently significantly less than at IPO). Moreover, there was little opportunity for further significant IPOs into the UK market. Although 2021 was a relatively bumper year for UK IPOs, with seven other UK listings alongside Oxford Nanopore, these additional listings raised an average of just £23.8m each, versus an average of \$130m for US peers (over 2020 average funds raised by UK listings was also £23.8m – albeit with just 3 listings – versus an average of \$183m for US peers).

Of note there have been no domestic UK life science IPOs over 2022-2024 (with the exception of AQUIS – see above).



As such NASDAQ remains an attractive choice for UK companies seeking an ambitious public listing.

Historically, the US NASDAQ exchange has offered clear potential for a liquidity event for both UK and European companies seeking an IPO, dual listing or relisting. A large number of (i) publicly traded life science companies, (ii) specialist, knowledgeable investors, and (iii) knowledgeable and commercially astute analysts, and (iv) investors with significantly larger pockets than their UK peers, have created an equity capital market environment characterised by mostly buoyant stock prices, relatively large volumes of traded shares and access to significantly larger pools of accessible capital. Moreover, a US listing may offer a potentially more impressive longer-term return to patient companies. We note that the largest UK biotechnology acquisition price to date was achieved subsequent to a listing on NASDAQ (GW Pharma).

In 2021 we saw five key IPOs of UK companies on NASDAQ (Exscientia; Centessa; Immunocore; Achilles and Vaccitech), with these listings raising an average of £180m each. In 2022 Virax Biolabs (London) IPOed on NASDAQ, followed in 2023 by Biodexa (Cardiff).

However fortunes have been mixed, whilst Centessa (now capitalised at \$2.3bn) completed a follow-on round of £172m in September 2024, however, Vaccitech struggled to achieve critical mass on the US market. It has subsequently restructured, as Barinthus Biotherapeutics, although is now capitalised at just \$39.0m, compared to a value of \$579m at time of listing. Any UK companies considering a US listing should study the history of this listing.

Interestingly, although from time-to-time UK companies consider listing on exchanges other than UK or US, the alternatives have all uniformly proven relatively ineffective. For example, whilst the Swiss exchange has proven attractive to some companies it functions best for domestic Swiss companies, often those with a relationship to existing key Swiss players. Similarly, Hong Kong, although mooted as an alternative to NASDAQ over 2018, failed to demonstrate sufficient rigour to lend confidence of post listing value accretion. The introduction of the Chinese Communist Party-backed Shanghai STAR exchange, established in 2019, has proven somewhat more successful in terms of (admittedly Chinese Communist Party backed) IPOs, although is principally domestic.

### UK FUNDING ENVIRONMENT FOR R&D SMES



Source: Akesios Associates Limited



## LOANS/CONVERTIBLE LOANS

Loan financing has long provided a lifeline for smaller companies that are either deliberately seeking non-dilutive capital, or have struggled to find sufficient equity investment.

It has historically enjoyed a renaissance in the European life science industry, catalysed by the European Investment Bank, which strongly promoted life science loans provided by the European Fund for Strategic Investments (EFSI). For larger companies, seeking project-specific financing, this approach was undoubtedly useful. However, for smaller companies, where debt is offered as a more mainstream funding instrument (i.e. not project specific), it should be treated cautiously, as:

1. the balance sheet is subsequently so burdened that new investors are deterred; or
2. planned royalty-stream payments, common amongst creditors serving the life sciences industry, have a significant detrimental impact on time to profitability, or valuation (as in the case of several loans by well-known and aggressive providers to UK life science companies in the 2000s).

In the case of corporate valuations, discounted cash flow (DCF)-based valuation models can be subject to disproportionate declines from royalty stream payments, given the front loaded nature of the discount methodology. The effect is compounded if venture debt is also offset against milestones, which again tend to be disproportionately valuable in DCF valuations.

Whilst companies do not plan to go into administration, liquidation preferences (creditors have seniority over shareholders) carried as part and parcel of a loan may cause unrest amongst existing equity investors.

Traditional Venture Debt is structured slightly differently, with repayment scheduled over a shorter period (i.e. 18-48 months) although with relatively robust interest rates. These can offer real value in terms of extending a company's cash runway, particularly if this extends to an inflection point when value uplift facilitates further equity investment and/or offsets the cost of the loan. Before considering Venture Debt, a company should think hard about its ability to service that debt from future revenues since there are few investors that will relish the idea of their investment being employed to repay debt – for many funds, it may even be barred by their investment criteria.

Convertible loans, consisting of an interest-bearing bond that can be converted into equity, also remain a popular form of financing, particularly in small public companies, allowing investors who wish to participate in the upside potential of the company made possible by their financing. Interest rates on convertibles are usually relatively inexpensive and interest may be reduced even further in return for agreement to discount the future converting share price. However, convertibles carry the risk that if a corporate valuation falls, issuance of additional equity poses a significant threat to share price.

Historically, some UK companies have been exposed to bond holder dominance in this scenario, with the bond becoming the dominant market instrument as investors seek to hedge their exposure to shares. However, amongst smaller, private companies this factor is less of an issue, although we note that bonds that carry a significant preference on conversion, can act as barriers to attracting new equity investment.

# GRANTS

Like convertible loans, a SAFE (Simple Agreement for Future Equity) is an increasingly popular way of raising capital without settling on a valuation. These are not debt instruments, but are promises to issue equity triggered by a future financing round, and almost always at a discount to that future round.

