April 25, 2007

The venture capital market has continued to show impressive growth since the internet bubble burst in 2001, marked by the five-year high of over $25 Billion in funding in 2006[1]. An integral component of this market is venture debt, an approach that is increasingly utilized by young companies seeking to leverage existing equity. Adding debt prevents further dilution of equity ownership while providing a cost and time effective solution to management's financial needs. The lending industry is becoming increasingly more competitive and the venture debt market continues to expand as an attractive alternative to equity investment.

The world of debt financing is constantly evolving and it can be difficult for companies to keep pace with changing lenders and loan structures. The CEO/CFO must make the right decisions to maximize the company's capital structure and ensure future growth. These decisions become critical when a company requires additional time in order to achieve certain milestones. Debt financing is an effective tool to significantly extend the cash runway while benefiting the owners by avoiding massive dilution. The key to securing debt financing is to find appropriate lenders that offer minimal restrictions such as financial covenants, warrants, and MAC clauses. Some lenders are able to structure unique term sheets that provide more financial flexibility, which is integral to the growth of a company.

This month's case study shows how our knowledge of the lending landscape and debt market helped us to craft a solution for a specialized debt financing need.

Profile

A representative mid-stage life sciences firm, "Pluto Medical," with $21MM in venture capital financing was looking to incorporate a $1MM equipment facility into its capital structure to finance specific capital expenditures.

DAG's Evaluation

Pluto Medical's Chief Financial Officer (CFO) along with its Board of Directors weighed their options about using equity investment or a debt facility for their $1MM equipment need. The Board was willing to utilize existing equity to cover the company's equipment purchases, but recognized the benefit of taking on a debt facility in order to finance the planned expenditures. The CFO selected DAG to manage the debt placement process.

Pluto Medical's Financing Goals

The CFO's explicit financing needs were to:

- Minimize or eliminate warrant coverage – Pluto Medical's CFO wanted a warrant free deal
- Minimize cost of capital
- Maximize financial flexibility

The DAG Process

The DAG team solicited proposals on behalf of Pluto Medical from four independent lenders with proven expertise in working with venture-backed companies. DAG was able to create a competitive bidding situation which helped to drive the terms and rates of the proposals.

The terms of the new financing included:

- Commitment of $1MM with a drawdown period of 12 months
- Specific Asset Lien
- 6 month interest-only period followed by 36 months of amortization
- 30% Soft Cost Maximum
- No Warrant Coverage
- Prepayment Penalty: Year 2: 4%, Year 3: 3%, Year 4: 1%

*All data as of 3/31/07.

The facts contained in this case study are fictional but realistic. Results achieved are based on a variety of factors, including each client's specific debt needs, financial objectives, and risk tolerance. Past performance is not a guarantee or assurance of future performance.

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[1]Johnston, Katie. **<u>Venture Capital Investing in 2006 posts five year high, reaching $25.75 Billion, highest annual investment since 2001</u>** Dow Jones VentureSource. 22 Jan. 2007