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European Innovation Council (EIC)

EIC Accelerator Fund – Pilot

Investment Guidelines

Introduction – EIC Accelerator Fund under the Pilot Phase

As part of the EIC Accelerator, the **EIC Accelerator Fund (EIC Fund)** is a breakthrough initiative of the European Commission (EC) with the support of the EIB Group (EIB). It aims to fill a critical financing gap in the technology transfer (TT) market: the fact that despite the channeling of significant amounts of grant funding to research projects in Europe by EC and national schemes, very few projects subsequently manage to attract equity-type financing and reach the commercialization stage.

The EIC Fund will provide patient capital in the form of equity or quasi-equity (which will be blended with a grant component) to EIC Final Recipient companies with potentially market-creating innovations (whether based on breakthrough disruptive technologies originating from research (deep-tech) or on social innovation), thereby contributing to bridge the gap between innovation and market take-up. The EIC Fund is the first of its kind EU intervention in direct equity-type investments in combination with grants (blended finance).

The EIC Fund's main guiding principles are:

- **Focus on** financing growth prospects of innovative businesses organized as single economic entities (i.e. only **SMEs** are eligible and not consortia, universities, etc.);
- Support selected companies and their projects **through financial structures that are inclusive** (crowd-in) **vis-à-vis private capital**;
- **Diversify** funding **across sectors, member states** and H2020 associated countries, and **company profiles**;
- While keeping **flexibility** to deliver tailored support, develop standardised **financial packages, due diligence processes** and implementation networks **to ensure efficiency, consistency and ability to contract across member state jurisdictions** (including H2020 associated countries);
- Create value through **connections with specialized mentors, ecosystems** and additional funding opportunities;
- **Monitor investments, support investee companies** in subsequent rounds of capital increase, and seek **exits** from such investments;
- **Report** to the governing bodies of the EIC Fund **on an investment portfolio** basis and adhere to the structures and instructions from these bodies, in line with EIC's policy objectives.

<p>1. EIC Accelerator Fund Pilot – Funding components and Process</p>	<p>The EIC Accelerator will initially be composed of:</p> <p>(a) a grant component managed by the EC; and</p> <p>(b) an equity component (an investment in equity or quasi-equity) operated by the EIC Fund with the support of the EIB Group as investment advisor and managed by the EIC governing bodies. In its pilot phase (until 2020) the EIC Fund will have an initial budget of EUR 100m.</p> <p>Candidate companies will apply to the EIC Accelerator through a public call for proposals published by the EC. The EC will collect, evaluate, select and award an indicative grant-only or blended finance support. Following the selection, the EC will initiate the grant agreement preparation and in parallel, will channel proposals selected for blended finance to the EIC Fund for the process regarding the equity component¹</p>
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¹ Investment proposals that have opted for the blended finance option and have been selected by the EC are channeled to the EIC Fund for the equity component [**Step 1**]. The EIB, in its role of Investment Advisor, will undertake due diligence (unless performed by co-investors please refer to Investment Scenarios section in page) [**Step 2**]. The EIB will negotiate and agree on draft financing terms with the

	<p>(due diligence, market assessment, negotiation of the equity agreement, etc.). The grant process may conclude (and the grant be signed) without waiting for finalization of the equity component process.</p> <p>EIC Fund Investment Process (illustrative)</p>
<p>2. Scope</p>	<p>Policy targets: The pilot will focus on capital-intensive policy-priority sectors including clean energy, advanced engineering, life sciences, digital, space, climate action, future mobility and social innovation.</p>
<p>2.1 Type of innovations</p>	<p>The EIC Fund will support different types of innovation, including deep-tech. For the purpose of the present guidelines, deep-tech innovations are those featuring an intense R&D content with interactions between distinct scientific domains and requiring significant levels of patient capital given the high risk involved - offset by a very high gain potential.</p>
<p>2.2 Target company development stage</p>	<p>Pre-Seed, Seed and Early-stage SMEs Eligible applicants are for-profit SMEs, including start-ups and early-stage companies, from any sector with typically a strong intellectual property component. Blended finance support aims to address high-risk projects that are not yet attractive for market players. The EIC Fund will usually invest in companies with no (or very limited) turn-over and negative EBITDA. Growth-stage companies are not within the focus of this pilot phase.</p>
<p>2.3 Geographical scope</p>	<p>Companies established and operating in the EU Member States or Associated countries to Horizon 2020</p>
<p>2.4 Exclusion</p>	<p>The EIC Fund shall not invest in economic sectors which are considered incompatible with the ethical and social basis of the Horizon 2020 mission. Such restrictions are summarised in the Horizon 2020</p>

