

From: Mike Whiting
Cabinet Member for Economic Development

To: Governance and Audit Committee

Date: 8 October 2020

Subject: Regional Growth Fund, Discovery Park Technology Investment Fund & Kent Life Sciences Fund

Classification: Unrestricted

Summary and Recommendation

This report provides an update and summary of the RGF equity investments made by KCC since the RGF programmes were launched in April 2012.

The Committee is invited to note the report.

1. Background

1.1 Between 2012/13 and 2015/16 the Department of Business, Innovation and Skills (BIS) allocated £55 million from the Regional Growth Fund (RGF) to KCC to deliver three schemes:

- Expansion East Kent (£35 million for projects in East Kent)
- Tiger (£14.5 million for projects in North Kent and Thurrock)
- Escalate (£5.5 million for projects in West Kent and parts of East Sussex)

1.2 These RGF schemes provided funding for loans, equity investments and grants to support businesses with investment plans leading to job creation and growth. When the Department for Business allocated RGF funding to KCC for businesses in East Kent in 2012, business support was generally in the form of grants with State Aid rules governing the maximum grant permitted in each case. KCC's decisions on which businesses should be supported were guided by a detailed appraisal of applications for funding from an Investment Advisory Board whose membership consisted of experienced businessmen and women from across the County. It was concluded early on that it would be more appropriate to provide the RGF support through loans and equity rather than grants. For most businesses, loan finance was provided at 0% interest, with a repayment period of between 5 and 7 years. To encourage repayment, appropriate security was taken against each loan. When the loans were repaid, those funds could be recycled to other borrowers. For some businesses, particularly those with few tangible assets but significant prospects for growth, equity finance was considered more appropriate.

- 1.3 From 2016/17, KCC used the recycled RGF loan repayments to enable the Kent and Medway Business Fund (KMBF) to provide further loans and equity investments ranging between £50,000-£500,000 to eligible businesses across Kent and Medway. The recycled RGF loan repayments were also used to finance the Kent Life Sciences Fund (KLS), a sub-programme of the KMBF scheme.
- 1.4 RGF funds can only be used in accordance with the Government's contract for support for business: they cannot be applied to other KCC uses.

2. The three RGF equity funds: summary

- 2.1 KCC has managed three equity programmes funded from the Regional Growth Fund.

KCC RGF Bespoke Equity Fund (KRBEF)

£3.8 million has been invested in the unlisted equity of 11 companies located across Kent. These investments were funded from the Expansion East Kent, Tiger and Escalate RGF programmes. £140k has been returned to KCC following a sale of shares but two companies are in administration and a further company is dormant. The shareholding in the 8 remaining companies in the portfolio was valued at £1.7 million as at 31 March 2020.

Discovery Park Technology Investment Fund (DPTI)

£5.1m investment has been made in the unlisted equity of 8 companies located in Discovery Park in East Kent. These investments were funded from the Expansion East Kent programme. One company has failed and the investment of £0.6 million has been written off. The shareholding in the 7 remaining companies in the fund was valued at £7.5 million as at 31 March 2020.

Kent Life Science Fund (KLS)

To date KCC has invested £2.3m in the unlisted equity of 6 companies via the Kent Life Science Fund. These investments are funded from the Kent and Medway Business Fund. All six companies are still trading and the shareholding in these companies in the portfolio was valued at £2.5 million as at 31 March 2020.

3. KCC RGF Bespoke Equity Fund (KRBEF): detail

- 3.1 Shares were purchased to the value of £3,763,072 in 11 companies which were early stage businesses, pre-profit and in many cases pre-revenue at the time of the investment. This portfolio consists of high-risk investments in companies judged to have very strong potential to bring significant economic benefit to Kent.

3.2 The KRBEF's mandate is:

- KCC will only make an investment in the company alongside other private sector investors investing *pari passu*.
- KCC will not be the lead in the funding round.
- KCC must only hold a minority shareholding.
- KCC must have the right to appoint an observer or to appoint a board member onto the company board.
- The investment must be made in accordance with state aid legislation and apply the Market Economy Operator Principles (MEOP). The Principles state 'an economic transaction carried out by a public body does not constitute State aid if it is carried out in line with normal market conditions'.

3.3 NCL Technology Ventures (NCL) Ltd has been appointed to manage, monitor and oversee these investments.

3.4 NCL reports quarterly to the RGF Investment Advisory Board which is chaired by a KCC Member and a majority of its members are drawn from the private sector.

3.5 The companies in which KCC has invested present on an annual basis an update on their performance to the Investment Advisory Board.

3.6 The focus of the portfolio is on companies with a strong potential for growth and economic impact in Kent alongside a high return on investment. Private sector investment is required on the same terms as the RGF equity is purchased to meet state aid legislation. The exit strategy is to obtain an acceptable value for the original investment.

