

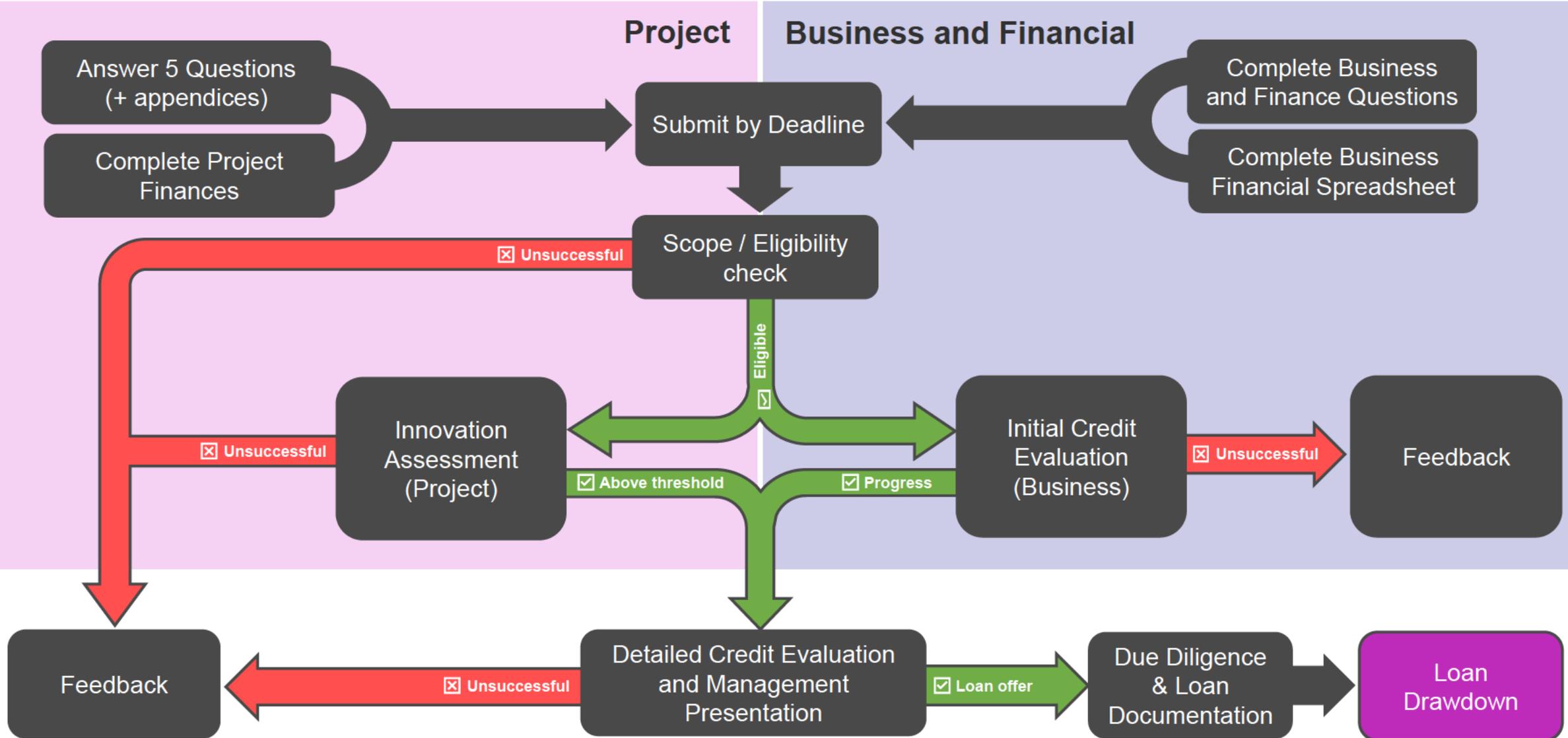


Innovate  
UK

# Innovation Loans Credit Evaluation Process



# Application Process



# What are we looking for?

We are looking for businesses who can demonstrate that their innovation activities have the best potential for future growth