Non-dilutive grant funding can be secured from many potential regional, national and trans-national sources.

These funding bodies are placing an increased emphasis on support for small and medium enterprises (SMEs) developing innovative, high-risk products and services including pharmaceuticals, medical devices and digital health technologies.

The majority of the UK's grant funders (Funders) are seeking to support and accelerate the translation of fundamental scientific research into successful commercial products and services. Many also have goals involving job creation or preservation of high-quality jobs in the technical sectors. Whilst most Funders cannot support research that's perceived to be anti-competitive they are able to offer grant funding to support innovators from initial concept through to clinical testing.

Certain grants are typically geared towards applied research, prototyping and market evaluation, including market intelligence and IP audits. Most Government agencies are also seeking to stimulate inward investment, particularly in the retention and creation of knowledge based roles and supporting facilities, as well as to address perceived market weaknesses.

The level of grant subsidy, or intervention rate, on offer from the Funder is typically determined by the

proximity of the product or service to the market. With the exception of micro-funds and specific initiatives such as the Small Business Research Initiative (SBRI), most Funders require the company to provide matching funds.

In addition to providing substantive sums of non-dilutive investment, grant funding can also provide other key benefits including:

- **Validation of the Product/Technology/Company:** Used as external due diligence by prospective investors/ commercial partners
- **Drive Commercialisation:** Used to catalyse business development
- **Access to Specialist Expertise:** Can open doors in both academia and industry

On the flip-side, grant funding is not *free* funding. Securing grant funding, particularly larger sums, is increasingly competitive requiring significant time and resources without guarantee of success. As with all sources of potential investment it should be carefully considered alongside other options when considering company strategy. Equally, the business plan should drive funding applications – in many instances companies repeatedly chase grant funding and diverge from their planned business aims, damaging their longer-term prospects.

It's also important to remember that grants are designed to help initiate and stimulate business growth.

If a company seeks to just live off multiple grants, the awarding bodies will at some point lose confidence and discontinue further support.

# GRANTS

## Key considerations to bear in mind include:

- Funds are typically paid in arrears and can't be applied retrospectively therefore sufficient working capital and accompanying cash-flow management is essential
- Funding is in most cases provided to support projects, rather than businesses, therefore if a company wishes to change project focus, it may be required to refund monies
- Fund bureaucracy can be challenging and time consuming to manage: most funds mandate regular reporting to a pre-agreed timetable and, typically, include some element of post-project monitoring
- Some Funders seek a conditional financial return and/or rights to IP
- Grants which are in the category of either 'Notified State Aid' or 'De Minimis State Aid' under EU provisions or Minimal Financial Assistance under the UK Subsidy Control Act 2022 can limit the availability of some tax reliefs, for instance EIS or R&D tax credits (see below), and in some cases this can work the other way round, for instance if the company has offered SEIS relief to investors, this may limit the amount of further grants it can receive in the 'De Minimis State Aid' or Minimal Financial Assistance category.



## KEY FUNDERS

Innovate UK is the UK's national innovation agency and part of UK Research and Innovation (UKRI), responsible for investing in high-potential entrepreneurs and businesses across the UK. Innovate UK drives productivity and economic growth by supporting businesses to realise the potential of new ideas.

To-date, Innovate UK has helped over 11,800 organisations create more than 100,000 jobs and added in excess of £32bn of value to the UK economy. Innovate UK's total core budget for FY23 to FY25 is approximately £2.4bn.

Since 2017, Innovate UK has operated its Investor Partnership programme. Through this programme, Innovate UK works with about 150 venture capital companies with the aim of aligning grant calls with venture investment strategies and co-ordinating grant awards with investment funding rounds. Under this programme, about £99m of grant funding has leveraged about £1bn in private capital. (The full list of Investor Partners can be found on the Innovate UK website).

Innovate UK's business-focused terms, including 100% IP retention by applicants, broad coverage of project costs and quarterly monitoring, often make their funding programmes more attractive than comparable sources. In addition to Innovate UK's general funding competitions, recent health-focused funds include the Biomedical Catalyst and Transforming Cancer Therapeutics. Innovate UK also manages the core funding for a network of Catapult Centres across the UK, including the Cell & Gene Therapy Catapult, Medicines Discovery Catapult and Centre for Process Innovation (part of the High Value Manufacturing Catapult).

**Innovation Loans** from Innovate UK are designed for UK registered SMEs looking to scale-up. They are flexible and patient (with payback periods up to 10 years) and can cover 100% of eligible project costs at favourable interest rates. They are for UK businesses carrying out later stage R&D projects - still with some risk - with a clear route to commercial success and who are able to take on a loan but who have difficulty in accessing commercial lending.



## GRANTS

In addition to their portfolio of sector-specific programmes, Innovate UK also funds a broad range of businesses through Smart Grants (typically up to £1m per project) for ambitious or disruptive R&D innovations that can make a significant impact on the UK economy. It should be noted that broad funding calls, open to a wide range of applicants, are likely to be highly competitive. Therefore, niche options should be considered if available.

