

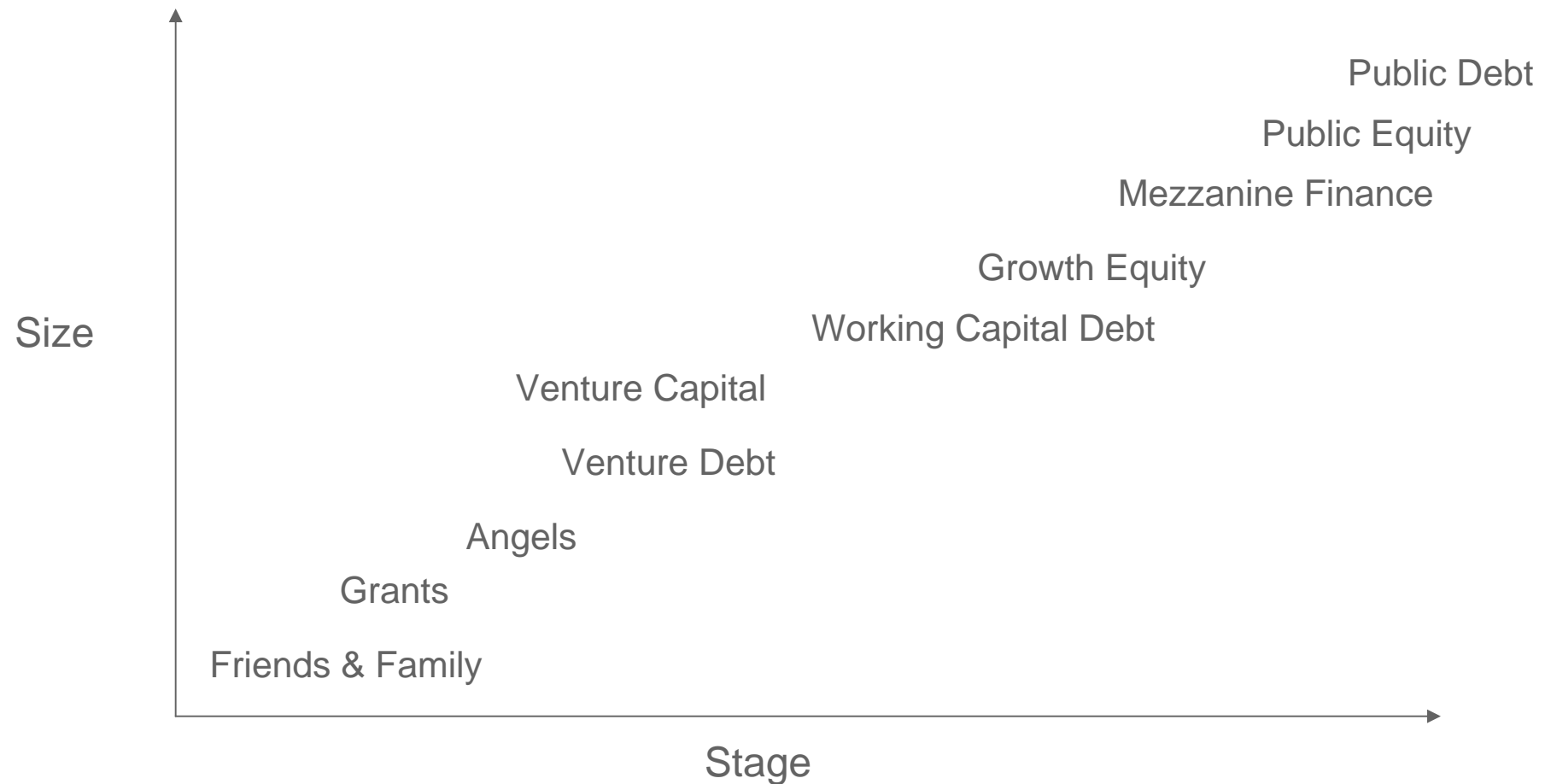
Debt Financing for Dynamic Companies

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