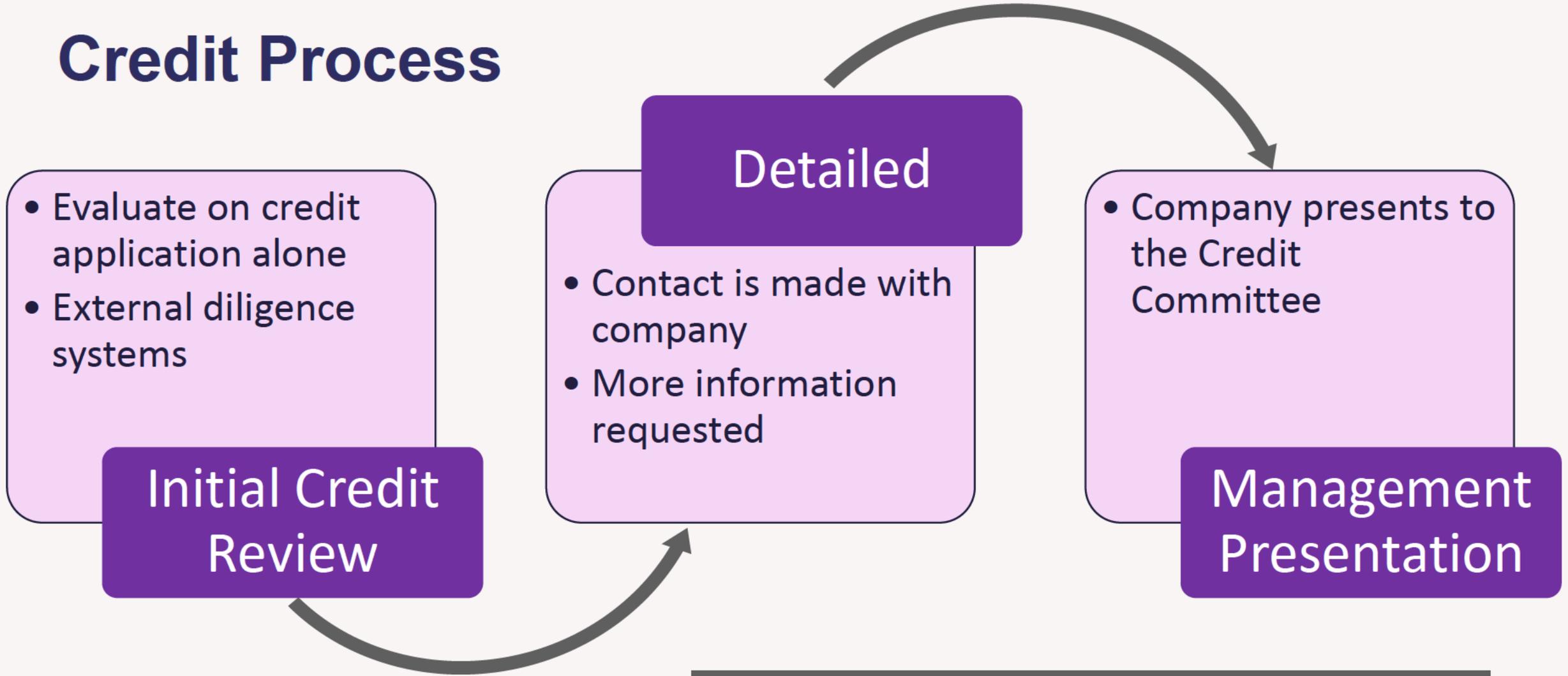
Your application will be evaluated on:

- the quality of your project
- our judgement on the suitability of your business to receive a loan

We look for applications that show:

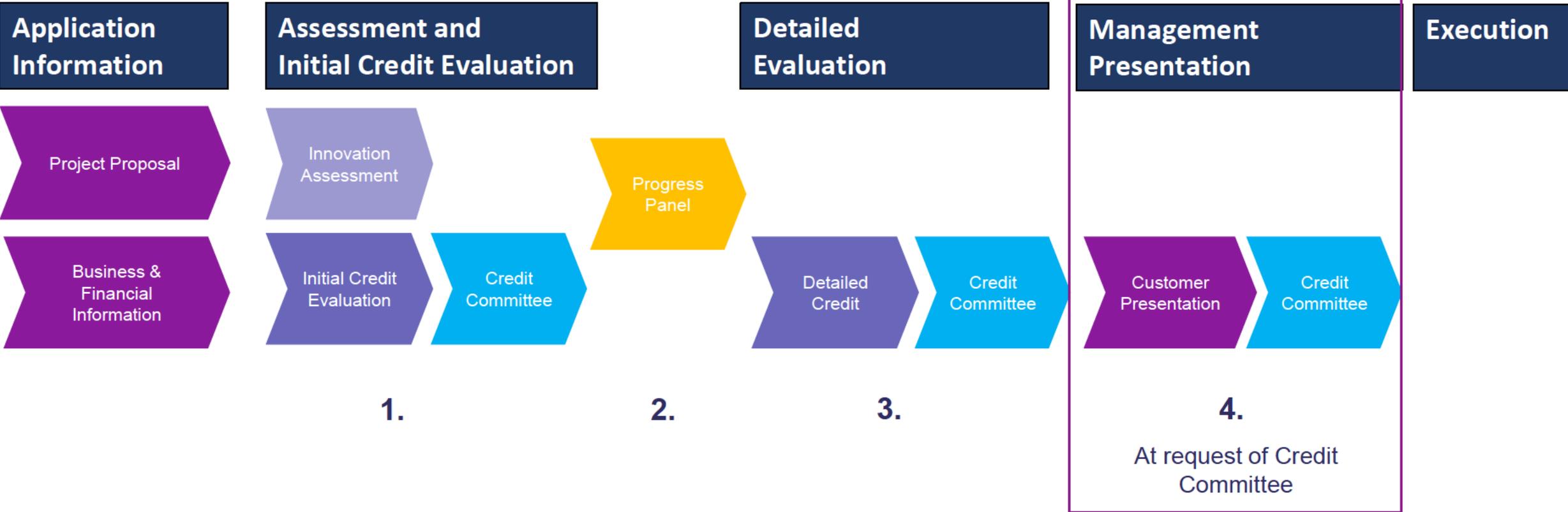
- an appropriate and evidenced borrowing proposal from a suitable business
- a high quality later-stage R&D project
- a clear route to commercial success
- a strong management team
- why you need additional public funding in order to be able to carry out your project
- why you are unable to fund the project from your own resources or other forms of private-sector funding

# Credit Process



At each stage Credit Committee will provide the final decisions whether to progress or to decline.

# Overview



- Customer input
- Independent assessment
- Credit evaluation
- Decision point
- Combined decision point

# Credit evaluation



# 1. Initial Credit Evaluation

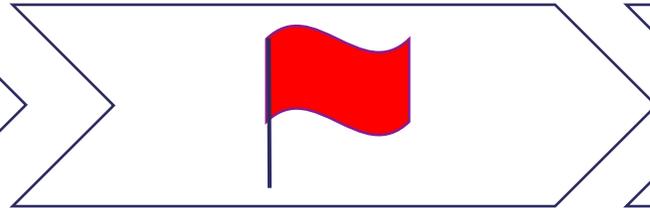
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## Full / Limited review

Early Metrics independent ratings methodology scores an applicant's business answers out of 100. We assign a credit risk rating based on an internal methodology. We identify any <40% and below CCC+ for a low scoring review.

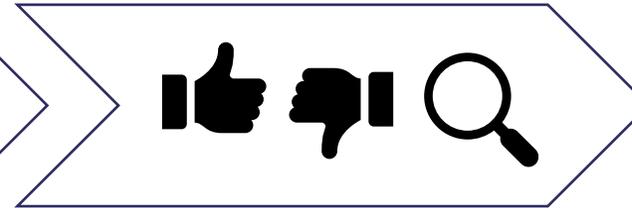
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## Due diligence

We conduct a number of flag checks identifying amber and red risk factors. These are sourced from internal and public sources. Cumulative ambers can mark down a case. Red flags result in a decline.

3



## Strengths / Weaknesses & High level financial analysis.

The whole application is marked for positives and negatives, forecast covenant adherence, liquidity and capital strength. A final report is prepared for decision at committee.



# Full / Limited review



## Early Metrics

Benchmark is usually 40%

Early Metrics Score: 32%



Team & company structure: 33%



Technical & product development: 49%



Finance & Funding: 32%



Commercial activity: 22%



## Manual Underwriting

CCC generally is outside appetite.