Whilst some funding calls permit single applicants, successful innovation is also about collaboration and networks. Innovate UK can connect your company with support, facilities, public bodies, investors and the UK's world-class research base. By working with partners, such as the KTN and Innovate UK EDGE, they have created a system of financial and non-financial support that stimulates successful innovation, boosts competitiveness and delivers

economic growth. Delivering growth at scale is at the heart of Innovate UK's emerging strategy and through their partners at Innovate UK EDGE, they offer Innovation & Growth Advisory services and Scaleup Programmes, to position high-potential businesses for long term success. See: <https://www.innovateukedge.ukri.org/>

Innovate UK provides grant funding in line with the UK's obligations and commitments to Subsidy Control. It is unable to award grant funding to organisations that are considered to be in financial difficulty. Further information about the UK Subsidy Control requirements can be found here: <https://www.legislation.gov.uk/ukpga/2022/23/enacted>

Full details on all current Innovate UK support opportunities can be found on the Innovate UK website at: <https://www.ukri.org/councils/innovate-uk/>



- Research Councils (Medical Research Council (MRC), Biotechnology and Biological Sciences Research Council (BBSRC); and Engineering and Physical Sciences Research Council (EPSRC))**

The majority of government research grants are orientated towards academia. However, at the interface between fundamental and applied research, grants are available to companies to fund research (albeit that the work is typically carried out at the academic partner). Such grants can effectively offset external R&D costs and enable access to specialist expertise and facilities. Information can be found on the UKRI website at: <https://www.ukri.org>.
- Private Foundations & Charities** (Wellcome Trust, X-Prize and the Bill and Melinda Gates Foundation). Foundations are increasingly important as a non-dilutive source of R&D funds, particularly for projects that address significantly underserved needs e.g. healthcare in low-income countries. The funding that these sources provide, terms and conditions and project criteria can vary, requiring careful selection to maximise a company's chances of success. In some cases, funding is channelled via particular centres of excellence which take on the mantle of distributing funds. It may be possible to seek funding from DFID if there is a perceived overseas aid benefit.
- Small Business Research Initiatives (SBRI)**s have been encouraged by UK Government to catalyse departmental procurement. They can provide attractive terms as funding is typically provided in the form of a contract which can cover 100% of project costs. Timing of payment (e.g. upfront or milestone based) can vary depending on each funding call. The most predictable and enthusiastic adopters of SBRI are the NHS (SBRI Healthcare) and MoD/Centre for Defence Enterprise (Enduring Challenge). Over 7m NHS patients have benefited from SBRI healthcare supported innovations and over 2,000 jobs have been created or retained as a result. For information on SBRI Healthcare, see: <https://sbrihealthcare.co.uk>
- National Institute of Healthcare Research (NIHR)** fund high quality, timely research that benefits the NHS, public health and social care. NIHR offer a variety of grant funding programmes including domestic funding programmes, global health research programmes and career funding programmes. Detailed guidance on preparing an NIHR application can be found on the NIHR website at: <https://www.nihr.ac.uk/support-and-services/industry/h>
- Health Innovation Network (HIN)**. Healthcare innovators based in England should consider approaching their regional Health Innovation Network (formerly known as Academic Health Science Networks) - the innovation arm of the NHS. The network comprises 15 organisations across England which were established to help adoption and spread of innovation at pace and scale to improve health outcomes and generate economic growth. Each organisation works across a distinct geography, serving a different population in each region. For more information see: <https://www.england.nhs.uk/ourwork/part-rel/healthinnovationnetwork/>
- Horizon European funding** remains accessible to UK companies since the UK and EU reached agreement in 2023. It is the largest international research collaboration scheme in the world with a budget of about €95bn and is targeted at all types of innovative SMEs showing a strong ambition to grow but only 'for profit' SMEs can apply for funding, and the focus is on market-orientated, close-to-market activities embedded in societal challenges and key enabling technologies.

# GRANTS

The UK is an associated country to the EU's R&I Framework Programme Horizon Europe (the successor to Horizon 2020) and will therefore have the same rights and obligations as other countries associated to the Programme.

The scope of association includes the European Research Council (ERC), the Marie Curie-Skłodowska Actions, the six 'Global Challenges' clusters and Missions, the partnerships, and the European Institute of Innovation and Technology, amongst others. UK entities including universities, research centres, scientists, innovative businesses and industry will have full rights to participate in the first calls for proposals of Horizon Europe as soon as they are published on the European Commission's website.

Further information at: <https://ec.europa.eu/info/funding-tenders/opportunities/portal/screen/programmes/horizon>

## Other sources

**The Advanced Research + Invention Agency (ARIA)** is an R&D funding agency built to unlock scientific and technological breakthroughs that benefit everyone. Relevant funding opportunities include Scalable Neural Interfaces to boost understanding of neurological disorders, providing funding up to £500k/project. <https://www.aria.org.uk/>

**The US National Institutes of Health (NIH)** and various parts of the US military have many grant programmes. These generally require a presence of some sort in the USA and are most relevant for somewhat more mature companies. Highly specialist expertise is required to leverage, but the amounts available are considerable so certainly worthwhile considering if appropriate.



### LEVERAGING INNOVATE UK GRANTS TO TRIGGER EQUITY INVESTMENT (Independent case study)

Company X is a small, early stage Biotech located in the “Golden Triangle”. A new CEO was appointed who selected a very high-risk but high reward disease area as the company’s second priority. Rather than spend shareholders’ equity on the risky project, the CEO secured an Innovate UK, Biomedical Catalyst grant, funding 60% of the new research, reducing the risk to a small, closely held company. The Board agreed to a higher risk strategy on the basis of the grant being awarded. This was a classic “valley of death” bridging project in a company with conservative shareholders involving a higher risk but potentially considerably higher return project.

