# Financing Technology: Trends in debt & equity termsheets

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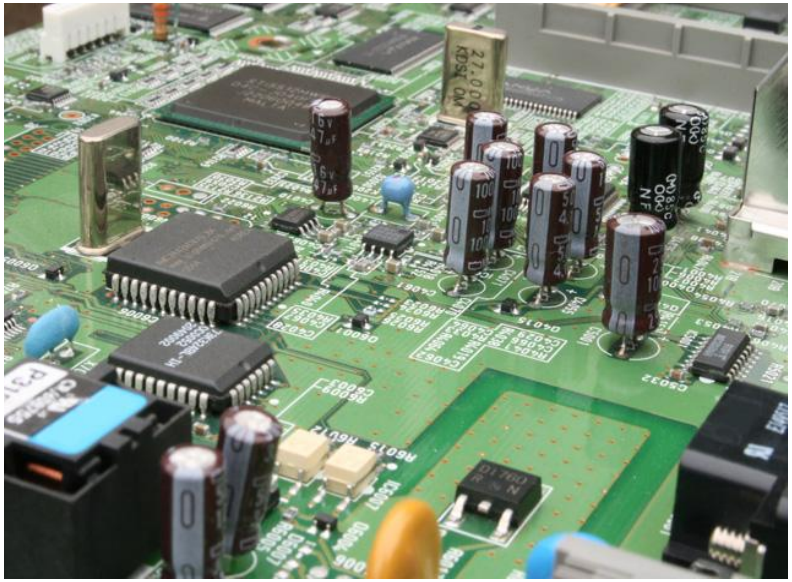
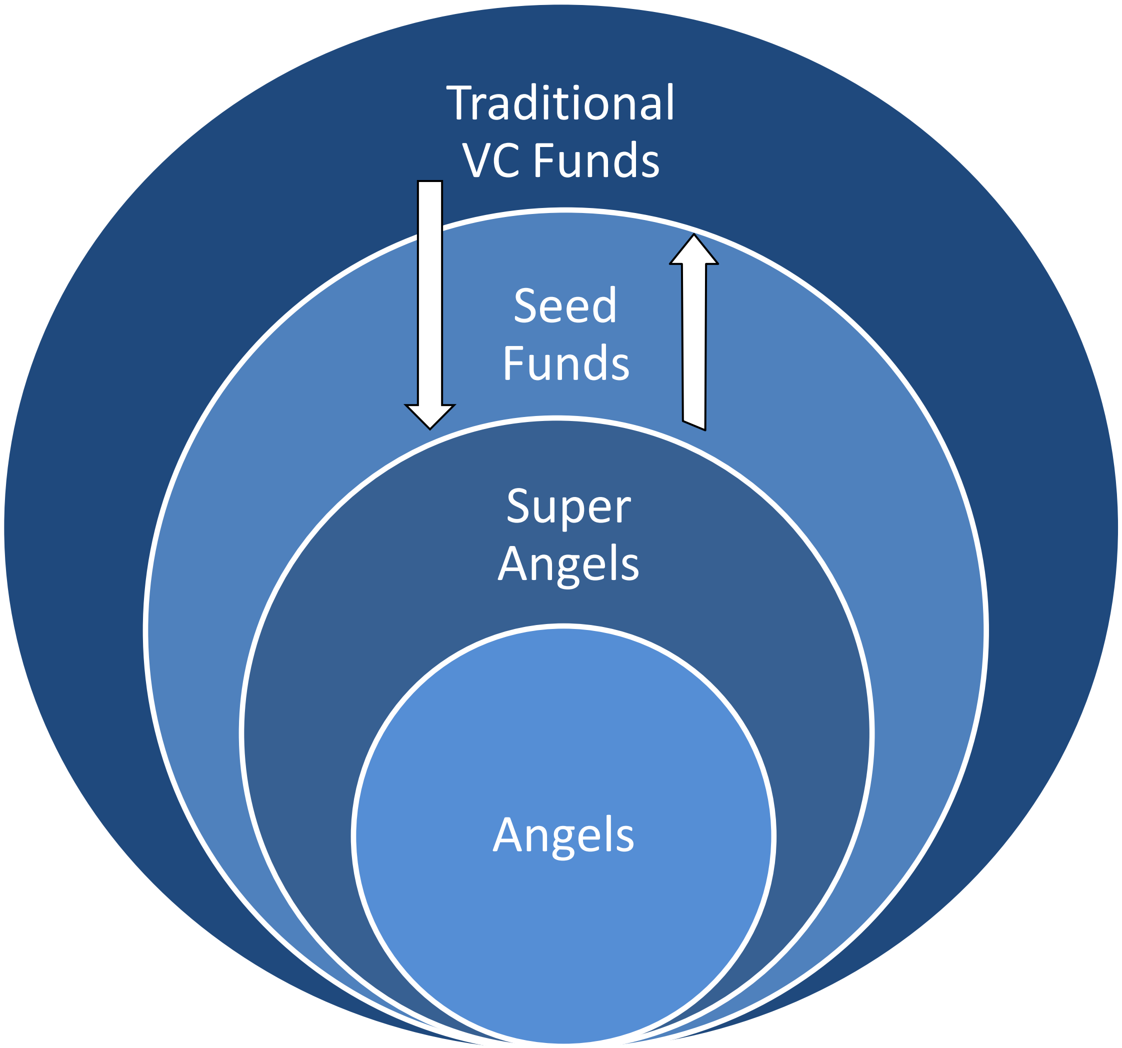
# Technology Risk vs. Market Risk



