



UNISEED MANAGEMENT PTY LIMITED
ACN 103 546 014

www.uniseed.com

dr peter devine
CHIEF EXECUTIVE OFFICER
p.devine@uniseed.com

Uniseed Response to Exposure Draft Explanatory Materials

Uniseed welcomes this policy initiative as an essential stimulus to technology innovation in Australia. However we would like to stress that the majority of tomorrow's technologies will emanate from publicly funded research organisations (PFRs) and that under the proposed 50% exempt entity ownership limit the majority of these companies **will not** receive a 45% refundable tax offset, but rather a 40% **non-refundable** tax offset (Exposure Draft Explanatory Materials 1.24). This is of little use to these early stage companies as they are not generating revenue and are at a stage in the development cycle where cash is limited.

Spin-outs from PFRs are critical in providing a pipeline of opportunities and effectively seeding innovation. These companies bear the brunt of the early developmental risk as they are at the earliest stage in the funding cycle. Consequently, these companies find it more difficult to raise funds.

Under the proposed scheme, this high risk R&D investment will not be eligible for an R&D Tax Credit which will disproportionately disadvantage these companies. Furthermore, investors will be discouraged from making riskier early stage investments, as their effective cost of capital would be increased relative to later stage deals. The overall effect is that innovation in Australia will be stifled, with a bottleneck at this early stage. That is, an 'innovation gap' will occur between research at PFRs and the investment market.

It is important to note that relaxation of the 50% limit on ownership and group turnover rules will only have small impact on the Government's taxation revenue, yet a major impact on the competitiveness of R&D intensive start-ups, as the typical investment at this stage is less than \$500,000. When these early stage companies achieve milestones and successfully raise follow-on capital, exempt entity ownership limits would fall below 50% through follow-on investment by other (later stage) investors. Consequently, it is during the first (seed) rounds of investment that the company is unable to draw on the R&D Tax Credit, which is arguably the time that the company needs this most.

We understand that a 50% limit may have been proposed to prevent PFRs funding their own start ups and then receiving a tax credit. Consequently, we urge the Government to remove the 50% exempt entity ownership limit and introduce the criteria that start-ups emanating from PFRs have received external funding. It is noteworthy that these start ups are not eligible for traditional university support through public programs such as the ARC or NHMRC. Removing of the 50% limit will ensure high risk early stage companies will not be disadvantaged.

Peter Devine, PhD MBA FAICD
Chief Executive Officer
Uniseed Management Pty Ltd

Appendix: PFRO Spin-Out Company Formation

University Intellectual Property (IP) Policy

Most universities in Australia operate under an agreement whereby the commercialisation/technology transfer office/holding entity of the university (e.g. UniQuest) holds equity in a start-up company on behalf of the university.

Company Incorporation

Investments in university start-ups are typically made into an incorporated company limited by shares. It is noteworthy that these companies are not eligible for public support through programs such as the ARC and NH&MRC.

License to the Initial Intellectual Property

The typical university spin-out investment is based on intellectual property (IP) owned by university. Most commonly this IP relates to one or more patent applications which are the result of the inventive work of the university's researchers.

These patents are made available to the company through the establishment of a license between the spin-out company and the University, or to be precise, the holding entity of the University.

The license would normally be world-wide and exclusive and hence provide sole access to the company to commercialise the IP. The University would also usually be granted back a sub-licence giving it the right to continue research in the field unimpeded. The start-up company would usually bear the costs of prosecuting the patents whilst the license is in force.

Due to the amount of research funding required to develop IP to a stage where investment is justified, university technologies are typically valued above \$500,000 at the time a company is incorporated or an investment is secured.

The University (or its holding entity) receive a payment of the IP value (>\$500,000) for licensing the IP to the start-up company. In return, the university (or its holding entity) apply for equity in the company – usually to the value of the IP license. The university typically receives Ordinary shares in the start-up company.