The £1m research project that was part funded by the grant was ultimately successful in three ways: new staff were hired who brought considerable additional expertise to the company, a new avenue of pre-clinical research was opened and most importantly, the research

was successful. Within six months of receiving the Innovate UK grant, Company X secured many millions in equity investment. The largest new shareholder, who invested 33% of the raise, did so precisely because of the new disease area enabled by the grant. The original main priority indication for the company failed within one year of the “high risk” research project starting. The original grant-funded project is now one of the company’s three equal first priorities. Company X has secured a further five Innovate UK or EU grants since then, and the majority of the company’s blue-sky research is enabled either by other grants or by HMRC R&D tax credits. The company actively uses all incentives available in the UK to foster innovation and intends to apply for the HMRC Patent Box corporation tax rate of 10% when taxable profits start to accrue in the year of its first out-licensing deal. Intimate knowledge of these incentives can make a real difference to company strategy as exemplified here.





# INVESTMENTS WITH TAX RELIEF

## ATTRACTING INVESTORS WITH SPECIAL TAX ENHANCEMENTS

This section covers sources of funding which are given special tax reliefs by the Government, and are widely discussed in the investment community. It is important to understand that they are not really separate funding mechanisms, as they are generally delivered by share issues as part of 'normal' equity rounds.

### EIS & SEIS TAX RELIEF ON SHARE INVESTMENTS – FOR INDIVIDUAL INVESTORS

As discussed earlier most companies will raise funds by the issue of shares to investors. In themselves, share investments do not give tax reliefs to the investors, however where they meet certain conditions, share investments can give very valuable tax reliefs, under the Enterprise Investment Scheme (EIS) or the related Seed Enterprise Investment Scheme (SEIS) provisions. As explained briefly below, SEIS are targeted more at very early stage companies.

The main benefit is that the investor can receive 30% relief from their annual income tax bill in the case of EIS, and 50% in the case of SEIS, and in both cases when the investor ultimately sells their shares (after a three-year period) any capital gain they make may be completely free of tax.

Dividends from the shares held are taxable in the normal way. The intention of these reliefs on share investments is to alleviate the perceived 'equity gap' or 'valley of death' which earlier stage companies experience in fundraising. They are very much aimed at attracting investment into such companies, and the tax reliefs available may mean that many prospective investors will prefer to put their money into companies which can offer these reliefs.

There are a number of conditions to be met by the company, the shares being invested in, the investment process, and the investors themselves. For example, the investor must have an individual holding of no more than 30% of the company's shares; and the company must meet conditions as to the number of employees, the extent of its assets, its age, and the type of trade it will carry on (though most early-stage technology based companies are likely to qualify).

One of the numerous conditions that HMRC scrutinise is the financial health of the company. This may be more complicated than it sounds as it can rely on a narrow definition of whether a company has simply spent more than half of the funds it has raised and this has created an accounting loss.

### A 'KIC' start for Biotech companies

There is a higher level of relief available and more relaxed conditions for 'Knowledge Intensive Companies' or KICs. KICs are those companies which meet an operating costs

condition (for instance it must have spent at least 15% of its operating costs on innovation and R&D in at least one out of three preceding years); and it must meet an 'innovation condition' (so it must be intending to develop and then exploit intellectual property) or meet a 'skilled employees' condition, where at least 20% of its employees hold a relevant higher education qualification which is being applied to the company's work.

If a company is a KIC, then it now has more relaxed conditions around its age when it is raising funds qualifying for EIS reliefs, and also the maximum it can raise under these reliefs. The lifetime limit for a KIC is £20m instead of £12m for a non-KIC company. Further, any individual investor can invest up to £2m in any one year under EIS reliefs (as opposed to £1m into non-KIC companies); and the company itself can raise up to £10m under EIS and related reliefs in any 12-month period (as opposed to £5m otherwise).

The limits on the amount that a company can raise (both the annual and lifetime limits) are reduced by other investments into the company which count as State Aid.

Although the conditions to qualify as a KIC are complex, many biotech companies will have a strong chance of falling under this KIC status, which will help them be more attractive to individual investors or funds for a longer period of their lifecycle.

As noted above, SEIS is targeted at smaller and younger companies (less than three years old), and with net assets of less than £350k. Conversely, EIS offers a lower income tax relief but on a higher maximum amount invested (£1m annually per person or £2m if the investment is made into a KIC) and is allowed for companies more than three years old, and with assets of up to £15m immediately prior to the investment and £16m immediately after.

Because these EIS and SEIS tax reliefs only operate in full if the shares are held for at least three years, this will need to be borne in mind in terms of the company's exit horizon. Investors looking for these reliefs will typically require a high level of confidence that the company and the investment will meet the various HMRC criteria. There is currently an 'advance assurance' process whereby the company or its advisors can request a formal assurance from HMRC before the shares are issued that the company is a qualifying company and that the shares proposed to be issued are qualifying shares.

This HMRC advance assurance is a valuable enhancement to attracting EIS investors, whether individually or in EIS funds, but the timescale to achieve this must be built into the investment process and timelines.