beneficiary and co-investors (if any), or advise the company in case of alternate investors. The Investment Committee appointed by the EC will examine the due diligence together with the structuring proposal from the EIB [Step 3]. The Investment Committee will recommend financing operations to the EIC Board [Step 4], which will take the final decision [Step 5]. The Investment Advisor will execute the financing contract on behalf of the EIC Fund [Step 6]. The Investment Advisor will undertake monitoring, milestone disbursements, reporting and exit [Step 7].

	Regulation ² including Article 19 (Ethical principles), the EU Financial Regulation ³ including Article 136 (Exclusion criteria and decisions on exclusions) and other applicable legislation.
3. INVESTMENT GUIDELINES	
Summary	<p>The EC will allocate a maximum total funding (grants and equity) of EUR 17.5m to the recipient companies to bring their innovations to the market.</p> <p>Under EC coordination, the timing and conditions for disbursement in tranches (upon achievement of predefined milestones) will be negotiated and managed by the EC for the grant allocations, and by the EIC Governing Body (advised by the EIB) for the equity investments. A material breach of the grant agreement shall prevent the EIC Fund to further invest in a company and eventually lead to exit, and vice-versa.</p> <p>For the purposes of these guidelines, milestones will be meaningful achievements in the development of the innovative project of a company. The funding tranches (grant + equity) shall fund the activities of the company until the expected reach of the relevant milestone.</p> <p>Whenever possible, the EIC Fund will co-invest with other investors, such as VCs, NPBs or corporate venture arms, to crowd in private financing and mobilise additional capital.</p>
3.1 Investment size and equity stake targets	<p>The EIC Fund equity investment (in the form of equity or quasi-equity) will range between EUR 0.5m and EUR 15m per company (to be blended with a grant funding component between EUR 0.5m and EUR 2.5m (EUR 3.5m for the Health sector) directly provided and managed by the EC).</p> <p>The EIC Fund will (when applicable) target minority ownership stakes (from 10 to 25%), and up to a blocking minority in cases identified by the EC as of strategic interest for the EU. It shall avoid situations where it holds majority stakes and control, unless resulting from external and unforeseen circumstances.</p>
3.2 Investment/co-investment scenarios under the EIC Fund	The EIC Fund will put its resources at work in order to connect the potential investee company, with its consent, to the EIC Fund investor community ecosystem to propose co-investment opportunities by interested investors. If the company consents, due diligence and negotiations will be performed by the co-investors.

² https://ec.europa.eu/research/participants/data/ref/h2020/legal_basis/fp/h2020-eu-establact_en.pdf

³ http://ec.europa.eu/budget/library/biblio/publications/2018/financialregulation_en.pdf