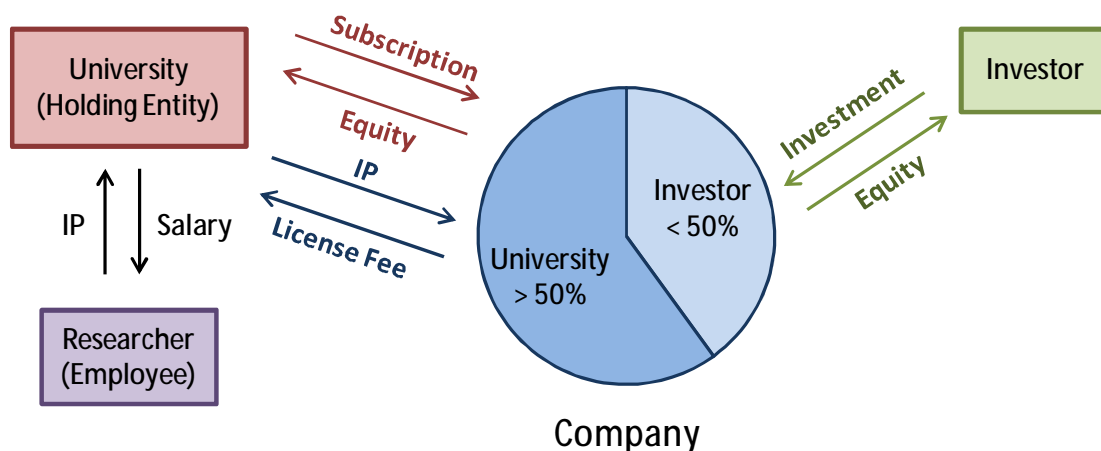
Seed Investment

Due to the early stage of investment, the investor is usually the only investor in the start-up, with the investment made for Preferred equity in the company. Typically, an investor such as Uniseed would invest less than \$500,000 in milestone based tranches.

In addition, many funds typically invest through a unit trust structure. It is noteworthy that these trusts cannot hold >50% of the equity in the start-up as trading trust provisions would be triggered, and the trusts would lose their flow-through tax status.

Consequently, after investment, the shareholders in the company are the investor (<50% equity) and the University holding entity (>50% equity).

The diagram below illustrates a typical university start-up:



Intellectual Property – Assignment

The IP license includes a provision for assignment of the intellectual property at a later stage, usually on the basis of certain milestone(s) being achieved. These milestones may be an event such as demonstration of a pivotal research result, listing on an exchange or reaching a threshold of total capital raised (\$1m being a typical amount so as to trigger assignment at the next round of investment).

New Intellectual Property

Any new IP developed through the seed investment is owned by the company. Thus over time it is common that the company's intangible assets would include a mix of the initial patents and those developed within the company itself.

Commercialisation Funds and PFROs

Commercialisation funds play a crucial role in seeding investments from PFROs in Australia and bridging the gap between academic research and the traditional investment markets. That is, these funds invest at the earliest and most risky stage – the investment leading to start-up formation. Consequently, the activity of these funds contributes directly in regard to the case for R&D tax reform – that an effective R&D tax incentive needs to result in firms conducting R&D that they would otherwise not perform because they cannot capture sufficient benefits from the activity to justify an investment.

These funds are characterised by an investment partnership between Australian superannuation funds and public research organisations. The funds operate as a stand-alone entity, with investment decisions made independently of the university partners.

Today, all major Australian (Go8) universities and major research organisations are associated with a fund of some sort, examples being Uniseed (Universities of Queensland, Melbourne and New South Wales), the Trans-Tasman Fund (Auckland, Adelaide and Monash Universities) and the Medical Research Commercialisation Fund (MRCF) (over 25 medical research institutions in Victoria, NSW, Queensland and Western Australia). Effectively, these funds now play the role that the Federal Government's Pre-Seed Fund (PSF) was designed to deliver.

Commercialisation Fund Example: Uniseed

Uniseed, established in 2000, was the first fund of this type in Australia. Uniseed is a \$61 million commercialisation fund operating at the Universities of Queensland, New South Wales and Melbourne. Since it was established, Uniseed has evaluation over 200 potential investment opportunities and made 38 investments across a range of technology sectors including biotechnology, cleantech, materials science and IT, with three investments exited through trade sale or IPO. Uniseed has committed over \$28 million to these start-ups, and this commitment has generated over \$250 million of investment from venture capital firms and other investors.

Unit holders in the Uniseed trusts are Westscheme (Western Australia's largest non-government superannuation fund) and the three universities in which Uniseed invests. These four unit holders each contribute 25% of the total investment made. Uniseed is a stand-alone entity and makes investment decisions independently of its university shareholders.