# INVESTMENTS WITH TAX RELIEF

## ATTRACTING INVESTORS WITH SPECIAL TAX ENHANCEMENTS

A lot of the focus on making EIS investment work relates to the conditions that the company needs to meet, both before and after the time of the investment.

But at the end of the day these reliefs are personal to the individual investors and it's crucial that they follow through with the steps at their end in order to benefit from them.

After the investment shares are issued, the company needs to formally obtain authority from HMRC to issue individual certificates for each EIS investor (there is usually a time limit of two years from the end of the tax year when the investment happens for it to do this) and then the investors must use their certificate to reduce their income tax bill on their tax return. They have to do that no later than five years after the end of the tax year of their investment. This sounds like a long timescale but unless both the company and the investors carry out their part of the process quite soon after the investment round, one or other of these aspects can easily be forgotten.

In one case a third party approached a company to make a sale offer just as three years was about to pass since the last major investment round which would have allowed the investors to enjoy all the EIS reliefs in full. However, it was only this approach which reminded the company that it hadn't already initiated its part of the EIS claim process outlined above. It was able to do this just in time (with days to spare). So, the message is with EIS reliefs – **follow up as well as prepare**.

See further:

<https://www.gov.uk/guidance/venture-capital-schemes-apply-for-the-enterprise-investment-scheme>

<https://www.gov.uk/guidance/venture-capital-schemes-apply-to-use-the-seed-enterprise-investment-scheme>

For very detailed HMRC commentary on the schemes:

<https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual>

### INVESTMENTS BY VENTURE CAPITAL TRUSTS – SPECIALIST CORPORATE INVESTORS

Venture Capital Trusts (VCTs) are pooled investment companies. Individual investors take shares in the VCT, which then has a pool of funds to invest in unquoted trading companies (which themselves broadly need to meet the same conditions as for the EIS and SEIS reliefs).

Therefore, if your company is invested in by a VCT, it will be one of a portfolio of other investments held by it.

Individuals who invest in VCTs receive tax reliefs on that investment, in this case at 30% of the amount invested. They can receive dividends tax-free from the VCT, and when they sell their shares in it these can be free from capital gains tax.

In return for the tax reliefs, the Government expects the VCTs to invest in smaller, innovative companies that will benefit the UK economy. Consequently, there are a host of restrictions on where a VCT may invest. The VCT cannot

control any one of its investee companies and there are limits over its 'exposure' to any single investment.

Whilst VCTs are restricted to investing in companies that do not exceed £15m in gross assets, most VCT managers will not generally invest in the earliest seed stage companies, although there are exceptions. They do not have to have all their investment in the form of ordinary shares in their investee companies, i.e. they are allowed to make loans to them.

See further:

<http://www.theaic.co.uk/guide-to-investment-companies/venture-capital-trusts-vcts>

## ENTERPRISE CAPITAL FUNDS

Enterprise Capital Funds (ECFs) are another form of funding based on Government legislation, also aimed at filling a perceived gap in funding (the 'equity gap'). The ECF programme is administered by the British Business Bank (BBB), the Government-owned investment bank that aims to make the finance markets work better for small businesses. ECFs combine private and public money to make equity investments in high growth businesses.

The programme aims to increase the supply of equity to UK growth companies and to lower the barriers to entry for fund managers looking to operate in the VC market.

ECFs are structured as traditional Limited Partnership funds – usually with a ten-year life span. They raise their money from a mix of private investors (both individuals and

institutions) and BBB itself. Unlike Venture Capital Trusts (VCTs), or the Enterprise Capital Scheme (ECS), there are no tax incentives for investing in an ECF. As a result, investors in ECFs may well be UK tax-payers, but equally may be overseas individuals or institutions.

Without the obvious attraction of up-front tax reliefs, private investors in ECFs nevertheless benefit from a magnified profit share as a result of BBB (usually) foregoing a material portion of its profit share in return for a preference coupon on its invested capital (which gets paid out ahead of other returns). In other words, BBB invests in funds on terms that improve the outcome for private investors when those funds are successful.

Since it began, BBB has deployed about £1.75bn into 37 ECF fund managers in the UK. These include established venture capital fund managers as well as new teams, often started by serial entrepreneurs with a track record of exiting their own businesses.

There are fewer constraints on how an ECF invests compared to the VCT scheme, although the various ECF managers will each have different strategies and target areas for investment (digital; healthcare; software; generalist etc). However, they will all have a general requirement to invest substantially in UK-based SMEs, and with certain constraints that will mean that they will tend to focus on start-up; pre-revenue; or early growth stage companies.

Further information on the programme can be found at: <https://british-business-bank.co.uk/ourpartners/enterprise-capital-funds/>



# MISCELLANEOUS SOURCES OF FINANCE

## RESEARCH & DEVELOPMENT TAX CREDITS – ENHANCED TAX FLOW BASED ON R&D SPEND

This is not strictly a source of external funding at the shareholder/lender level, but the Government Research & Development Tax Credits (R&D Tax Credits) Schemes can offer valuable cash flow for research driven companies. A series of recent reforms to the rules means that understanding exactly how the R&D tax relief regimes work and when the many changes apply, may be of critical importance to your financial projections as they will affect the level of benefit available.

### HOW THE RELIEF WORKS

For accounting periods beginning prior to April 2024, there were two R&D tax credit regimes. The most familiar one to early-stage life sciences and technology companies is likely to be the Small and Medium Enterprise (SME) scheme.