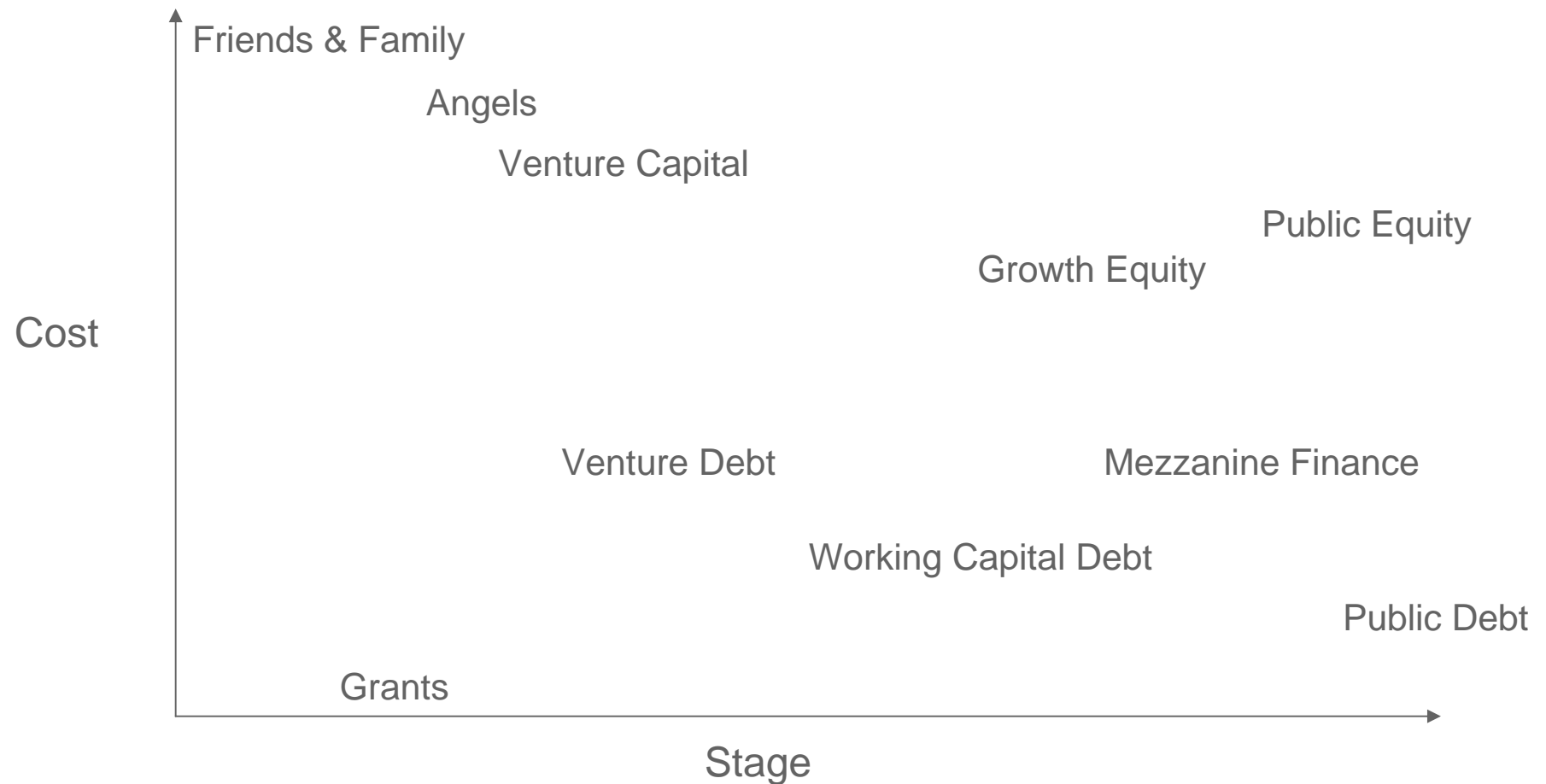
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9/16/08 TCN Event