BBB	BB	B	CCC
<ul style="list-style-type: none"> <li>Revenue generating</li> <li>Operating profits</li> <li>Surplus cash</li> <li>Additional equity being raised upfront</li> </ul>	<ul style="list-style-type: none"> <li>Revenue generating</li> <li>Operating losses</li> <li>Sufficient cash on balance sheet</li> <li>Follow on equity being raised</li> </ul>	<ul style="list-style-type: none"> <li>Minimal revenues</li> <li>Insufficient cash on balance sheet</li> <li>Additional equity required above what is in application</li> </ul>	<ul style="list-style-type: none"> <li>No revenues</li> <li>Inadequate capitalization</li> <li>Inadequate funding strategy</li> </ul>

Companies with revenue generation

S&P	Term (Years)							SME Descriptors
	1	2	3	4	5	6	7	
BBB+	0.1%	0.3%	0.6%	0.8%	1.1%	1.4%	1.7%	Likely to provide limited additionality
BBB	0.2%	0.5%	0.8%	1.2%	1.6%	2.0%	2.4%	
BBB-	0.4%	1.1%	1.7%	2.4%	3.1%	3.7%	4.3%	
BB+	0.9%	2.0%	3.1%	4.2%	5.3%	6.3%	7.1%	SME is <b>ADEQUATE</b> capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments.
BB	1.6%	3.5%	5.2%	6.8%	8.4%	9.8%	10.7%	
BB-	2.8%	5.5%	7.9%	9.8%	11.9%	13.5%	14.6%	
B+	4.7%	8.4%	11.6%	13.9%	16.1%	17.9%	19.1%	SME is <b>LESS VULNERABLE</b> in the near term than other lower-rated SMEs. However, it faces major ongoing uncertainties and exposure to adverse business, financial, or economic conditions which could lead to the SME having inadequate capacity to meet its financial commitments
B	7.2%	11.7%	15.6%	18.1%	20.7%	22.7%	24.0%	
B-	11.6%	16.6%	21.0%	24.0%	27.1%	29.2%	31.0%	
CCC+	17.4%	23.2%	28.6%	32.5%	36.3%	39.0%	41.4%	SME is <b>MORE VULNERABLE</b> , but the currently has the capacity to meet its financial commitments. Adverse business, financial, or economic conditions will likely impair the SME's capacity or willingness to meet its financial commitments
CCC	26.0%	32.5%	39.0%	43.9%	48.8%	52.0%	55.3%	
CCC-	51.0%	57.0%	62.4%	66.2%	69.8%	72.1%	74.3%	

Outside State aid investment criteria

# Limited review

## EM Rating

EM Average score below 40%



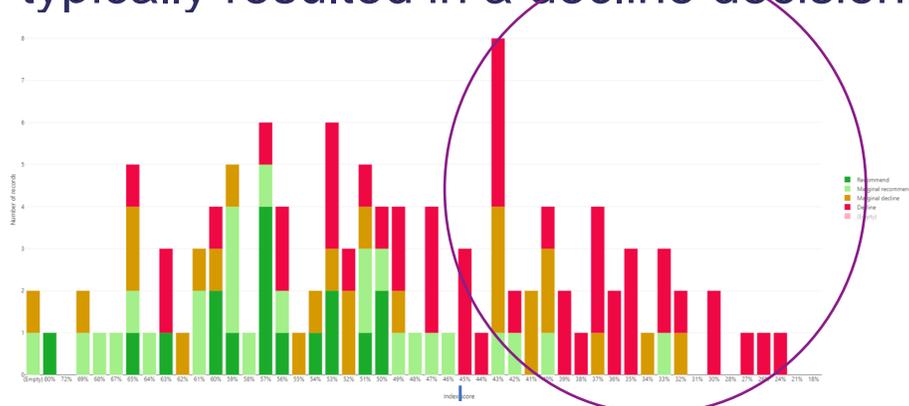
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## Manual Underwriting