This is for companies (or groups) with:

- Fewer than 500 employees, and either:
- Turnover not greater than €100m; or
- Gross assets not greater than €86m.

A company must also meet various structure tests to confirm it is in fact an SME, for instance, if it has significant corporate shareholders. There are also guidelines to consider in terms of whether its activities do meet certain definitions of 'qualifying' R&D for tax purposes. In addition,

the R&D projects concerned must not have received certain forms of external grant funding.

R&D claims under the SME scheme attract an uplift (an enhanced tax deduction) for qualifying R&D expenditure. At historic rates of corporation tax (19% prior to April 2023), profitable companies could generate a corporate tax saving of 24.7p for every £1 spent.

For expenditure incurred prior to April 2023, loss making companies (most early-stage biotech companies), can surrender their uplifted tax losses in return for a tax credit that equates to 33.35p for every £1 spent. This is paid out in cash relatively promptly (although HMRC reserve the right to enquire into the R&D claims at a later date and claw back any excess R&D tax credit cash paid out with interest). These credits give an important cash flow advantage for many early-stage companies - they are effectively a form of funding that is not dependent on shareholders or similar stakeholders.

However, there is a cap on the payable form of R&D tax credits – for SMEs this is equal to £20,000 plus three times the amount of PAYE and NICs that have been paid over by the company to HMRC for any accounting period. A company is exempt from the cap if:

- its employees are creating, preparing to create or managing Intellectual Property (IP); and
- less than 15% of its total R&D expenditure is on work subcontracted to or using employees of connected persons.

For companies that do not meet the above threshold and/or subsidised or grant funded projects, the Research & Development Expenditure Credit (RDEC) is available for qualifying R&D projects. Relief is given in the form of a pre-tax credit in the company's accounts (i.e. Above the Line). This R&D Expenditure Credit is itself taxable so the historic above the line rate of 13% gives an effective benefit of 10.5% for years prior to April 2023. However, the credit is only given where certain conditions are met (including that the company's other tax liabilities have been settled and that the company is operating as a going concern and not financially reliant on the RDEC). Again, there is a PAYE/NIC based cap for loss making businesses, albeit the mechanics are slightly different to those outlined above.

## CHANGES TO THE RELIEFS

The Government has been overhauling the R&D rules to try and improve the effectiveness of the relief after HMRC estimated annual fraud and error at around £1.13 billion for 2020/21 (with the majority of this within the SME scheme).

In the 2022 Autumn Statement, changes to the rates of R&D relief for both the SME and RDEC schemes were announced - these apply for expenditure incurred from April 2023. Relief under the SME scheme has reduced to a saving of 21.5p for every £1 spent (assuming the 25% corporation tax rate applies). The credit for surrendered tax losses has dropped to 18.6p for every £1 spent; however, a new 'R&D intensive' scheme was also introduced for loss making SME companies to claim relief at the more generous rate of 26.97%, which is welcome news for companies in the life sciences sector. Meanwhile, for RDEC, the effective benefit increased from 10.5% to 15%.

The 2023 Autumn Statement brought further changes intended to 'simplify and improve' the UK's R&D schemes. These merge the existing SME and RDEC schemes into one above-the-line credit scheme which broadly follows the

current RDEC scheme, with a headline rate of relief of 20% (before tax). The merged scheme takes effect for accounting periods beginning on or after 1 April 2024 and runs alongside the SME R&D intensive scheme (which also sees some changes).

Importantly, under the merged R&D regime, all companies will be able to claim qualifying subcontractor payments ('contracted out R&D') where the principal 'intended or contemplated' at the time the contract was entered into, that the subcontractor would be required to undertake R&D to satisfy the contract. SMEs that were previously claiming under RDEC where they themselves were being engaged as a contractor by a larger entity/group, may now lose out as a result.

For SMEs, another key aspect of the merged scheme is that it is no longer possible to receive immediate relief for qualifying pre-trading expenses. Broadly, such costs will attract relief only once the company commences trading; this could create a cash-flow issue for early-stage companies.

More significantly for established businesses, for both the merged and R&D intensive scheme for accounting periods beginning on or after April 2024, companies cannot claim costs of subcontracted work where this takes place outside the UK. There are some limited exceptions to this, such as where there are particular factors relating to the research that are not present in the UK, or where there are regulatory or other legal requirements that research activities must take place outside the UK (for example clinical trials). However, companies intending to claim R&D tax reliefs must now be even more careful that their costs fall within these exceptions (and all other conditions) – keeping suitable supporting documentation is vital.

# MISCELLANEOUS SOURCES OF FINANCE

## COMPLIANCE AND ADMINISTRATION

HMRC has also launched a compliance initiative to reduce the level of perceived fraud and error. For example, currently, around 20% of claims are being reviewed in detail. As part of this compliance initiative, important changes to the way R&D claims must be made came into effect from 8 August 2023, requiring companies to complete an 'Additional Information Form' through HMRC's online portal.

Companies who are new to, or returning to, claiming R&D are also now required to inform HMRC in advance of their intention to file a claim. This advance notification can be completed at any time from the start of the accounting period to six months after the end of the accounting period to which the claim relates. However, HMRC have confirmed that if an 'Advance Notification Form' is needed but not completed, this renders the R&D claim invalid and HMRC will remove it from the corporate tax return as an "error".

