Refinancing Properly Used

Renovating Your Venture Debt Structure

Increased competition among lenders in the corporate debt financing market is leading many companies to evaluate refinancing options. More advantageous terms can extend amortization schedules, free up cash flow, or even increase their leverage to build out operations and pursue acquisitions. Unlike equity, debt can often times be refinanced to suit changing corporate objectives and dynamic market conditions. And because debt terms negotiated even one to two years ago can be substantially different from the current environment, refinancing allows companies to "refresh" their debt facilities to current market terms and conditions. However, negotiating a corporate debt facility aligned with one's business objectives and current market terms is often a moving target. Early-stage businesses can change direction rapidly as can the terms for the best negotiated debt deals.

Therefore, it is sound business practice to annually review a firm's debt structure to determine: (1) if the facility maps to the company's current business model and (2) if the terms and conditions would compare favorably to optimum terms and conditions in the current market. Of course, (1) must be examined in light of specific corporate goals in mind. As for (2), corporate lenders specializing in targeting VC-backed firms have recently raised a significant amount of new capital and, in an effort to put these funds to use, have created a much more competitive venture debt marketplace. Longer terms and cheaper rates are making this market more favorable for borrowers. Thus, it can be advantageous for early-stage companies to re-evaluate their debt facilities in light of the current market.

Cost-Benefits of Refinancing

Costs of Refinancing

1. Breakage fee (i.e. prepayment penalty) on initial loan
2. Additional amount of "equity kicker" (i.e. warrants, success fee, etc.)
3. Closing costs on new loan

Potential Benefits

1. Improved Cash Flow
   - Longer payback and improved cash flow arising from increased term
   - Lower rates from more competitive market conditions
   - Larger loan amount due to improved business profile
2. Increased Financial Flexibility
   - Reduction or elimination of restrictive covenants
   - Lower lien coverage

Re-evaluating a Venture Debt Facility of Two Years Prior*

A medical device company had received FDA approval and was to begin commercial operations in the U.S. Management had raised a significant equity round to assist the process of commercialization and the capital was projected to support the company for 16 months. The company decided to accompany the equity round with a venture debt facility in order to provide additional cash runway extension. After six to nine months, it became apparent that initial sales projections were overly optimistic. The company then returned to the equity market for another sizeable round to assist in the delayed commercialization process. Facing significant cash-flow implications with the initial debt deal about to begin principal and interest amortization payments, the company contacted our debt consulting group for our opinion on potential debt refinancing.

After a careful review of the company's financials, Capital Advisors Group's debt consulting team modeled out the projected improved cash flow that a successful refinancing could bring to the company. Based on this analysis, the company engaged our debt consulting practice to competitively source the best available debt terms and conditions. The following is a side-by-side comparison of the important terms and conditions of the initial debt structure compared to the eventual refinanced term loan:

Exhibit 1: Term Sheet Analysis

Terms	Original Debt	Refinance
Total Term	48 months	48 months
Loan Amount	$12.5M	$20M
Liquidity	$20M	$32M
I/O Period	12 - 18 months	18 - 24 months
IRR	12.25%	11.20%
Warrants	5.00%	3.95%
Financial Flexibility	80% to plan following tranche acquisition	No Covenants
Lien Coverage	All assets including IP	All assets negative pledge on IP
Cash Runway Extension	~5 months	12+ months (Breakeven)

*For illustrative purposes only.

Refinancing Case Study Summary

Costs of Refinancing

1. Breakage fee of 2 percent ($250,000) on remaining principal

2. Three percent of $20MM in additional warrants (less than 1 percent potential total equity in company)

3. Closing costs (legal, placement, etc.)

Benefits of Refinancing

1. Improved Cash Flow
   - Increased loan horizon by 12 months
   - Increased interest only period by another 18 - 24 months
   - All-in interest rate (IRR) payment decrease of 1.05 percent
   - Increased loan amount by $7.5MM
   - Projected runway increase to profitability