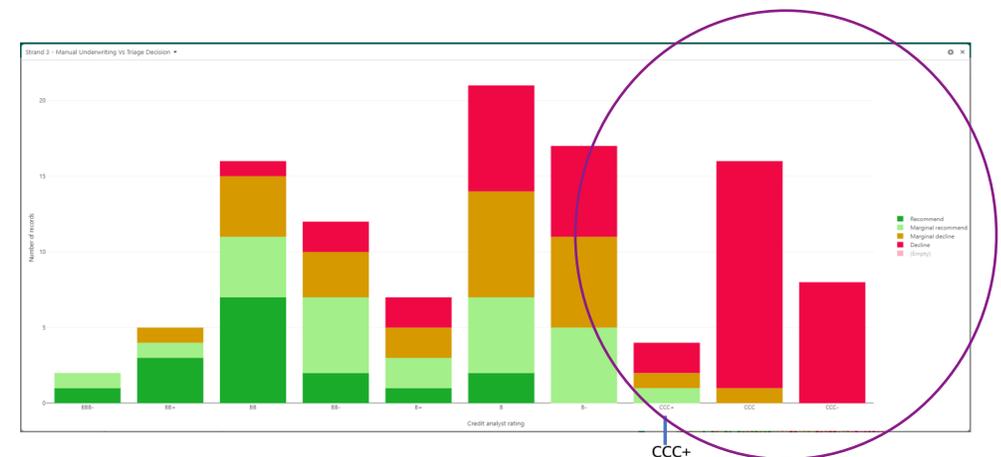


CCC+ or below

The Early Metrics business survey scores a company across team & company structure / technical and product development/ finance and funding and commercial activity. Back testing of the data found those which scored cumulatively <40% typically resulted in a decline decision.



Given the nature of the applicants they typically do not have a formal credit risk rating. In this instance we assign one based on our internal methodology. CCC+ and below mean no revenues, inadequate capitalisation, inadequate funding strategy.



# Limited review

Applicants that have been identified early in the credit analysis process as being of potentially lower quality and/ or outside our normal credit risk appetite are not declined outright. These proceed to a low scoring review which is intended to be a less intensive analysis.

- The financials are analysed for typical IUKL covenant compliance – **Liquidity and DSCR.**
- The application is reviewed looking for evidence that would warrant further consideration by the credit committee. There are three areas which are considered key
  1. **Strong management team** – Reviewed as per the lending manual looking for technical qualifications, track record, experience and depth/ breadth.
  2. **Clear route to commercial success** – Has the applicant detailed a strong link to first sales, market entry. This may be through a signed partnerships, offtake agreements and pilots / trials with expected first customers etc.
  3. **Capital or Equity Raises** - Does the applicant indicate in the business survey that the business has secured equity investment or will secure it in the next 12 months which has been omitted from the financials.



The credit recommendation is submitted to the delegated members of the credit committee.

# Flag checks.

0 2

**Eligibility:**

Funding Amount: **True**    Organisation Type: **True**    Non UID: **False**    Eligible project costs: **True**

Submitted both parts A & B: **True**

**Triage Check:**

Status: 	Directors: 	Adverse Data: 
No liquidation / Winding Up? <b>True</b>	No disqualified? (At level of undertaking) <b>True</b>	No CCJ's >£5K satisfied, or >£500 unsatisfied. <b>True</b>
No proposal to strike off? <b>True</b>	No individual IVA or bankruptcy sanctions? <b>True</b>	No CCJ's <£5k that are satisfied? <b>True</b>
UK Incorporation? <b>True</b>	Business has more than one director? <b>False</b>	There are no CCJ's <£500 that are unsatisfied? <b>True</b>
<b>Establishment:</b>	No linked entities (inc directorships) in administration? <b>True</b>	No evidence of litigation re the public purse? <b>True</b>
Dormant or yet to be established? <b>True</b>	Directors / shareholders in application match companies house? <b>True</b>	No evidence of other ongoing litigation? <b>True</b>
Three years old (or will be in 12 wks)? <b>True</b>	No directors associated or employed with IUKL/IUK? <b>True</b>	No evidence of sanctions re the business? <b>True</b>
	No PEP's have been identified? <b>True</b> <small>*No impact on flag result</small>	Rating -Unadjusted Moodys rating is between BBB and CCC+? <b>True</b>

**TOTAL COUNT: Amber Flags: 2    Red flags: 0    Result - Validate analyst triage recommendation**

Utilises internal and external data sources

In this case the two amber flags identified did not adversely affect the decision

# Positives & Negatives / High level financial analysis.

## Positives & Negatives

Positives:	Negatives:

Sourced from the application and any other sources available.