	<p>Following an assessment, the EIC Fund will classify the proposals for the Equity Component of the blended finance applications into four types of investment scenarios, translated into the 4 buckets presented below:</p> <ol style="list-style-type: none"> 1. Bucket 1: market shows no interest in the immediate or near future – the EIC Fund (with the support of the Investment Advisor) will perform due diligence on the potential investee and will invests (using equity or quasi-equity instruments) on its own under standard terms. External mentoring will be sought. 2. Bucket 2: market shows no immediate but potential interest in the near future – as for bucket 1, except if the potentially interested co-investors are willing to perform the due diligence. In addition, the Investment Advisor could provide independent advice on potential co-investment opportunities in future funding rounds. Potential co-investors may secure a future investment priority by providing mentoring. 3. Bucket 3: market shows immediate but partial interest in investing into EIC selected companies – the EIC Fund will invest but relying on the due-diligence performed by the potential co-investors. On behalf of the EIC Fund, the Investment Advisor will negotiate the terms with potential co-investors, including mentoring tasks, and will provide independent advice to the company on exiting co-investment opportunities. 4. Bucket 4: market shows immediate interest in investing into EIC candidate companies – in principle no investment to be undertaken by the EIC Fund, which would leave the priority to alternate investment opportunities (based on the independent advice provided by Investment Advisor). The Investment Advisor will connect the potential investee, following its approval, to investor communities using the available ecosystem. <p>While the Accelerator will aim to ensure founder friendly terms to preserve the value of the founders, investor friendly terms will need to be equally considered to attract potential private capital. Moreover, it is of utmost importance that the EIC Fund does not create market distortion and caters for its high-risk target.</p>
<p>3.3 Due diligence process</p>	<p>The due diligence process will focus on the following aspects contributing to the detailed risk assessment of the potential investment:</p> <ul style="list-style-type: none"> ▪ Governance and quality of the company’s management ▪ Capital structure and financial planning ▪ Business strategy ▪ Competition ▪ Market assessment ▪ Alternative sources of financing

	<ul style="list-style-type: none"> ▪ Value creation ▪ Legal form and jurisdictions
<p>3.4 Rejection</p>	<p>Some applications may be dismissed following the due diligence process [Step 1 and 2 in the process chart above] where fraud, misrepresentation, exclusion, ineligibility or non-compliance issues are established. In such cases, any grant agreement that may have been entered into will also be terminated by the EC.</p> <p>The eligibility of the investee company, including any possible fraud, misrepresentation and non-compliance, will be checked at each tranche disbursement (i.e. follow-on investments). Ineligibility may lead to terminate the grant on the EC side, and hence stop any further investment from the EIC Fund and exit from the company.</p> <p>The investment agreement will contain protection clauses for the EIF Fund in case of material breach/fraud, whereby the company will have to fully reimburse/cash settle the financial instrument received from the EIC Fund.</p> <p>Non-compliance issues could be linked to tax, political or integrity aspects. Information provided by the company at application and during due diligence will be assessed in detail.</p>
<p>3.5 Valuation methods</p>	<p>The use of equity or quasi-equity instruments will require discussions on valuation and possible equity stakes in the potential investee companies.</p> <p>Methods for the valuation of the companies could vary case-by-case depending on business models, markets and sectors, technology and other intangible aspects to consider in evaluating a start-up company. For ease of reference, some methods commonly used in the VC market are listed below:</p> <ol style="list-style-type: none"> 1. <u>Multiples of Earnings:</u> For a start-up, it is usually considered a Times Revenue Method (sometimes it could be applied on an expected value). This formula calculates a business's maximum worth by assigning a multiplier to its current revenue. Multiplier benchmarks vary according to industry, economic climate, and other factors. 2. <u>Fair Market Value:</u> it reaches the value of a company by comparing it either to similar businesses that have sold previously or to a peer group of comparable companies listed on the stock markets. 3. <u>Book Value:</u> It takes into consideration the value of the business's equity by taking into account the market value of the assets (not the accounting value in the financial statements), intangible assets (goodwill created at the time of the valuation) minus total liabilities (eventually adjusted if there is a relevant swing in the cost of debt). 4. <u>Price of recent investment:</u> takes account of the valuation used in a recent previous investment in the company, then estimates the current valuation based on the value creation from that reference point.

