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CLIENT BRIEFING

THE BORROWER'S GUIDE TO VENTURE DEBT

BY
DR ANDREAS TAMASAUSKAS
CARSTED ROSENBERG ADVOKATFIRMA

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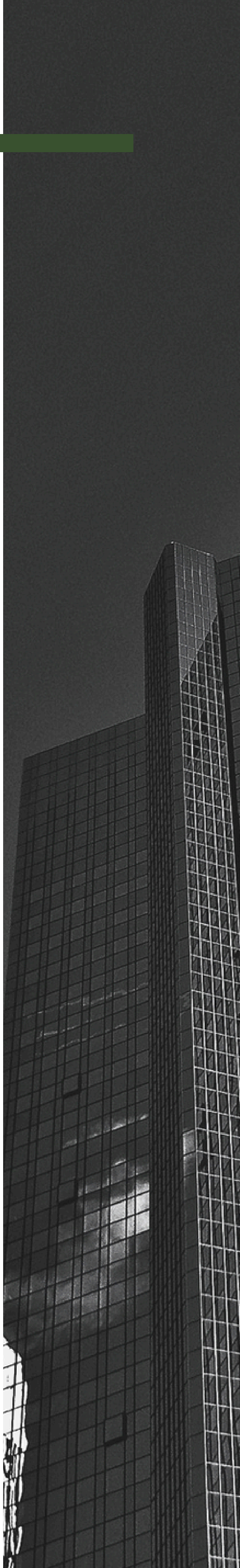
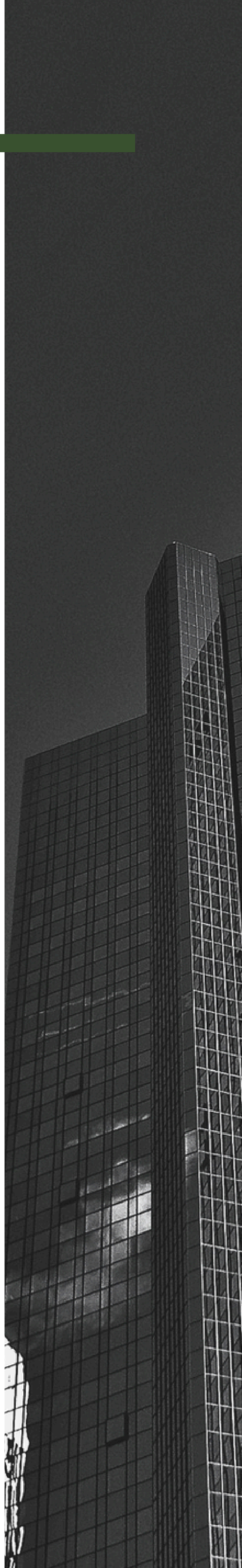
This brief overview of the main aspects of venture debt is intended to provide borowers with a useful guide to navigate external financing with venture debt.



INTRODUCTION

Venture debt can broadly be defined as the loan financing of start-up or early-stage companies.Typically, start-ups will initially be funded purely through equity from their founders, their friends and families and potentially business partners. As the company grows over time additional equity financing is available in the form of seed-financing and at later stage venture capital.

While this early-stage equity financing is absolutely essential to grow the business the downsides of equity financing – in the form of dilution of the founders and the early investors equity share in the company – will also grow as the company matures. At some stage the downside will outweigh the upside of additional equity financing.



If the company at this stage has already become EBITDA positive other options are available – typical in the form of traditional bank financing. However, if the company is still EBITDA negative due to its investments in further growth bank financing will often not be available given that most banks for regulatory reason will not finance companies which from the onset have negative EBITDA.[1]

For such companies venture debt may be an option.

[1] Depending on the local banking regulations most banks would in such a scenario either have to make a loss reservation in respect of the loan or write off the loan in full or in part.

