



Venture Debt – a Hybrid Form of Financing for VC-backed Emerging Growth Companies

A brief overview and legal snapshot - Switzerland

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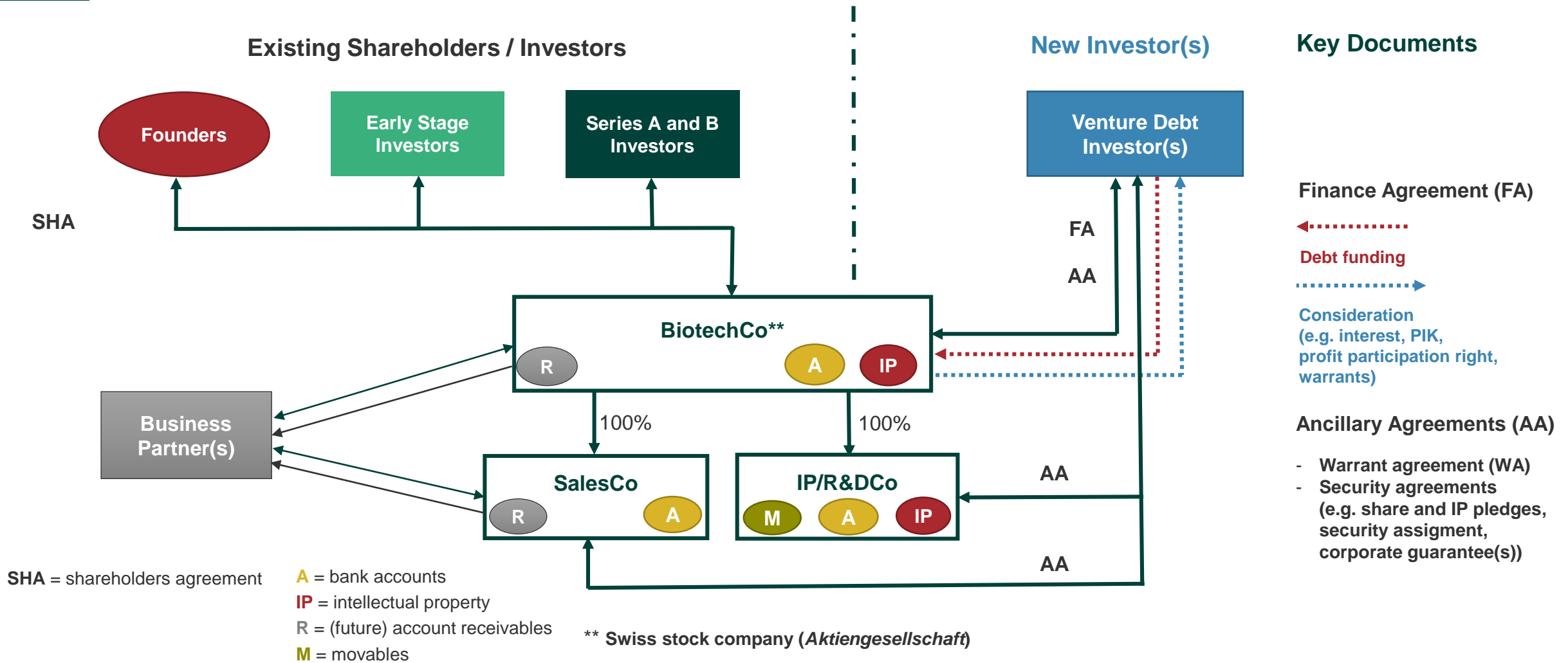
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Introduction

- **Financing of VC-backed Companies**
 - Emerging growth companies (e.g. Life Sciences or Tech sectors)
 - Ongoing need for funding >> R&D, development IP portfolio, launch of products, international expansion
- **Purpose of Venture Debt**
 - Funding for acquisitions or capital expenditures
 - Bridge to next round of equity
- **Venture Debt is a Type of Loan granted by Banks or Non-banks to VC-backed Company**
 - Traditional bank loans unavailable >> company is not cash flow-positive (lack of sufficient assets, cash flow, profits)
 - Company has solid investor base (e.g. VC funds, corporate VC) and (equity) fundraising track
- **Venture Debt Investor**
 - Professional investor >> expects protection, return and repayment (e.g. next financing round)
 - Venture Debt Investor is often a partnership-oriented investor