	<p>5. <u>Discounted Cash Flow</u>: it values a business based on its projected cash flow discounted by a factor (usually the average cost of capital). The result is present value. It is more often applied to companies in growth or mature stage as cash flow generation is needed.</p> <p>6. <u>Other asset-Based methods</u>: among several other asset based approaches there is the liquidation value.</p> <p>The above-mentioned methods are market references for valuation purposes and tools for companies in their negotiations with potential investors. Such negotiations are often time consuming and interfered by intangible factors such as bargaining power, which will significantly influence the valuation. The EIC Fund can provide support and advice to investee companies via the Investment Advisor or external mentors.</p>
<p>3.6 Possible forms of equity-type financial instruments to be used</p>	<p>There are different types of instruments an emerging business may use to finance its growth. The financial instruments used by the EIC Fund will take the form of equity or quasi-equity investments. The terms and conditions will be defined and standardized to the extent possible (adjustments may be needed to reflect business and legal specificities).</p> <p>Standard equity and quasi-equity instruments are summarized as follows:</p> <ol style="list-style-type: none"> 1. <u>Common shares</u>: represent an ownership interest in a corporation, including an interest in earnings and dividends. They may be voting or non-voting and may be divided into classes with special voting privileges assigned to each class. In the VC market, founders and management team usually hold common shares. 2. <u>Preferred shares</u>: represent a hybrid in the sense that it is an equity interest with debt-type features such as seniority at dividend payments and liquidation proceeds. VC funds usually hold preferred shares. 3. <u>Convertible instruments</u>: like convertible loans, have a convertibility feature attached to a debt instrument that is attractive to the issuing company, since they bear a lower interest rate and postpone dilution. They offer flexibility to investors allowing them to shift the risks and rewards of their investment to some point in the future after the initial investment. 4. <u>Other equity-type instruments</u> appropriate to achieve the objectives of the EIC Fund.
<p>3.7 Investment Implementation</p>	<p>The Investment Advisor will proceed in a timely manner with the execution of the investment. This includes, among others, the identification of the most appropriate financing structure (based on the investee’s needs, development stage, investment plan, jurisdiction and sector specificities), the investment terms negotiations, the availability of third party financing from other sources and the closing of the final investment agreement. The EIC Fund will contract with and finance directly the investee companies.</p>

<p>3.8 Monitoring and follow-up investments</p>	<p>The Investment Advisor will follow up individual investments. This includes monitoring and acting on milestone funding, financing events (conversions, top-ups, etc.), write-downs and restructurings, exit, etc.</p> <p>Roles such as representative or observer on boards of investee companies could be performed by EIC Fund representatives appointed for this purpose (external mentoring). Such details will be discussed on a case-by-case basis during the due diligence and investment process.</p>
<p>3.9 Mentors</p>	<p>The EIC Fund will put the company, with its consent, in contact with its network of mentors, which could also be potential investors, in order to provide advice and recommendations for the business development of the company and for any potential corporate actions.</p>
<p>3.10 Duration of the investment and exit strategy</p>	<p>The EIC Fund will invest patient capital, with a long average perspective on return on the investment (7-10 years) with a maximum of 15 years. There are no pre-defined levels of returns sought (this will be examined on a case-by-case basis) – the EIC objective being “impact investment” rather than maximizing return on the investment.</p> <p>The exit strategy for each company is to be set on a case-by-case basis given the specificities of each business plan, industry, expected holding period as well as the development of the companies compared to the initial milestones set. Exit routes may include IPOs, management buy-outs, secondary sales or liquidations.</p>
<p>4. Intellectual Property management and European Union interests</p>	<p>EIC Accelerator projects benefiting from blending finance, hence from EU equity (buckets 1 to 3), will be exempted from Horizon 2020 obligations on Intellectual property (except if the operation is terminated by anticipation). Within applicable national legislation, the investee and co-investors should be given maximum autonomy regarding IP management, to the best interests of the deployment of the innovation and the companies development, so as to attract further investments to scale-up and allow for an effective exit strategy for the EIC Fund.</p> <p>Yet, and in particular but not only in the cases where strategic interests of the Union are at stake and the EIC Fund acquires a blocking minority, the Investment Advisor will seek to secure European ownership of IP and of the company wherever it makes sense for its development. The same guiding principle will apply for exit from investees.</p>