

**Morgan Lewis**

**STARTUP &  
ACCELERATE  
UNDERSTANDING VENTURE DEBT:  
EXPLORING OPTIONS FOR GROWTH**

**May 11, 2023**

Andrew Ray and Christopher Ronne

@MLGlobalTech

# Before we begin

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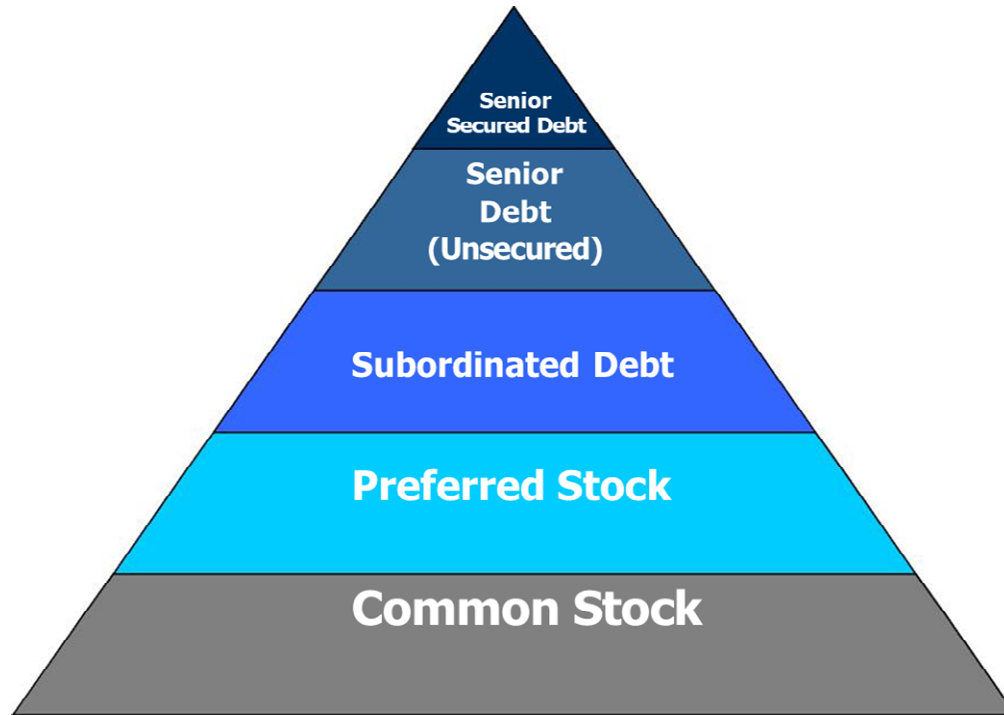
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# Capital Structure

"Seniority"



# Early-Stage Debt Financing

## Debt v. Equity

Debt Financing	Equity Financing
Debtor/Creditor Relationship	Equity Partner Relationship
Lower Cost of Capital	Higher Cost of Capital
Based on Cash Flow	Based on Expected Future Value
Periodic Interest Payments	"Interest" Accrued, but not Paid
Fixed Maturity Date	Defined Range of "Exit" Dates
Financial and other Covenants; Warrants	Less Restrictions
Retired through Operating Cash Flow	Redeemed through IPO, Recapitalization, or Sale
Board Observer Rights	Board-level Participation
Little to No Governance Involvement	Active Governance Involvement, as appropriate

# Early-Stage Debt Financing

## Debt v. Equity

### Key Types of Debt

- Capital Expenditure/Equipment Financing
- Working Capital Line of Credit
- Bank Debt Financing/Accounts Receivable/Borrowing Base Credit
- Convertible Debt
- Venture Debt