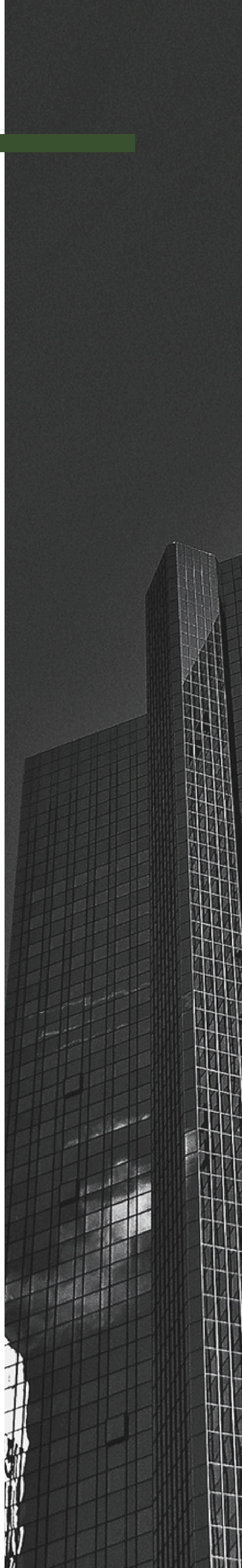
WHO PROVIDES VENTURE DEBT?

There are in general three different providers of venture debt:
First there may be public venture debt funds or state-owned financial institutions which offer venture debt or more generally growth finance. These will often have been established by law for the purpose of nurturing and helping start-ups to grow into mature businesses. In Denmark for example the Export and Investment Fund of Denmark (EIFO)[1] inter alia provides growth financing to start-ups and early-stage companies. The investment criteria and investment terms of such funds will often be very specific depending on which types of start-ups the government wants to support and – in relation to the investment terms (especially pricing) – to avoid that the fund competes and potentially distorts the competition in relation to its private sector counterparts.

Secondly venture debt is offered by a substantial number of private credit funds. While venture debt still only makes up for a fraction of the total private credit market a number of private credit managers have set up new venture debt funds in the recent years trying to capitalize on a quite active venture capital market.

Apart from a stringent focus on growth companies looking to finance an accelerated growth there is no real common denominator as to their investment criteria. While some funds will only finance companies in certain jurisdiction or geographical areas or within certain industries others will take a more sector/industry agnostic approach. It all depends on in which markets or sectors that the private debt managers and their investor think there is the greatest risk-reward potential.

[1] EIFO was established in 2023 as a merger of the Danish Export Credit Agency (EKF Danmarks Eksportkredit), the Growth Fund (Vækstfonden) and the Green Investment Fund (Danmarks Grønne Investeringsfond).



Finally, a number of banks have set up specific departments which offer financings which resemble the venture debt products offered by private credit funds, although they are often referred to as growth financing, innovation banking etc. The key difference between such departments and the rest of the bank is the disapplication of the traditional credit matrix. While they still base their investment decision on a credit assessment of the potential borrower and the business model, negative EBITDA etc. will not as such be a show stopper.

This guide will focus on venture debt provided by the latter two debt providers.

WHEN IS VENTURE DEBT RELEVANT?

As previously mentioned, venture debt is relevant where a company is seeking to finance further growth and where raising further equity is no longer an attractive option. Venture debt may also be relevant where a company is seeking to bridge its finance needs between equity rounds.

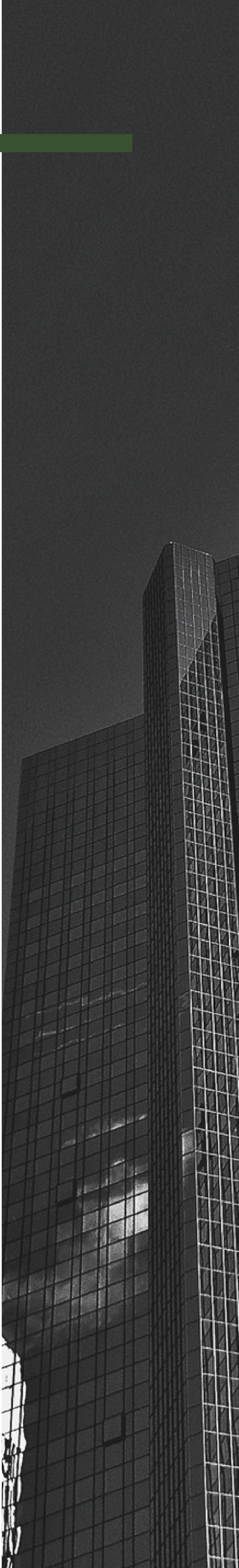
Venture debt is a supplement to and not a substitute for equity. If a start-up or early-stage company cannot raise further equity it is unlikely that venture debt is even an option. Venture debt is senior to equity and if the potential equity investors do not like the risk-reward ratio neither will a venture debt creditor.