Overview on a Venture Debt Setting

Case Study



Structure and Key Features of Venture Debt Deal

Case Study

BiotechCo

- **Clinical-stage biotech company** with two foreign subsidiaries (IP/R&D Co, Sales Co)
- Swiss stock corporation (*Aktiengesellschaft, société anonyme*)
- Pre-financing: **different categories of shares** (common shares, preferred A and B shares)

The Venture Debt Financing

- **Purpose and timing**
- **Debt financing**
 - Term loan, disbursement in tranches (base interest, PIK interest)
 - Tranche of convertible loan (convertible into preferred B shares)
- **Warrants**
- **Security package**

Structure of Venture Debt Financing

- **Finance Agreement (FA)**
- **Warrant Agreement (WA)**
- **Security documentation**
 - Pledge agreements (e.g. shares in subsidiaries, IP rights)
 - Security assignment or pledge (e.g. receivables)

Selected Aspects and Challenges – Funding Terms

Qualification of Finance Agreement (FA)

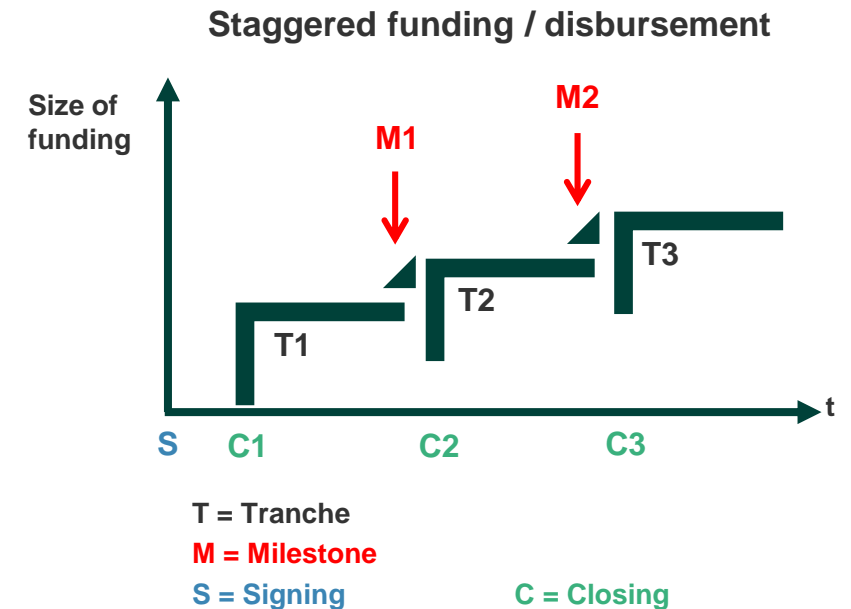
- **Financing arrangement** between Venture Debt Investor and BiotechCo
- Elements of "**classic**" **loan agreement** with professional investors
- **Innominate contract**, composed of different elements (loan, profit participation, grant of warrants/options, conversion features, security package)

Funding in Tranches

- Staggered **disbursement of loan tranches**, subject to CPs
- Achievement of **business milestones**
- **Other CPs** (e.g. no MAC, co-investment by Existing Investors)

Interest and Profit Participation

- **Base interest**
- **PIK (Payment In Kind) interest** (e.g. payment in cash and/or further shares)
- Additional **success-based compensation**
 - Calculatory basis (profit, revenues, royalties)
 - Legal limitations / restrictions
 - Rights of Venture Debt Investor



Selected Aspects and Challenges – Equity-linked Features

Conversion Rights (Tranche of CLA)

- Conversion of debt into equity

Warrants (Option Rights)

- Equity kicker for Venture Debt investor

Considerations before Grant of Rights / Warrants

- Protection of Existing Shareholders >> **Impacts on deal?**
- Pool and type of shares >> **How to source the shares?**

Process for Granting Conversion Rights and Warrants

- (1) Creation of conditional share capital in articles >> shareholder approval
- (2) Registration of conditional share capital in commercial register
- (3) Board approval re. grant of conversion and/or option rights (warrants)
- (4) Signing of Financing Agreement (FA) and/or Warrant Agreement
- (5) Exercise of conversion rights and/or warrants and completion
- (6) Accession to SHA >> simultaneously with (5) (!)