# Early-Stage Debt Financing

## Key Considerations:

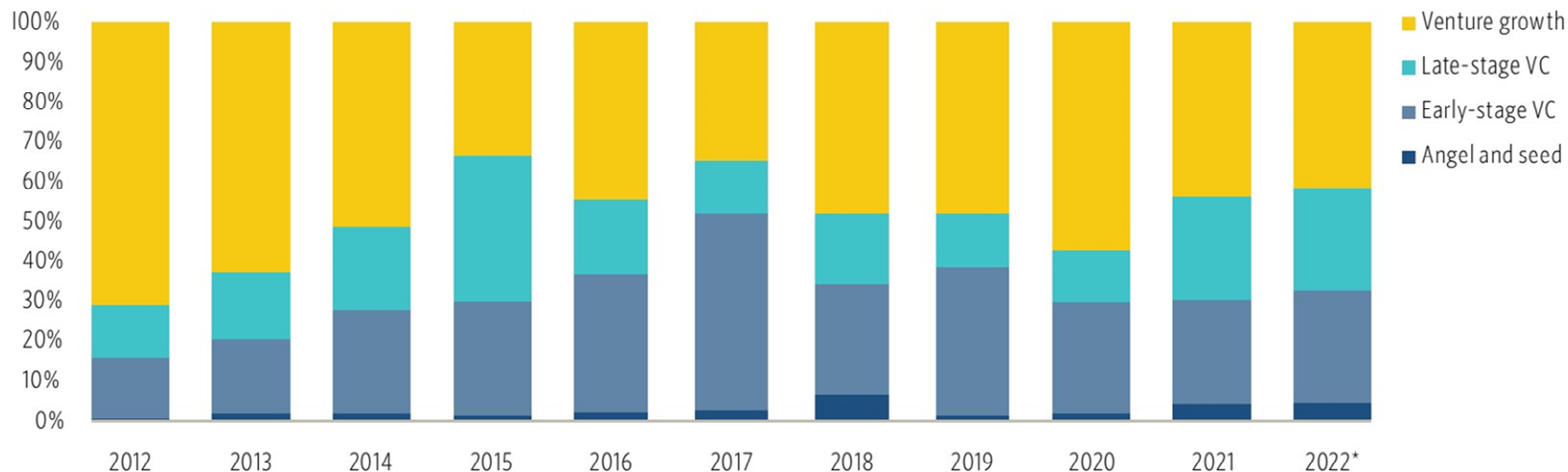
- Size (Dollar Amount)
- Duration
- Pricing of Loan (Fees and Interest)
- Timing of Amortization
- Covenants

## Market Players

- Commercial banks with venture-lending arms
- Specialty Finance Firms
- Hedge Funds
- Venture Capital Funds
- Family offices
- Angel investors

# Early-Stage Debt Financing

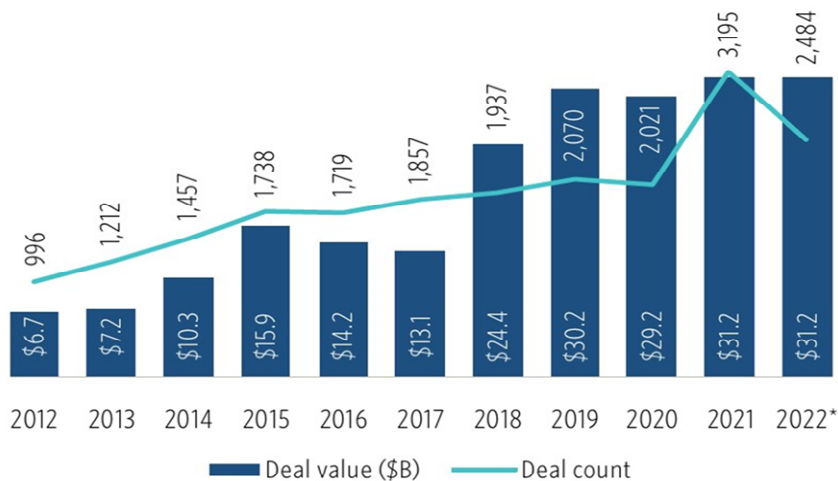
Share of venture debt deal value by stage