Venture debt is relevant where the banks are not able or willing to provide the requested financing. Venture debt is almost by definition more flexible than a bank loan since venture debt funds are not as such subject to rigid bank regulations or internal credit models. A venture debt fund is only restricted by its investment mandate and its investment criteria.

The flexibility however comes at a cost. Private debt investors are looking for a return on investment that exceeds the return that a shareholder in a bank would look for. Compared to a bank, a venture debt fund only makes a few deals a year so the overall costs of running the fund and making the deals will be allocated to significant fewer deals. This obviously impacts the pricing of its loans.

So, in general if bank financing is available this should normally be the preferred option unless there is a specific need for extraordinary flexibility in respect of the financing terms.

That being said a start-up or early-stage company still needs a bank for its day-to-day business and for more specialised products such as cash management, bonding facilities etc.



THE PROCESS

The venture debt process varies depending on the venture debt provider and the relevant company. For most private venture debt funds and banks which offer venture debt products the process will however often involve the following steps:

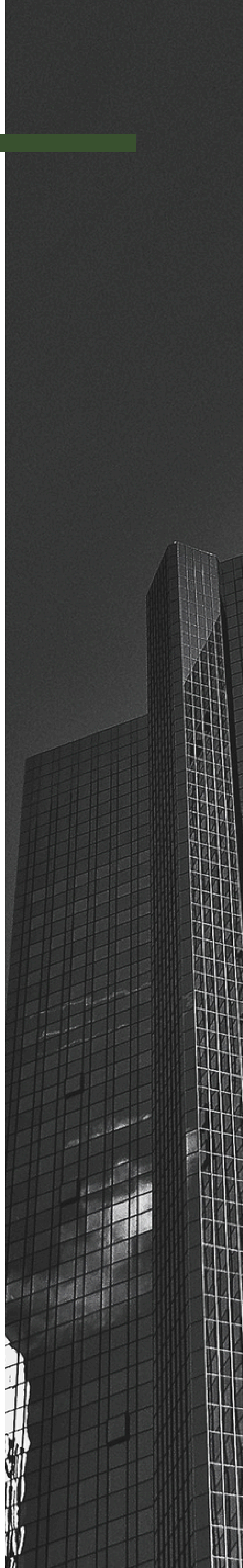
- **Initial contact:** Typically, either the company itself or its accountant or corporate finance advisor will contact the relevant fund with its financing request. An initial meeting will be convened where the fund makes a very general assessment of the financing request, i.e. whether it prima facie satisfies the fund's investment mandate, whether the financing request looks reasonable, whether the company and its business model looks attractive etc. A number of financing request will already be rejected at this stage.

- **Initial assessment:** If the financing request passes the initial phase the fund will try to get a better understanding of the company and its business model. During this phase the fund will often request the following information:

    - ·The company's latest pitch deck;
    - ·Financials for the past three years and budgets for the coming years (P&L, cash flow, balance sheet);
    - ·Group structure chart and board pack;
    - ·Latest capitalization table, including the total invested amount per shareholder and the last equity round share price;
    - ·Latest valuation.
    - The purpose of this phase is in part to assess whether the financing proposal fits the investment criteria of the fund, in part to structure the financing package and prepare a draft term sheet.

- **Term sheet:** If the initial assessment has been positive the fund will issue a term sheet outlining the terms of the proposed financing. While the structure and length of the term sheet differs from fund to fund it is normally relatively high-level and short form (3 – 5 pages).

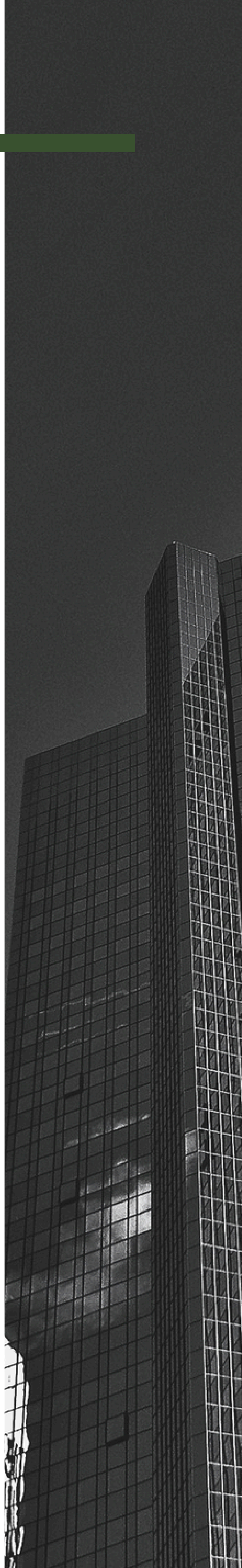
- **Due diligence**: If the term sheet is accepted the fund will normally engage in a confirmatory due diligence where they seek to corroborate the initial investment analysis. Apart from certain legal due diligence the fund would speak to the management of the company, existing investors as well as customers and business partners. If the initial assessment is validated the fund would seek investment committee approval for the deal.