## High level financial analysis

- Interest cover ratios / Debt service cover ratios
- Liquidity / Affordability
- Liquidity and Leverage ratios
- Cashflow comments

Comments are made on the following areas based on current & forecasted positions.

## 2. Progress Panel

If an application is recommended and above the innovation quality line (typically 70%), it proceeds.

Recommend

Marginal  
Recommend

If an application is marginally recommended and not in the bottom quartile of those above the innovation quality line draw (long run average 74%) , it proceeds.

If an application is marginally declined and in the top quartile of those above the innovation quality line draw (long run average 80%), it proceeds.

Marginal  
Decline

Decline

If an application is declined, it will not proceed (even if it is scored highly on innovation).

If an application is below the quality threshold (c70%) or has a majority of assessors not recommending, it will not proceed (even if it is recommended by Credit).

# 3. Detailed Credit Evaluation

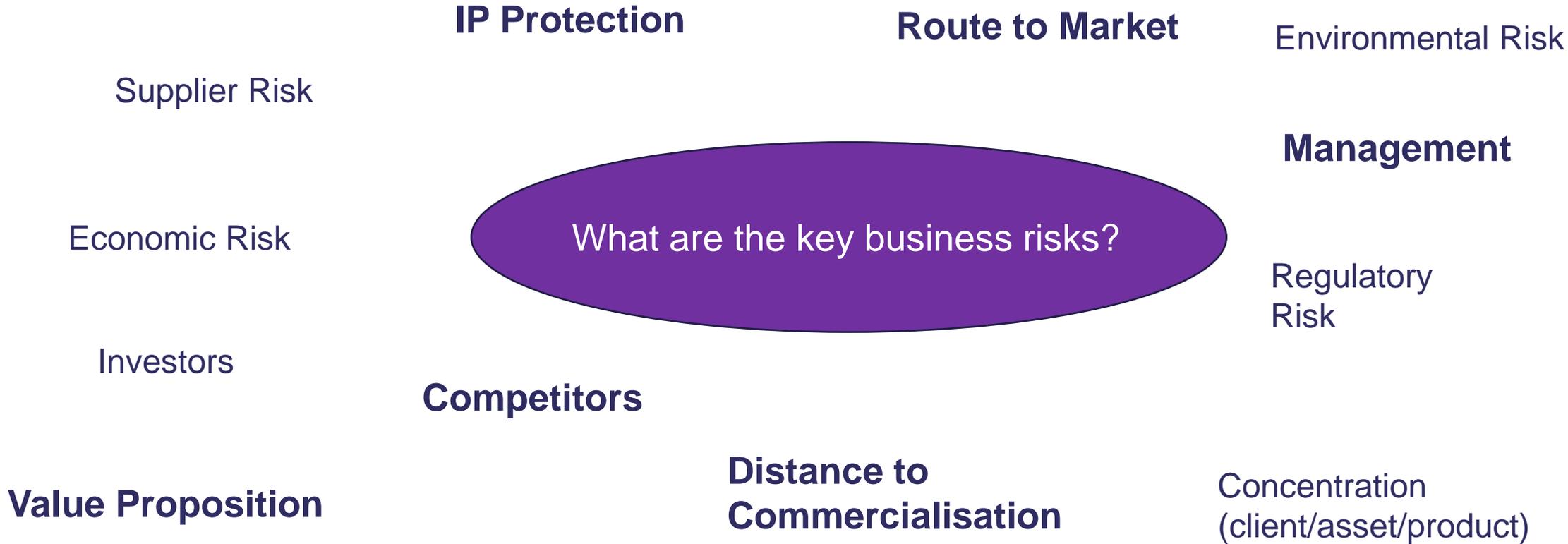


# Credit Risk Analysis

## The 5 'C's of Credit

1. Character (credit history)
2. Capacity to repay (the financial standing of the business)
3. Capital (the equity in the business)
4. Conditions (the terms of the transaction)
5. Collateral (your security)