HMRC have also set out 14 expectations for best practice steps that should be taken before an R&D claim is submitted in its "Guidelines for Compliance".

## CONCLUSION

In summary, there have been many significant changes to R&D tax credits in recent years and companies should seek professional advice if in any doubt. Happily, in the 2024 Autumn Budget, the Chancellor confirmed there would be no further changes for the remainder of

this parliament. Hopefully this will provide companies claiming this valuable relief with some stability and certainty for the next few years.

## THE PATENT BOX – A LOWER RATE OF TAX FOR INNOVATIVE COMPANIES

The Patent Box scheme is available to companies earning profits from goods and/or services that have been patented in the UK or with the European Patent Office. It takes the form of an effective tax rate at 10% of the relevant profits compared to the UK's usual 25% rate.

The aim is to incentivise UK companies to commercially exploit their patented products or processes based on R&D carried out in the UK. Companies can benefit from the regime if they own or exclusively licence patents granted by the UK Intellectual Property Office, the European Patent Office, or a number of major countries in the European Economic Area.

They must also have made a significant contribution to either the creation of the patented invention, or to the product incorporating it. Indeed, there has to be a link between the R&D work undertaken and the patent itself (see below).

While patents are the most common form of qualifying intellectual property (IP) for the Patent Box regime (and likely most relevant for life science companies), it's important to note that other types of IP can also qualify. These include:

- Supplementary protection certificates
- Medicinal and veterinary products with marketing

authorisations and marketing or data protection

- Plant breeders' rights / plant variety rights

## THE TAX REDUCTION

The reduced rate primarily applies to a proportion of the profits derived from the sale of any products protected by a patent or which incorporate a product protected by a patent. A company can also benefit if it generates profits from the use of a patented process. Multiple revenue streams can qualify - for example, selling products that incorporate a small but intrinsic patent, earning licensing income related to a patent (either intergroup or third party), and even selling the patents themselves.

The reduced rate of tax to be applied is determined by calculating the qualifying Patent Box profit obtained by the company and by applying a specific formula to calculate their deduction in the company's overall corporation tax liability. This includes applying an R&D fraction so that attributable R&D expenditure by the company is taken into account.

HMRC have released some practical and helpful guidance for compliance due to the increased interest in the regime. This guidance includes examples of what HMRC considers best practice and the level of disclosure they would like to see.

It's never too early to start considering Patent Box.

While companies may not want to elect into the regime until they are profit making, it's important to start capturing relevant financial information that will be required for the subsequent claims and to ensure that the operating structure is right. The way you structure your income and contracts, the roles within a group, and how you track and trace R&D activities all matter. Additionally, moving IP can impact your future Patent Box claim, so careful planning is best practice.

It's also worth noting, as detailed in the Corporation Tax Roadmap, that while Corporation Tax rates are not expected to decrease any time soon, Patent Box relief will also stay at the same rate for this parliament.





# MISCELLANEOUS SOURCES OF FINANCE

## BRITISH PATIENT CAPITAL

In July 2018, following the government's Patient Capital Review, the British Business Bank ("BBB") launched the £3bn Patient Capital programme, known as British Patient Capital. The aim of the programme is to provide long-term 'patient' finance to a generation of companies seeking to grow to billion-dollar valuations. The BBB-administered programme is primarily a fund-of-funds, backing venture capital managers, but includes specific funds making direct investments into companies (see Future Fund: Breakthrough). However, by watching carefully where British Patient Capital makes its investments (and these will be a matter of public record and should be in the BBB website news flow), it will be possible to identify which investment funds have fresh capital designed to invest in, amongst other places, ambitious life science companies. The British Patient Capital Fund is also able to co-invest directly in companies that are investees of funds which it has already backed.

Other conditions were also perceived as onerous and the withholding tax implications of conversions caught a number of companies and investors unawares.

## FUTURE FUND: BREAKTHROUGH – AN OPPORTUNITY FOR HIGH-GROWTH, INNOVATIVE FIRMS?

In its March 2021 Budget, the Government announced the launch of a new UK-wide scheme (known as "Future Fund: Breakthrough"), which seeks to encourage private investors to co-invest with Government in high-growth, innovative firms. Launched in summer 2021, the £425m Future Fund: Breakthrough is run by the BBB's British Patient Capital arm (see above) and has committed about £134m into 18 companies. It enables the BBB to take direct equity in companies, on the same terms as other private investors. The fund focuses on R&D intensive companies that are UK based and with significant UK operations. Future Fund: Breakthrough will only participate in minimum investment round sizes of £20m, and the maximum Future Fund: Breakthrough share of a funding round is 30%, meaning that the minimum amount of private sector funding in a round would need to be around £14m.

The "Breakthrough" element of the fund's name derives from the focus on companies that seek to accelerate the deployment of breakthrough technologies that can be transformative to major industries or in the development of new medicines. As a result of high R&D costs, such breakthrough technology companies often require more capital and investment than other technology companies to launch the later stages of their growth. Future Fund:

Breakthrough is not available for companies looking to develop or employ products with a short time-to-market, as there is perceived to be a sufficiently strong private sector market for such investments.