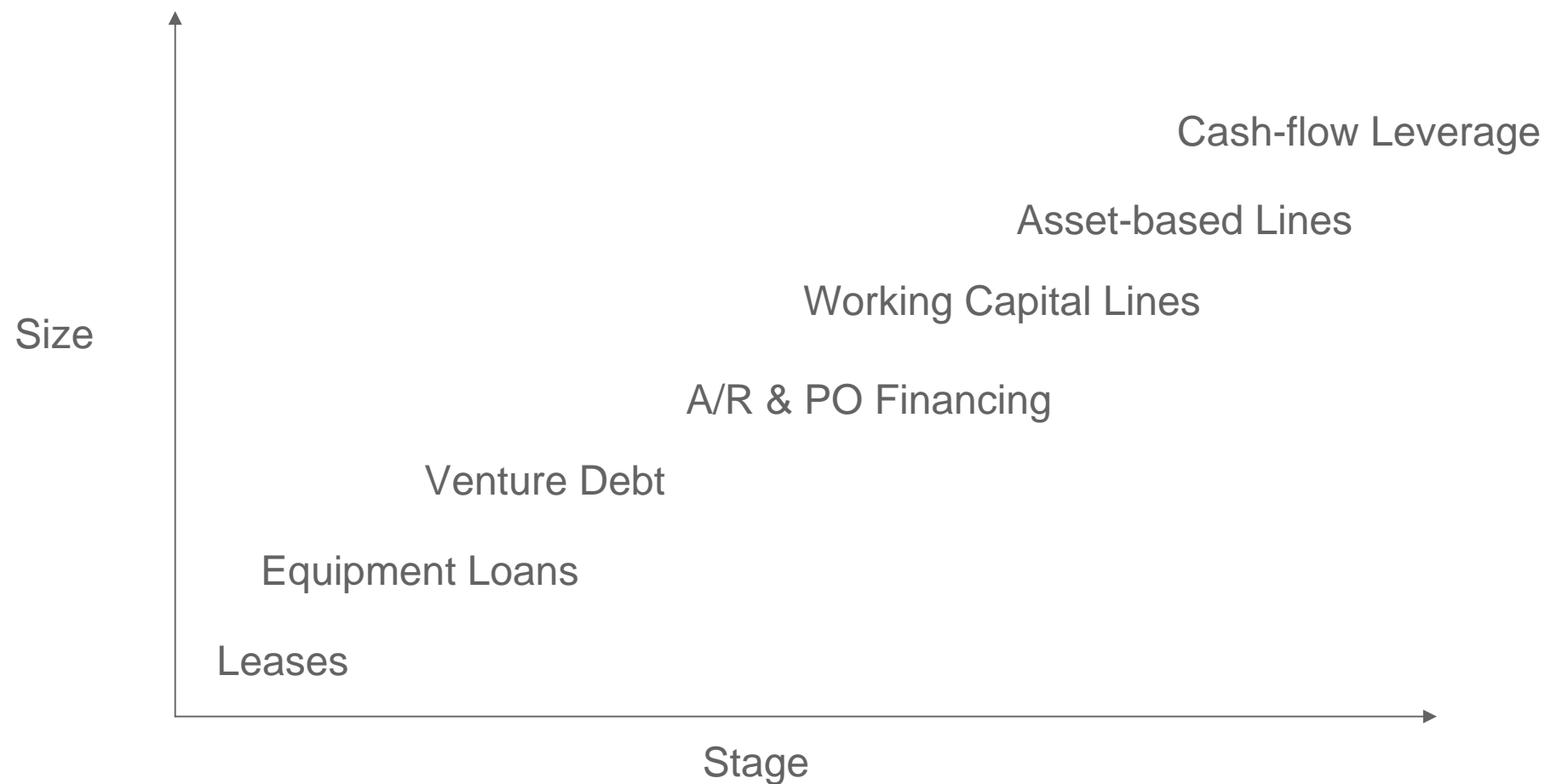
The Money Food Chain (by size & stage)