- **Documentation**: If approved by the investment committee the fund's external counsel will prepare and negotiate the loan and security documents.

- **Funding:** Once the loan and security documents are signed and the conditions precedents have been satisfied the loan will be funded and disbursed to the company.

In respect of timing this differs considerably depending on the company and the fund in question, the complexity of the proposed financing, whether all requested information is readily available etc. Notwithstanding this, steps from initial contact to due diligence described above would normally last anything between 4 – 8 weeks. Steps from documentation to funding are more difficult to estimate as this would inter alia depend on the company's appetite for negotiating the loan documents as well as the time needed to file or register security in the relevant jurisdiction(s). Anywhere between 2 – 4 weeks would be common.



TERMS

The terms of the debt financing vary considerable depending on the fund, the company, the business case and the general market conditions. Nevertheless a venture debt transaction will often include the following structure and terms:

Parties

- **Borrower**: The start-up or the early-stage company would normally be the borrower. However, depending on the financing structure other entities within the group may also become co-borrowers.

- **Guarantors**: The subsidiaries of the borrower would often become guarantors. Depending on the group structure it may be that only “material subsidiaries” need to become guarantors.

- Lender: The Fund.

Facility

- **Facility**: Term loan facility - Venture debt funds have a very limited product range and are not able to provide other types of facilities such as revolving credit facilities. Depending on the financing request the loan agreement may also provided for an accordion facility.

- **Amount**: This would entirely depend on the financing request and the investment mandate of the fund. However, a common financing range would be from €15 m – €50 m. However, some funds will go as low as €5m while other funds will go as high as €75m or €100 m.

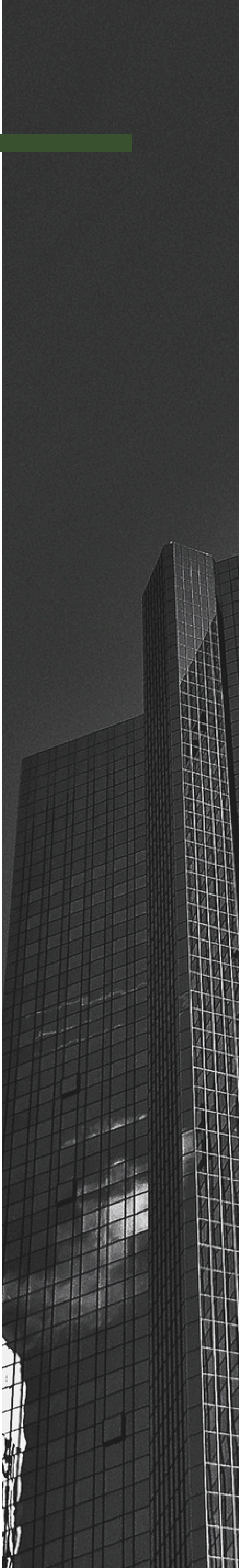
- **Tenor**: Often 3 – 5 years.

- **Repayment**: Depends on the financing request, but interest only periods for the first of 12 – 18 months are common, after which the facility is amortized with x% over the term of the loan with a balloon at the end.

- **Prepayments**: Voluntary prepayment would normally be subject to substantial prepayment fees. It would be common for such prepayment fees to decrease as the facility matures or be limited to the first two years. Mandatory prepayment will be required in case of an illegality, change of control and in relation to disposal proceeds. Prepayment fees may be applicable in certain instances.

Pricing

- **Arrangement Fee/Structuring Fee**: 2 – 3% would be common.