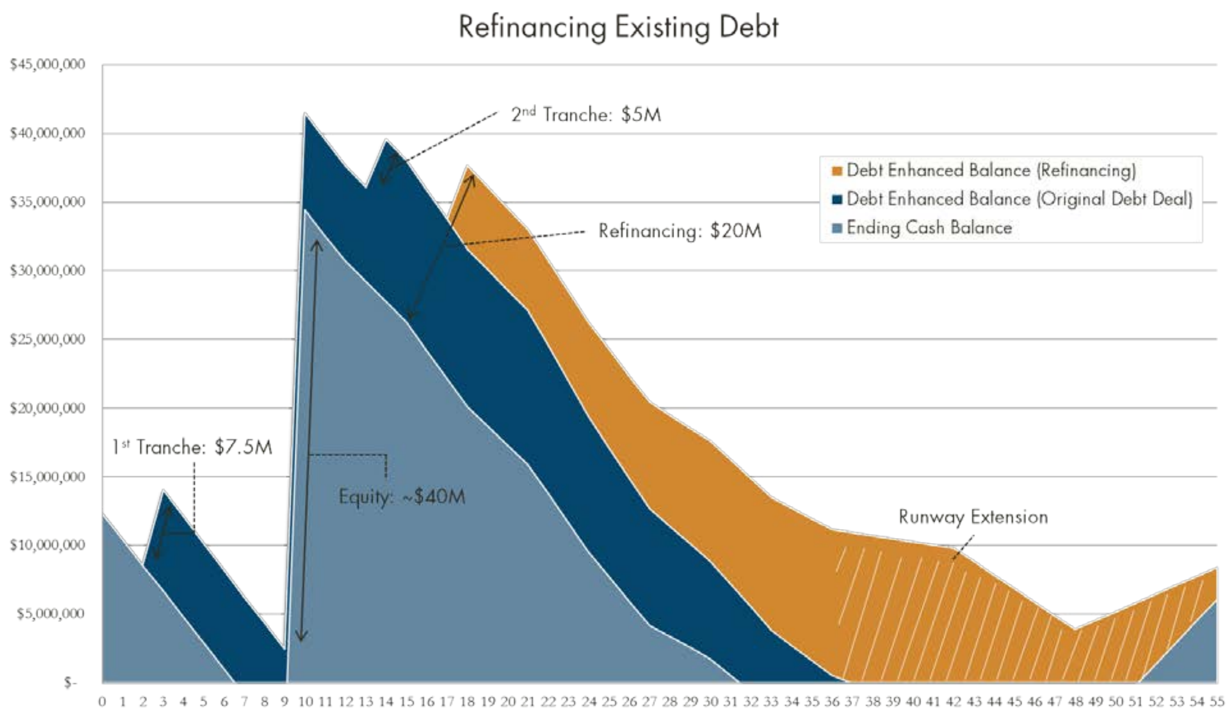
2. Increased Financial Flexibility
   - Not cash collateralized recognizing true runway extension (leverage)
   - Negative pledge on IP

Key Consideration

The key consideration in this refinancing case was recognizing that the projected extended runway would help bridge the company to profitability without needing to raise additional funds in an uncertain equity environment.

Exhibit 1: Runway Analysis

The graph below illustrates the case study from Exhibit 1. The light blue shaded area indicates the company's cash life exclusive of any debt they would receive. You'll see that they were on track to be cash negative during the 31st month after the equity infusion at month 10. The dark blue indicates the runway extension the $7.5M and $5M debt tranches gained the company, pushing the cash negative mark out 6 months to the 37th month. However, a refinancing of that debt in the 18th month (orange) extends the company's runway to breakeven at the 48th month and on to profitability. You'll see the orange striped section details the significant benefit the refinancing had on the company's cash runway.



Refinancing

With the debt financing market growing ever more competitive among lenders, Capital Advisors Group is advising more and more companies on their refinancing options. Companies are realizing that the time may be right to extend their amortization schedule, free up cash flow, and increase their leverage to build out operations and pursue acquisitions. However, it is crucial to note that debt financing and refinancing is not for every company. As an experienced advisor on these transactions, our goal is to put companies in the best position to use debt financing thoughtfully and strategically for growth. In some cases it may be too expensive to refinance existing debt, or the company may simply not be in a position to improve its terms. But in light of the potential benefits, we encourage companies to seek out experts and fully understand their options before wading into this rapidly moving market.

About Us

Capital Advisors Group's debt consulting division has provided early-stage corporate debt solutions to clients since 2003. We also manage customized separate cash accounts that seek to protect principal and maximize risk adjusted returns within the context of each client's investment guidelines and specific liquidity needs. We provide FundIQ® money market fund research, and our CounterpartyIQ® service provides aggregation and credit analysis of counterparty exposures and risk assessment on short-term fixed income securities and portfolios.

Headquartered in metropolitan Boston, Capital Advisors Group maintains multiple U.S. regional offices.

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Disclosure Information