The Money Food Chain (by cost & stage)



The Credit Food Chain (by size & stage)



Two Sources of Repayment (The Traditional Credit Model)

- Primary: cash-flow
 - Question: what is the probability that cash-flow will be sufficient to support operations and repay the loan?
- Secondary: 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?

Two Sources of Repayment (A Variation on the Theme – venture lending)

- Primary: 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: 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 profile

- Early-stage term debt a/k/a “Venture debt”
 - Generally companies that are venture backed and looking to prolong the life of their equity to attain milestones which will provide for an enhanced valuation at the next equity event.
 - Risk: roller-coaster; primary risk is around ongoing financing.
 - Structure: generally non-formula; loose financial covenants or no financial covenants; term loans with draw periods ~6-12 months and amortization periods ~30-36 months.
 - Pricing: cash cost in high single digits to low double digits (interest rate and fees); warrant coverage in single digits; cost is higher with more leverage and lower with less; deposits, banking provide additional income to lender. Warrants are typically part of compensation as lender is taking a degree of equity risk as the repayment is dependent on future financing.

Two Sources of Repayment

(Another Variation on the Theme – working cap. lending)

- 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 Debt profile

- Working capital debt
 - Generally companies that are ramping their working capital assets such as accounts receivable and inventory and need to finance that growth.
 - Risk: more predictable as debt balances correspond to working capital balances; risk shifts from financing risk to performance risk.
 - Structure: formulaic borrowing bases (advance rate against A/R or other W/C assets); more likely to have financial covenants to measure liquidity and performance-to-plan.
 - Pricing: Prime based interest rates; margins over Prime vary depending on strength of covenants; commitment fees and perhaps unused line fees depending on length of commitment and expected usage; may include warrants depending on degree of reliance on ongoing equity funding (or if loan is utilized as a substitute for equity funding).

Asset-based Debt profile

- Asset-based debt
 - Generally companies with significant working capital needs that either a) have thinner balance sheet liquidity, and/or b) need more flexibility around financial covenants.
 - Risk: primarily around the performance of the W/C assets; do they convert to cash in a manner sufficient to revolve the loan?
 - Structure: formulaic and close to real-time (i.e. borrowing bases are calculated frequently); collections pay down outstanding loan balances as received and new advances are made as new billings are completed. Looser covenants than working capital lines discussed on prior slide.
 - Pricing: many of the same pricing elements as the prior slide, but these loans are typically more expensive from a cash cost perspective. The Borrower is essentially paying for the greater flexibility around covenants.

Two Sources of Repayment

(Another Variation on the Theme – SaaS model lending)

- Primary: cash-flow within the working capital cycle
 - Question: what is the probability that collections of subscriptions or other recurring revenues will continue on a consistent basis?
- Secondary: ability to sustain cash-flow within the cycle
 - Question: what is the probability that subscriptions “due” could be collected (has the service been fulfilled, and if not could the Bank and/or the shareholders sustain the service to collect out on the remaining life of the contracts?)

Pros and Cons of Debt

- Pros

- Fixed cost on cash compensation.
- Equity upside limited as warrant is relatively small relative to amount of capital put to work.
- Established “creditworthiness” with vendors, suppliers, etc.
- Aligns lower cost of capital with more mundane uses (equipment financing, working capital financing), freeing up more expensive equity for developing and growing the business.

- Cons

- It’s cheaper for a reason....
- Introduces another party to the financial picture of the company.
- Lenders are able to exercise rights against collateral if the loan obligations are not met.
- Debt essentially puts a liquidation preference in front of the equity investors and the common shareholders.