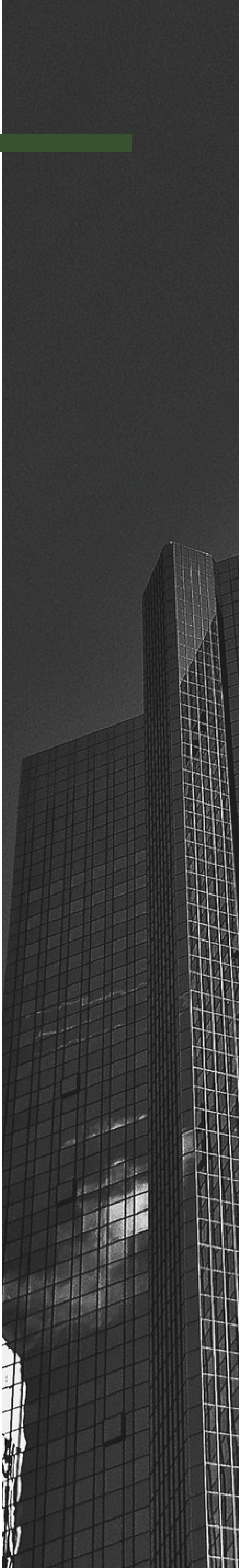
- **Interest**: Either floating or fixed interest rate depending on the fund.
    - Floating interest rates would often be EURIBOR or SONIA with a margin of 7 – 9 per cent. depending on the general market interest rate.
    - Fixed interest rate would typically be between 10 – 12,5 per cent. again depending on the general market interest rate.
- **Warrants**: Most funds would in addition to the upfront fee and the interest want to participate in the potential upside of the company through warrants. The number of warrants would normally be set as a percentage of the drawn term loan and based on an agreed valuation of the company. The exercise price for the warrants would often be set with reference to the most recent equity round.

Security

- **Security**: Full security would normally be required typically in the form of share pledges over the company and its subsidiaries shares, floating charges, assignment of intercompany loans, fixed security over IP and other valuable and material assets as well as assignment of insurances etc.
    - Guarantees from group companies.
    - All security and guarantees would be subject to customary corporate benefit and financial assistance limitations.

Other Terms

- **Representations**: Standard loan documentation representations including representations in respect of status, binding obligations, non-conflict with other obligations, power and authority, validity and admissibility in evidence, governing law and enforcement, insolvency, tax, no default, no misleading information, security and financial indebtedness etc.
- **Information Undertakings**: The information undertakings would typically include financial statements, compliance certificates, budgets and reporting on KPIs, anti-corruption information, KYC, notification of defaults etc.
- **Financial Covenants**: The financial covenants would be tailored to fit the specific company and the financing request. Given that the borrower will be an early-stage growth company the financial covenants tend to focus on measuring growth and liquidity as opposed to the more classic investment grade covenants.



- **General Undertakings**: The general undertakings would be more or less standard undertakings such as maintaining authorisations, compliance with laws, negative pledge, restriction on disposals, arm's length principle, restriction on loans, credits, guarantees and indemnities, restrictions on dividends and share redemptions, restrictions on financial indebtedness, restrictions on mergers, joint ventures and change of business, restrictions on acquisitions, taxation, preservation of assets, treasury transactions etc.

- **Events of Default**: Standard loan documentation events of default including non-payment, non-compliance with financial covenants and other obligations, misrepresentation, cross default, insolvency and insolvency proceedings, creditors' process, material adverse change etc.

- **Board Observer**: The fund will often require board observer status as long as the facility is outstanding. This enables the fund to monitor the company more closely and provide it with early warning in case the business does not progress as anticipated.

- **Documentation**: Often LMA-based loan documentation.

- **Governing Law and Jurisdiction**: Typically, the law and jurisdiction where the fund is based or English law and English courts. Security documents would be subject to local law.

NEED HELP?

We have acted as borrower's counsel to a substantial number of early-stage companies and are well accustomed to negotiate and project manage venture debt transaction.