Source: PitchBook | Geography: US  
\*As of December 31, 2022

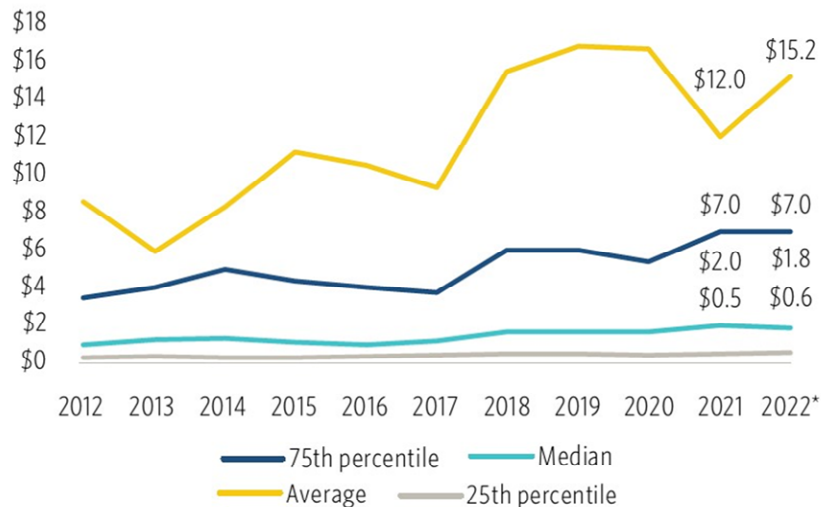
# Early-Stage Debt Financing

## Venture debt deal activity



Source: PitchBook | Geography: US  
\*As of December 31, 2022

## Range of venture debt deal values (\$M) for all debt rounds



Source: PitchBook | Geography: US  
\*As of December 31, 2022



# Early-Stage Debt Financing

## Why Debt?

- Nominal to no dilution of capital
- Leverage equity raised to reduce the average cost of capital
- Extend cash runway

### Example:

- Series A round: \$5 million at 20% ownership
  - \$25 million valuation
- Monthly cash burn of \$500,000
  - Series A provides 10 month runway
- Debt loan of \$1.5 million
  - Even with warrant at 50 bps, provides additional 3 month runway with 1/40th the dilution

# Early-Stage Debt Financing

## Potential Obstacles

- Lack of track record
- Lack of Revenue
- Negative earnings
- Strong competition
- Cash on hand

## Mitigants

- Founder's technical/market expertise
- Well-connected angel and venture investors
- Intellectual Property Assets
- Evidence of Growth
- Well-defined business plans

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# Early-Stage Debt Financing

## Key Terms

### **Due Diligence/documentation**

### **Costs**

### **Break Fee**

### **Availability**

- Entire Loan at Closing v. Tranched Loan v. Delayed Draw

### **Maturity Date/Repayment Schedule**

- May be interest deferred for some period to reduce cash needed to service loan
- Bullet payments

### **Interest Rate**

- Fixed / variable
- Current pay
- PIK

# Early-Stage Debt Financing

## Key Terms

### **Maturity Fee**

- Also known as an “End of Term” Fee; often in exchange for the reduction or absence of warrants

### **Prepayment Fee**

- Make Whole v. Discounted Make Whole v. Percent of Drawn amount

### **Warrants**

- Investor has the option to purchase stock in future at fixed price

# Early-Stage Debt Financing

## Key Terms

### Financial Covenants

**Affirmative and Negative Covenants are Common**

**Reporting**

**Closing Date**

**Closing Fee**

# Early-Stage Debt Financing

## Key Terms

### Board Observer Status

### Board Seats

### Security and ranking

- Negative Pledges over IP
- IP SPVs

# Early-Stage Debt Financing

## Key Terms

### Legal Documentation

### “Material Adverse Change” Clauses

### Defaults and Events of Default

- Acceleration
- Waivers and Consents



# Early-Stage Debt Financing

## Collateral Issues

### **Scope of collateral security is often negotiated**

- Equity pledges
- Personal property
- Real estate collateral
- Intellectual Property
- Bank Accounts
- Accounts Receivable
- Customer Contracts

# What to Expect Over the Next Twelve Months

- The consequences of the Silicon Valley Bank failure are still to be determined
- The interest rate environment is uncertain
- Pressure from existing lenders to pursue liquidity
- Continued downward pressure on valuations

# Biography



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Andrew Ray represents public and private companies, financial sponsors, investors, including venture capital and private equity firms, entrepreneurs and management teams in cross-border mergers and acquisitions (M&A), financings, and growth equity transactions. He has transactional experience in a broad range of industries, including technology, financial services, government contracts, life sciences, real estate, energy and the not-for-profit sector.