In addition to the fundraising round size requirements, various conditions need to be met for a company to be eligible:

- the company receiving investment should be UK based (UK incorporated) with significant UK operations (meaning at least half of its overall employment base and half of its research employees are based in the UK);
- the company must be carrying out R&D activity in the UK by meeting all of the following criteria:
  - R&D spending must have been at least 10% of total operational cost base on average over the last 3 years or at least 15% in one of the past 3 years;
  - the company must be developing defensible IP in the UK which is expected to be the company's main revenue source;
  - the company must intend that 20% or more employees will be carrying out research for at least 3 years from the date of investment, in roles that require a relevant master's degree or higher; and
- the company must have raised at least £5m of equity investment from third-party investors in previous funding rounds in the last five years.

In focusing on later stage financing rounds there is not the equivalent rigid set terms for investment that were involved with the Future Fund. Previous participation in the Future Fund does not impact eligibility for the new fund.

Applications for Future Fund: Breakthrough can only be made via a sponsor investor, which needs to be:

- any fund managed or advised by an FCA (or equivalent) authorised firm with private sector investment making up greater than 50% of the total fund size and who is currently managing an active fund greater than £100m (and meeting certain other criteria);
- any fund or investment vehicle with an appropriate investment strategy, managed or advised by a fund manager which has applied to and obtained an investment from a member of the British Business Bank group; or
- other equivalent investment vehicles i.e. those with greater than £100m of investment capital, a broad range of independent investors, and an appropriate investment strategy (where these have been approved by Future Fund: Breakthrough).



## REFERENCES AND OTHER LINKS

- Guide to Venture Capital Trusts:  
<http://www.theaic.co.uk/guide-to-investment-companies/venture-capital-trusts-vcts>
- Guide to Enterprise Capital Funds:  
<https://www.british-business-bank.co.uk/ourpartners/enterprise-capital-funds/>
- Innovate UK :  
[www.gov.uk/government/organisations/innovate-uk](http://www.gov.uk/government/organisations/innovate-uk)
- EIS & SEIS Tax Relief on Share Investments – For Individual Investors:  
<https://www.gov.uk/guidance/venture-capital-schemes-apply-for-the-enterprise-investment-scheme>  
<https://www.gov.uk/guidance/venture-capital-schemes-apply-to-use-the-seed-enterprise-investment-scheme>
- For detailed HMRC commentary on the schemes:  
<https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual>
- R & D Tax Credits:  
<https://www.gov.uk/guidance/corporation-tax-research-and-development-rd-relief>
- The following general guide to business finance is provided by the Corporate Finance Faculty of the Institute of Chartered Accountants in England & Wales, and the British Business Bank:  
<https://thebusinessfinanceguide.co.uk/partners/>
- British Patient Capital:  
<https://www.britishpatientcapital.co.uk/>
- For more information on OBN's ITAG look here:



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- **Venner Shipley LLP** for assistance with “The Patent Box”: [www.vennershipley.co.uk](http://www.vennershipley.co.uk)
- **BDO LLP** for contributions to content, artwork and printing <https://www.bdo.co.uk/en-gb/industries/life-sciences>

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# APPENDIX

## FURTHER DETAILED POINTS

This Appendix picks up on some more detailed technical areas of funding which may only arise in specialist situations.

### **CONVERTIBLE DEBT PAYING INTEREST IN SHARES – THE FUNDING BOND RULES**

Companies can raise debt from various sources including convertible loans. They may be secured or unsecured.

The terms of convertible loans in turn can be myriad and are largely dictated by the lender. Interest terms again are by negotiation but can include paying interest in shares or cash at the borrower's/lender's option. It is a judgement call at the time as to whether it is in the corporate borrower's interests to deplete its cash reserves.

Where the UK company has the option to pay "interest" in the form of shares, rules are in place from HM Revenue & Customs ("HMRC") to accommodate the tax treatment of such. These are known as the Funding Bond rules.

At the date of settlement by the corporate borrower of the interest (as with a cash interest payment) the company must provide an interest certificate to the lender. The certificate must show the cash value even though shares are issued in settlement. N.B. Even if the borrower elects to pay the lender's interest in shares the borrower has the option of paying HMRC in either cash or shares.

Example:

Loan for 1 year with 10% interest:	£100k
Conversion rate:	£1 of debt = 1 share
<b>Interest due:</b>	<b>£10k</b>

For payment to individuals, trusts, partnerships, and overseas investors the company must deduct UK withholding tax at the basic rate of income tax, currently at 20%. Double taxation arrangements may apply to overseas lenders in some jurisdictions, see below:

On conversion where withholding tax applies:

- 100,000 shares are issued to settle the debt (converted at £1 per share)
- 8,000 shares are issued to the lender in settlement of the interest (converted at £1 per share)
- 2,000 shares are issued to HMRC in settlement of the interest. This represents the 20% withholding tax. The shares are paid to HMRC under the quarterly return procedures by the borrower.

### **Valuation of the interest shares**

HMRC has a specialist valuation unit which will want to value the shares they receive for interest, albeit that this may take place sometime after the issue of the shares. This may give rise to a difference to the amount of interest shown on the certificate. The interest shown on the certificate is the specified value of the convertible transaction.

### **Withholding tax/Double taxation**

Whether interest is paid in cash or shares overseas lenders may be based in a jurisdiction that enables them to make a reclaim from HMRC of some or all of the shares lodged with them in the form of UK withholding tax. The reclaim process differs from country to country and the lender would need to take specific advice'

As with most investments it is recommended that professional advice is sought.

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