CONTACTS

For more information, please contact:

Dr. Andreas Tamasauskas at
ata@carstedrosenberg.com
T: +45 31 88 13 25

Michael Carsted Rosenberg at
mcr@carstedrosenberg.com
T: +41 79 901 3713

Carsted Rosenberg Advokatfirma

Bredgade 3
DK-1260 Copenhagen K
Denmark

Kaiserstrasse 10 am Kaiserplatz
D-60311 Frankfurt am Main
Germany

Kägiswilerstrasse 17
CH-6060 Sarnen
Switzerland

E: info@carstedrosenberg.com
W: www.carstedrosenberg.com

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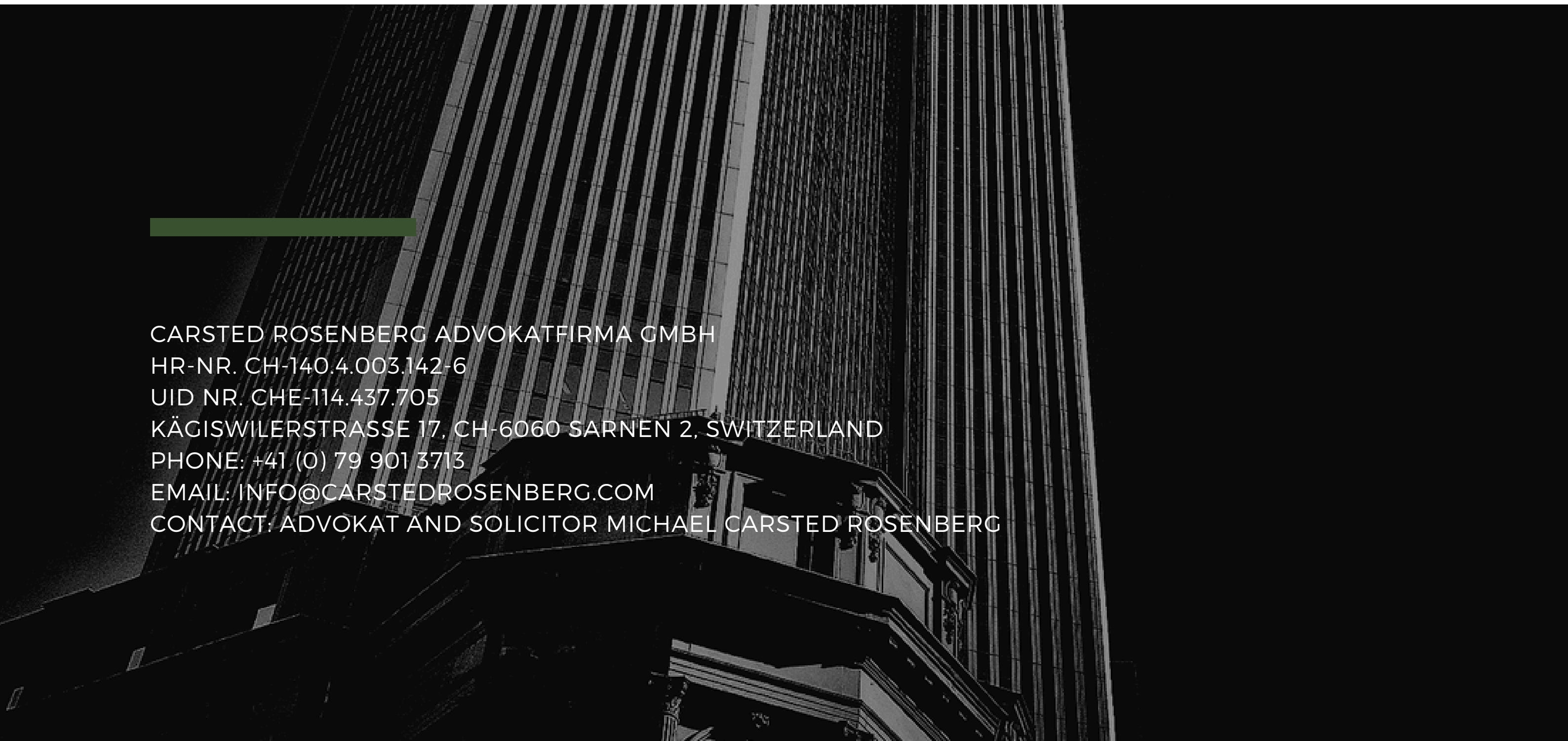

CARSTED ROSENBERG ADVOKATFIRMA GMBH
HR-NR. CH-140.4.003.142-6
UID NR. CHE-114.437.705
KÄGISWILERSTRASSE 17, CH-6060 SARNEN 2, SWITZERLAND
PHONE: +41 (0) 79 901 3713
EMAIL: INFO@CARSTEDROSENBERG.COM
CONTACT: ADVOKAT AND SOLICITOR MICHAEL CARSTED ROSENBERG