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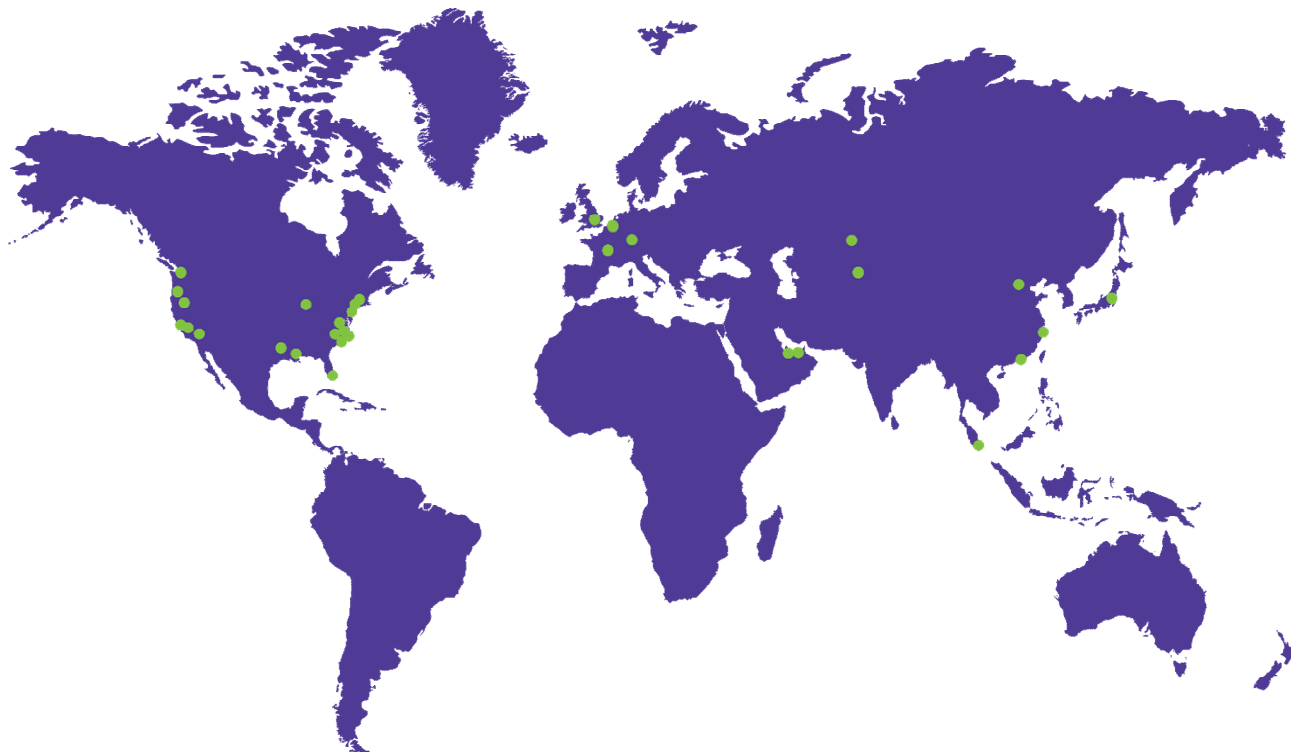
Chris Ronne counsels public and private companies, private equity, individual and institutional investors, and entrepreneurs in cross-border mergers and acquisitions, financings and strategic investments, and corporate governance matters. Chris has transactional experience across various industries, including biotechnology, life sciences and specialty pharmaceuticals, consumer products and retail, financial services and fintech, and technology and telecommunications.

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