# Business Risk Analysis

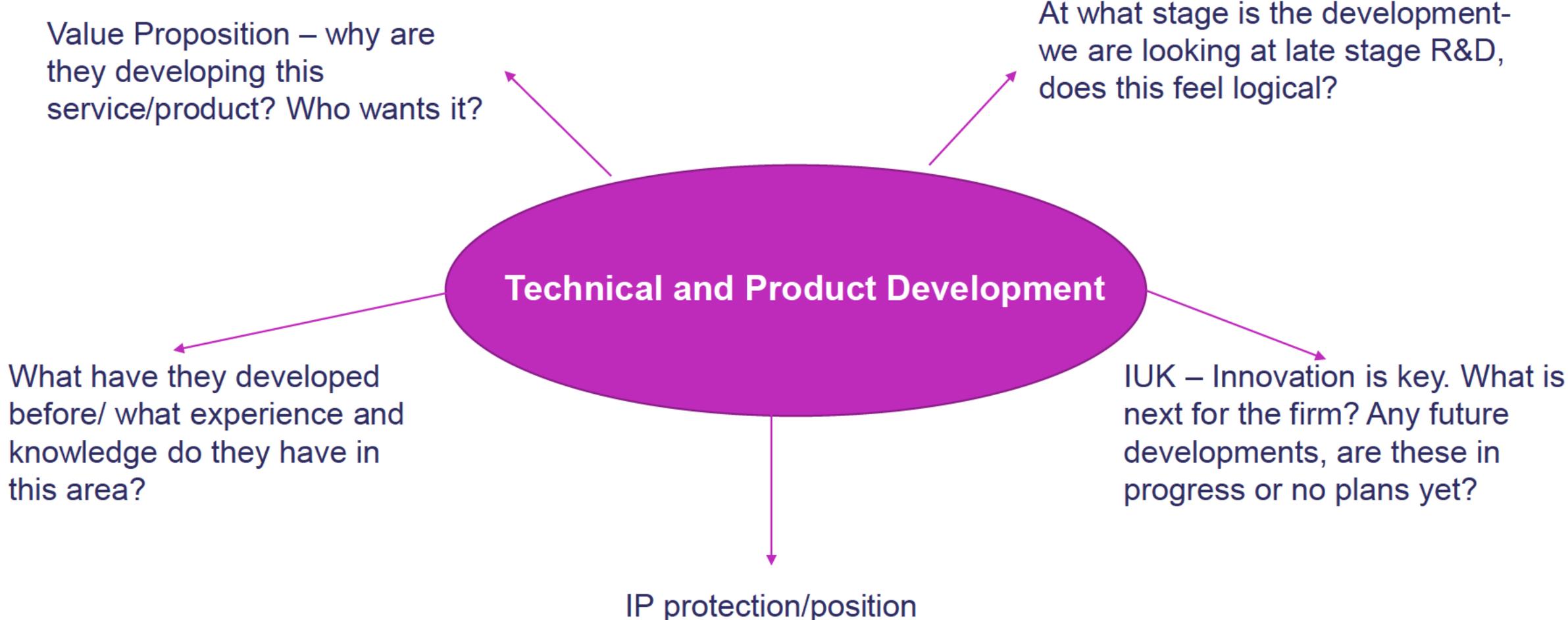


# Team & Company Structure

- Management team – breadth, depth, diversity
- Qualifications
- Technical capability
- Investors
- Experience
- Character
- Associated businesses – past and present
- Location – team, sites and project



# Innovation Risk Analysis



## 4. Management Presentation (Optional Step)

Presentation / Slide Deck



At the discretion of the Credit Committee, applicants are asked to prepare a slide deck which is akin to an investor pitch deck. It covers project, problem, solution, market, competition, business model and financials.

45-minute presentation followed by Q&A.



Applicants present directly to the committee. The opportunity is for them to present why an innovation loan is right for their business and to address any outstanding concerns to the members. They also have to show a thorough understanding of the financials. The committee question and challenge during and after the presentation.

Summary to credit committee.



A summary of the presentation and key questions asked is presented to the full committee. The application is deliberated on for a final time before a decision is made.

Recommend

Decline