3.7 Companies in which the KRBEF has invested can also obtain RGF loans at 0% interest. Two companies in the portfolio have repaid these loans in full.

3.8 There has been one successful exit: KCC accrued £140,000 while retaining shares to an equivalent value in the company which bought the company in which KCC originally invested. The shareholding in the 8 remaining companies in the portfolio was valued at £1,749,707 as at 31 March 2020.

4. **Discovery Park Technology Investment Fund (DPTI): detail**

4.1 The Discovery Park Technology Investment Fund (DPTI) was launched in January 2015 to attract companies to locate at Discovery Park and sites in East Kent.

4.2 NCL was mandated to carry out detailed analysis of each potential company including management structure, financial position and technical analysis of the product. A full report with NCL's recommendations is presented to the RGF Investment Advisory Board (IAB) by NCL. Representatives from those

companies are invited to present their proposals to the IAB once the due diligence investigations have been completed.

- 4.3 The investment structure consists of a beneficiary holder of the shares, a special partner (NCL) and general partner (NCL). This ensures the fund operates under FCA regulations and is a structure that replicates existing Venture Capitalist funds. This allows for private sector funding of the equity alongside KCC's funds.
- 4.4 The mandate for the DPTI is:
- KCC will only permit an investment if there are other private sector investors investing *pari passu*.
 - NCL acting on behalf of KCC may take the lead role in the funding round to acquire other investors.
 - The fund must only hold a minority shareholding.
 - NCL / KCC must have the right to appoint an observer or to appoint a board member onto the company's board,
 - The investment must be made in accordance with state aid legislation and apply the Market Economy Operator Principles (MEOP). In commercial terms this means the investment of public funds must be made in line with normal market conditions. As the Principles state 'an economic transaction carried out by a public body does not constitute State aid if it is carried out in line with normal market conditions'.
 - The company receiving investment must be located in Discovery Park or relocate to Discovery Park.
- 4.5 £5,101,713 has been invested in 8 companies in the DPTIF portfolio. An exit strategy has been prepared for each investment and varies from three to ten years. One company has subsequently gone into administration. The shareholding in the 7 remaining companies in the fund was valued at £7,450,397 as at 31 March 2020.

5. Kent Life Science Fund (KLS)

- 5.1 Kent Life Science Fund (KLS) was launched in 2017 to attract companies in the life sciences sector to locate in Kent.
- 5.2 NCL was mandated to carry out detailed analysis of each potential company including management structure, financial position and technical analysis of the product. A full report with NCL's recommendations is presented to the RGF Investment Advisory Board (IAB) by NCL. Representatives from those companies are invited to present their proposals to the IAB once the due diligence investigations have been completed.
- 5.3 The investment structure consists of a beneficiary holder of the shares, a special partner (NCL) and general partner (NCL). This ensures the fund operates under FCA regulations and is a structure that replicates existing

Venture Capitalist funds. This allows for private sector funding of the equity alongside KCC's funds.

5.4 The mandate for KLS is:

- KCC will only permit an investment if there are other private sector investors investing *pari passu*.
- NCL acting on behalf of KCC may take the lead role in the funding round to acquire other investors.
- The fund must only hold a minority shareholding.
- NCL / KCC must have the right to appoint an observer or to appoint a board member onto the company's board,
- The investment must be made in accordance with state aid legislation and apply the Market Economy Operator Principles (MEOP). In commercial terms this means the investment of public funds must be made in line with normal market conditions. As the Principles state 'an economic transaction carried out by a public body does not constitute State aid if it is carried out in line with normal market conditions'.
- The company receiving investment must be located or seeking to relocate in Kent.

5.5 £2,325,000 has been invested in six companies in the KLSF portfolio. An exit strategy has been prepared for each investment and varies from three to ten years. All six companies are still trading and the shareholding in these companies in the portfolio was valued at £2,527,974 as at 31 March 2020.

6. **Conclusion**

- All three equity programmes are still in their early stages and it is anticipated that some of the investments will not show a positive return on investment for another 3 to 5 years.
- The exit strategy is different for each investment.
- There are early signs of increased value of shareholdings in some of the investments. However, the short to medium term impact on investments caused by the Covid-19 pandemic is unclear.
- The Investment Advisory Board receives quarterly reports on the performance of all the companies and an independent valuation from NCL.
- The independent valuation of the RGF investments in the three funds as at 31 March 2020 show a net increase in value of £678,293 above the original cost of the investments. It should be noted that the value of these investments could rise or fall in future, but all of them have already had a significant impact on the economy of Kent.

7. Recommendation

The Committee is invited to note the report.

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