Debt Financing for Dynamic Companies

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SVB Financial Group (SIVB – Nasdaq)

TCN

SVB Financial Group

SVB Silicon Valley Bank

Commercial Banking

-VC / PE Backed & Large Tech Cos.: Term Debt, Asset based lines, Cash Flow lending

-Total Loans $3.0 B

-Deposit & Cash Management Services

- Total Deposits: $4.0 Billion

-Private Equity Services: Lending and Cash Mgmt

-International: foreign exchange, letters of credit, etc.

SVB Analytics

Valuations & Capitalization Software

-Private Co. Valuations (409A) – 30 people

-Cap Table management (eProsper) – 900 companies and 30,000 optionees

-Established in 2006

- Hundreds of engagements in first 12 months

-FAS 157 in 2008

SVB Capital

Venture Capital & Private Equity

-Relationship Mgmt with VC / PE for SVBFG

-Family of funds: VC fund of funds, Co-Investment Fund, Gold Hill venture debt, Partners for Growth

-LP Investments (parent company) since 1995

SVB Global

Global Networks

-London office: lending to emerging cos. in Europe

-Israel and Canada: commercial banking in '07

-India & China: Consulting offices

- Assisted 450 clients and VC / PE firms overseas

SVB Private Client Services

Private Banking

-Personal loans to CEOs, CFOs, General Partners and extended SVB network.

SVB Securities/ SVB Asset Mgmt

Funds Management

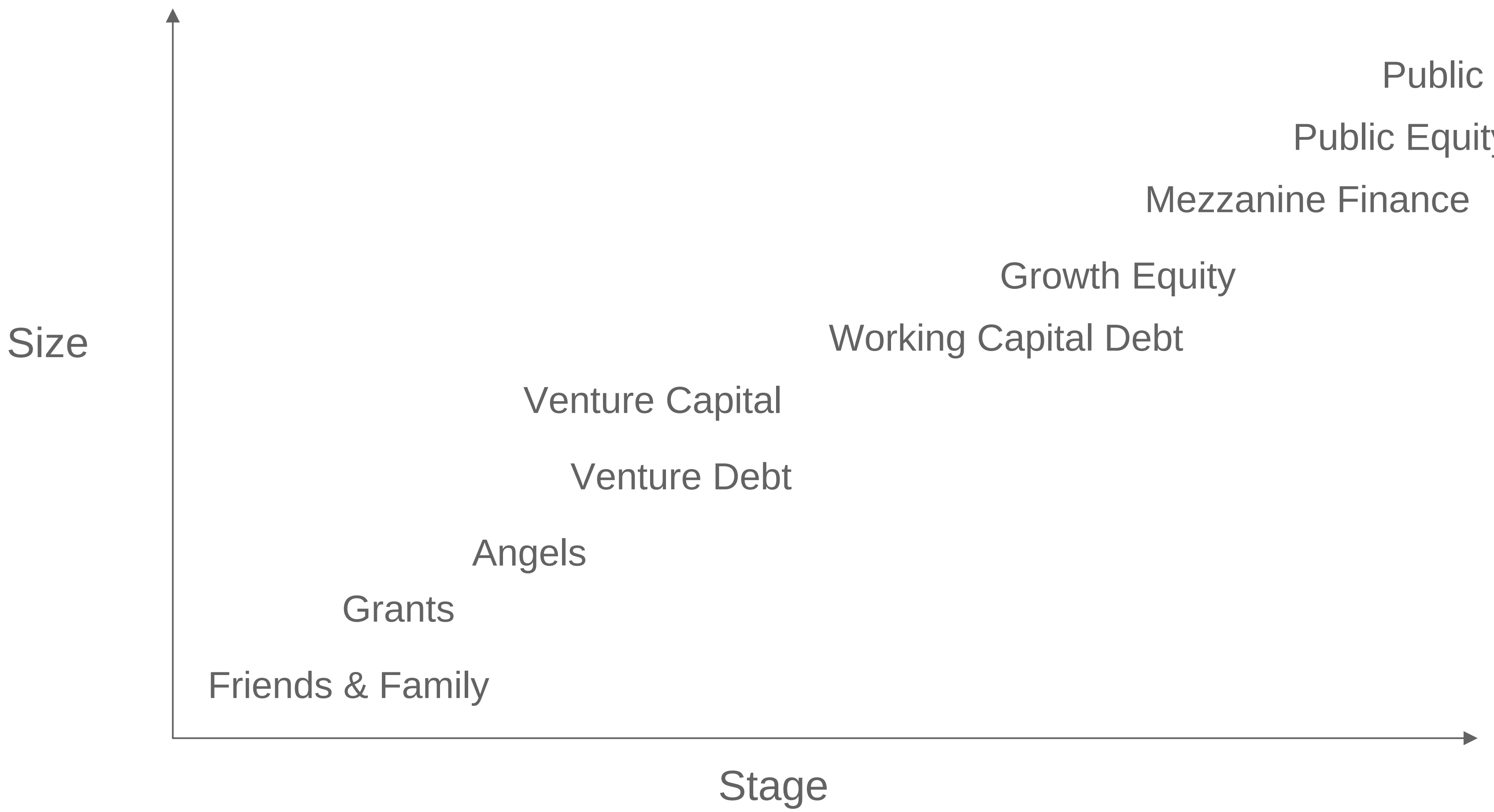
$20 Billion of SVB client assets under management in:

REPOs: collateralized, overnight investments which generate interest income only

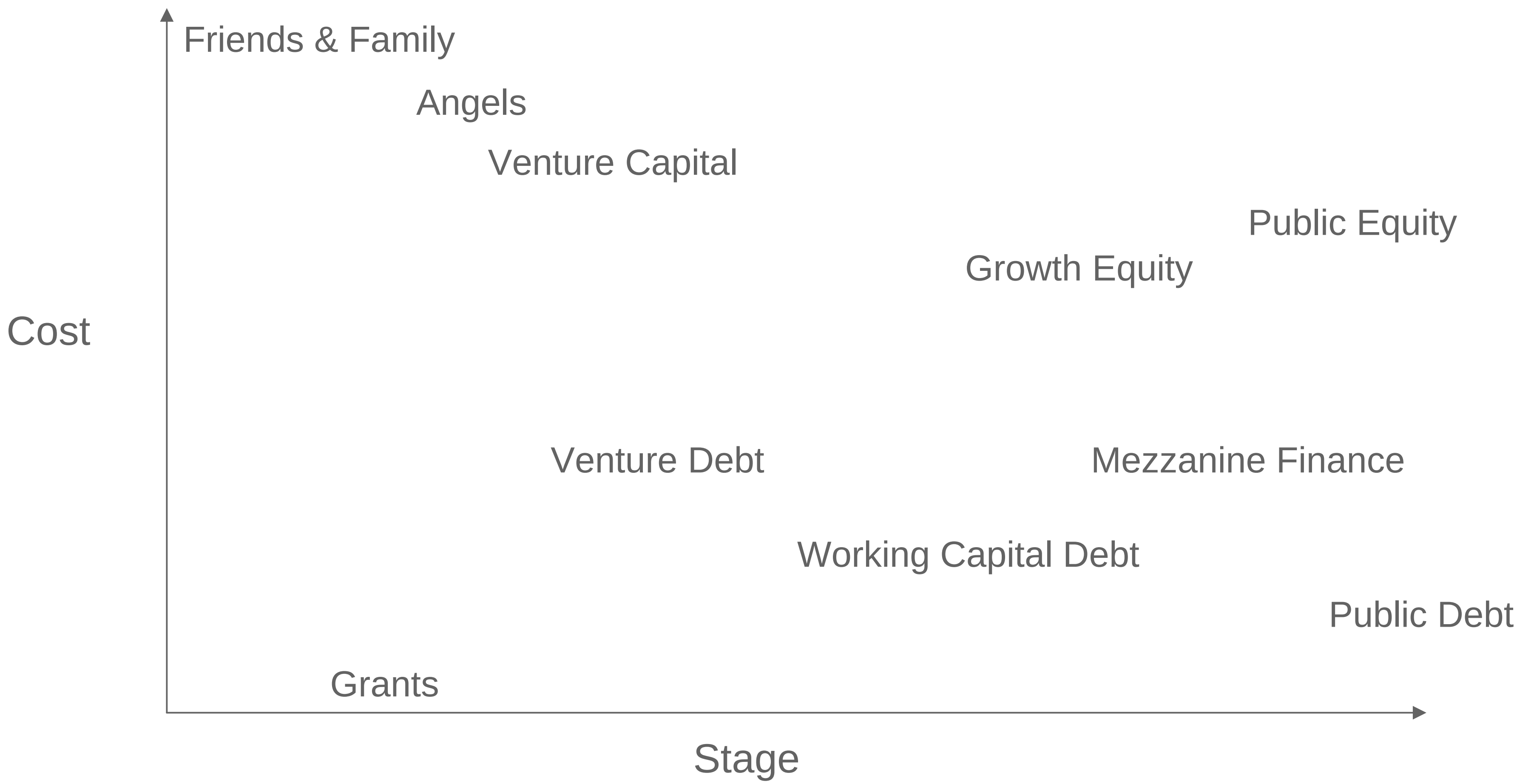
SVB Securities: self directed investment in money market mutual funds

SVB Asset Mgmt. managed accounts for greater performance, customization and reporting