# Funding sources: the lines are blurring

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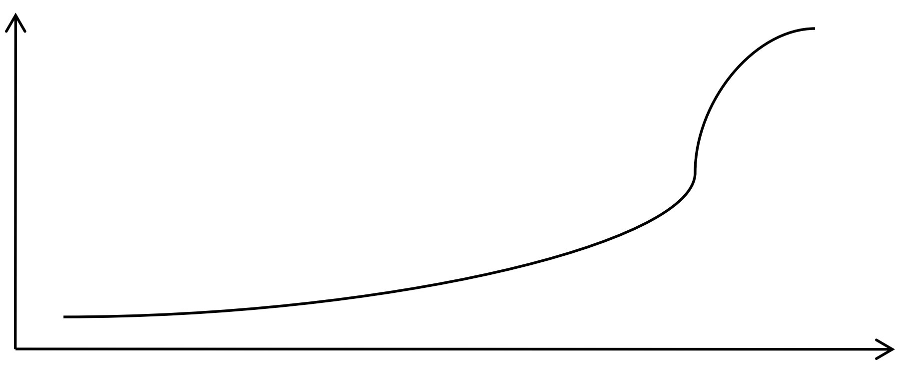
# Debt vs. Equity

**Debt**

- Lower risk: first money to be paid back
- Relatively inexpensive
- First lien on company assets
- Negative covenants

**Equity**

- Higher risk: lives & dies with the company
- Very expensive
- Unsecured (typically)
- BOD governance



# Primary uses of debt

- Financing assets
  - Working capital
  - Fixed assets
- Financing growth
  - Growth capital
  - “Venture debt”
- Special situations
  - Bridge loans
  - Financing “near” assets

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# Think like a lender

The traditional credit model

- Primary source of repayment: cash-flow
  - Question: what is the probability that cash-flow will be sufficient to support operations and repay the loan?
- Secondary source of repayment: collateral value
  - Question: what is the probability that the liquidation value of the assets would be sufficient to repay the loan should the cash-flow prove insufficient?

# Think like a "venture lender"

## A twist on the traditional credit model

- Primary source of repayment: cash-flow from future equity
  - Question: what is the probability that the investors will provide additional equity sufficient to support operations and repay the loan?
- Secondary source of repayment: enterprise value
  - Question: what is the probability that the enterprise value (IP, customer base, licenses, etc.) is sufficient to repay the loan should the venture support prove insufficient?

# Venture debt termsheets

- Uses of capital
  - General corporate purposes
  - Financing specific fixed assets
- Security
  - First priority lien on all business assets
  - Typically a negative pledge on IP
- Structure
  - 6-9 month interest-only draw period followed by ~30-36 month principal repayment
  - Few financial covenants
  - Standard negative covenants (i.e. consents needed for M&A, subordinate financing, changes in management, etc.)
- Pricing
  - Interest rates in the high single digits to low double digits
  - Warrants typically equal to ~0.25-1.00% fully diluted ownership

# Think like a working capital lender

## Another twist on the traditional credit model

- Primary: cash-flow within the working capital cycle
  - Question: what is the probability that the accounts receivable are collectable in a timeframe sufficient to revolve the loan?
- Secondary: collateral value of working capital assets
  - Question: what is the probability that the Bank could collect the accounts receivable and liquidate the other working capital assets after the Company ceases operations?

# Working capital termsheets

- Uses of capital
  - Financing working capital assets such as A/R and inventory
  - Sometimes includes a portion available to finance POs
- Security
  - First priority lien on all business assets
  - Typically a negative pledge on IP
- Structure
  - Revolving line of credit with formula borrowing base (i.e. 80% of A/R)
  - Financial covenants to measure liquidity (i.e. balance sheet covenant) & performance to plan (i.e. income statement covenant)
  - Standard negative covenants (similar to prior slide)
- Pricing
  - Prime based interest rates ranging from Prime to mid double digits based on liquidity levels
  - Commitment fee ~0.5-1.0% and perhaps unused line fees as well
  - Warrants may be included if there is an element of “venture risk”

# Special Situations

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# Questions?

White paper on financing market risk vs. technology risk available at TCN Blog (www.thecapitalnetwork.org/tcnblog)

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