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Is your company ready for venture debt?

By Matt Schwartz

Once a company closes its first institutional round of equity financing, it is a candidate for a venture debt facility. Venture debt is a supplemental source of capital that can help with day-to-day costs and expenses, finance working capital and capital expenditures, create extended runway until your next equity round and provide a cushion should there be a cash crunch, unexpected expenses or rapid growth.

What is venture debt?

Venture debt is a loan product for companies that have raised institutional rounds of equity provided by a wide variety of banks and funds across the world. Depending on the stage of the company (Series A/B/C), the quality of the VCs in your syndicate and your industry, the size and terms on which a venture debt facility will be offered can vary significantly. Interest rates and pricing can all vary as well but expect that your lender will want fees and/or a warrant to purchase stock in the company as part of the loan documentation.

What makes a company attractive for a venture debt provider?

Venture debt providers assess prospective companies based on a wide variety of factors, among them:

- How much cash have you raised and how much runway does the company have? The more money you have raised and the longer your runway, the more advantageous the venture debt terms will be.
- Who are the primary VCs and how much dry powder do they have reserved for a follow-on round? Venture lenders often have strong relationships with particular VCs, so your investors may have a preference about which lenders to work with.
- What is the purpose of taking on the venture debt? The more specific you are about why you want the additional funds, the more likely you are to get the deal that fits your company best.
- How dynamic is your leadership team? A very strong executive team can help attract more advantageous terms.
- What are the prospects for a liquidity event? If your company is a strong target for an acquisition or an IPO (even if not in the immediate future), then you will be able to obtain more advantageous terms.

What are the types of venture debt facilities?

There are a few basic types of venture debt facilities:

- **Term loan/growth capital** – Typically, these loans will have a draw/interest-only period of 6-36 months, followed by a 18-36 month amortization schedule. These loans are often tranched with availability based on certain milestones based on various financial, operational or fundraising metrics.
- **Revolving lines of credit** – These loans use a borrowing formula based on the company's accounts receivable, inventory, recurring revenue or other metrics. Revolving lines of credit are "interest only", with principal due at maturity or when the amount outstanding exceeds the borrowing formula. Some lenders will allow for some

nonformula availability, depending on the size and structure of the deal and profile of the company.
- **Equipment financing** – These loans have terms similar to those in a term loan, but are used to finance specific equipment or other capital expenditures.

Which venture lender is right for me?

The variabilities around venture credit facilities are enormous. An emerging company may wish to consider seeking advice to determine the most appropriate loan product and the most appropriate lender. To learn more, please reach out to your usual DLA Piper contact or the author.