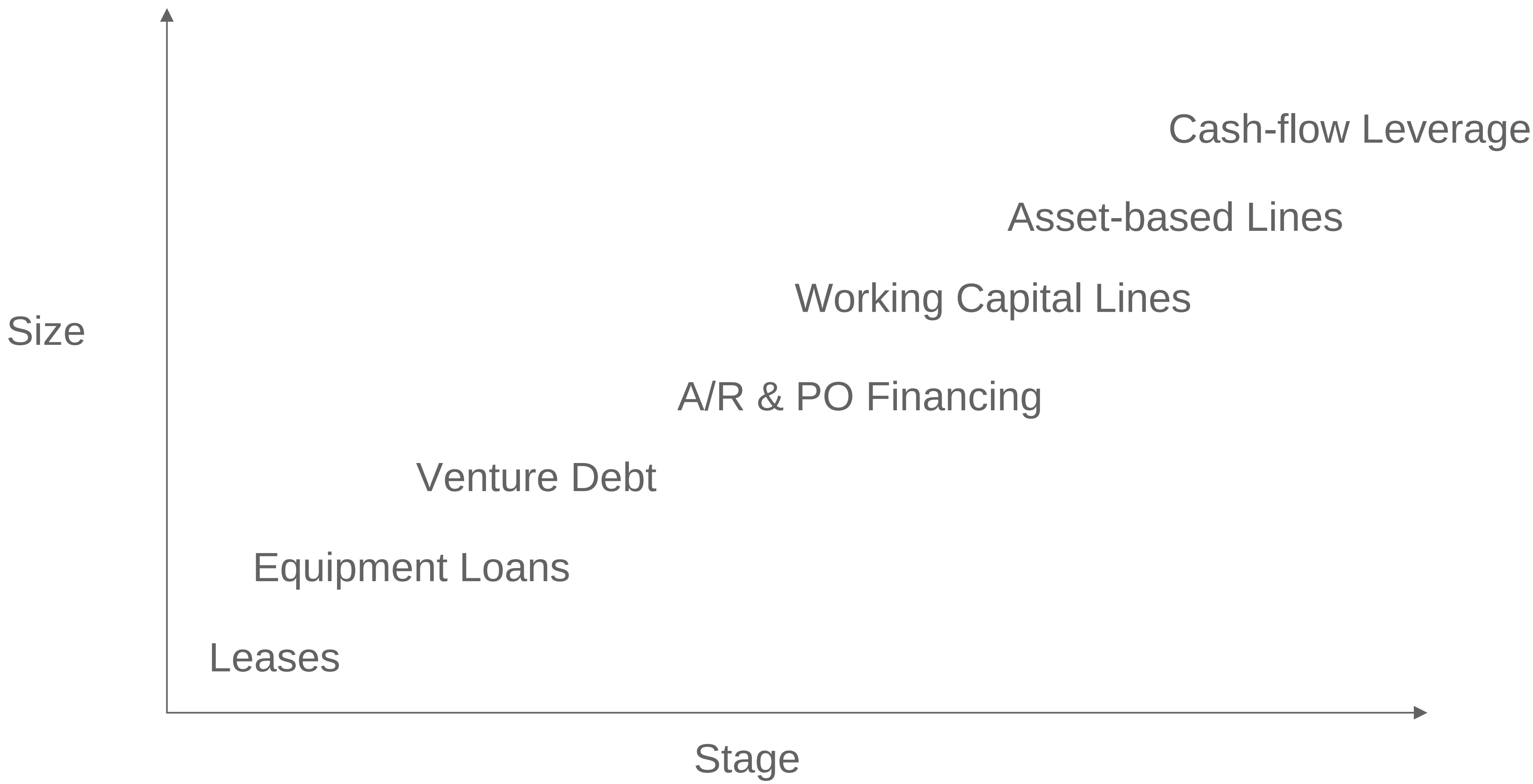
The Money Food Chain (by size & stage)



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)

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- Primary: ~~cash-flow~~ cash-flow from future equity
  - ~~Question: what is the probability that cash-flow will be sufficient to support operations and repay the loan~~?
  - Question: what is the probability that the investors will provide additional equity sufficient to support operations and repay the loan?
- Secondary: ~~collateral value~~ enterprise 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~~?
  - 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?

Two Sources of Repayment (Another Variation on the Theme – asset-based lending)

TCN

- Primary: ~~cash-flow~~ cash-flow within the working capital cycle
  - ~~Question: what is the probability that cash-flow will be sufficient to support operations and repay the loan?~~
  - Question: what is the probability that the accounts receivable are collectable in a timeframe sufficient to revolve the loan?
- Secondary: ~~collateral value~~ collateral value of working capital assets
  - ~~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?~~
  - 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?

Two Sources of Repayment
(Another Variation on the Theme – SaaS model lending)

- Primary: ~~cash flow~~ cash-flow within the working capital cycle
  - ~~Question: what is the probability that cash-flow will be sufficient to support operations and repay the loan?~~
  - Question: what is the probability that collections of subscriptions or other recurring revenues will continue on a consistent basis?
- Secondary: ~~collateral value~~ ability to sustain cash-flow within the cycle
  - ~~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?~~
  - 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?

Venture Debt profile

- Early-stage debt and/or 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 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.

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 build-up.
  - 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 liquidity on the balance sheet, or b) need more flexibility around financial covenants.
  - Risk: primarily around the performance of the W/C assets; do they covert 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 cpaital 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.

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.