Protection of Existing Shareholders

- Pre-emptive / subscription rights
- Advance subscription rights
- Waiver of rights possible / common
- Exclusion of rights only in case of important reasons

Pool Shares / Creation of Shares

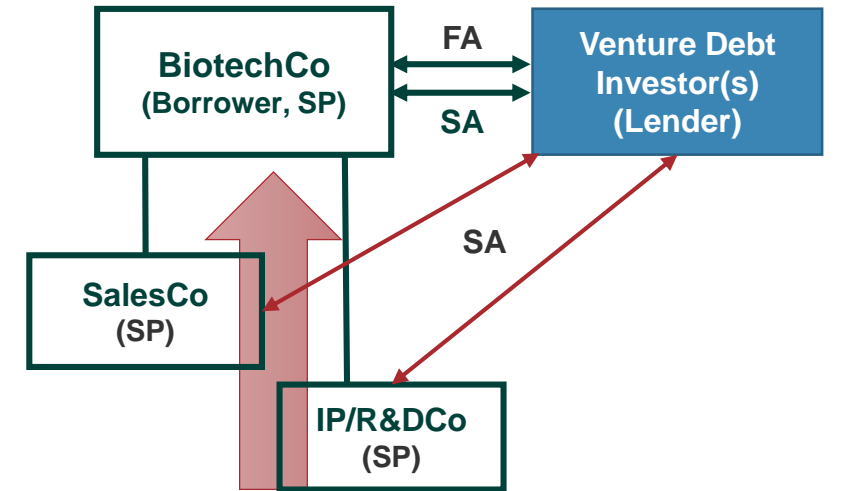
- (1) **Conditional share capital for financial instruments** (if type of shares is known upfront) >> most investor-friendly, easy execution
- (2) **Ordinary capital increase** (if new series and type of shares will only be known later) >> shareholder covenants / consents, elaborate process
- (3) **Capital band** >> pool of shares available for issuances by board, elaborate process
- (4) **Treasury shares** >> often not available

Selected Aspects and Challenges – Security Package

Security Package

- Securing **obligations of Borrower** under FA
- **Collateral**
 - Assets of BiotechCo as Borrower (e.g. **IP**, **receivables**, **bank accounts**, shares in foreign subsidiaries)
 - Assets of subsidiaries (e.g. **IP**, **receivables**, **movables**)
 - Corporate (upstream) guarantee(s)?
- **Local law requirements** for creating security interests
 - Feasibility of floating charge over movables?
 - Pledge of shares, assignment or pledge of **receivables**
 - Registration requirements (e.g. pledged **IP**)
- **Financial assistance limitations** in relevant jurisdictions
 - Ability of subsidiaries to grant security for Swiss parent
 - Corporate actions / approvals
 - Limitation language in security agreements
 - Other requirements / limitations
- **(Commercial) viability?**
 - Creditors under pre-existing secured debt (if any)
 - Existing shareholders/investors

Upstream Financial Assistance



FA = financing agreement
 SP = security provider
 SA = security agreement(s)

Selected Aspects and Challenges – Covenants, Alignment, Tax, etc.

Covenants and Information Rights

- Covenants of borrower (financial; positive; negative, like negative pledge)
- Lender participation / control rights >> risk of simple partnership, lender liability?
- Information rights

Repayment and Alignment with (future) Equity Financings

Tax: Swiss 10/20 Non-Bank Lender Rules

- Swiss withholding tax (WHT) on interest / other payments under bonds and bond-like instruments
- Qualification of financings as bond or bond-like instruments
- 10/20 Non-Bank Lender rules
- Limitation of non-bank lenders of Swiss borrower in FA
 - Transfer restrictions / consent requirements
 - Covenants, reps/warranties

Key Takeaways and Outlook, Q&A

In Brief

- Venture Debt primarily used for VC-backed companies (e.g. Life Sciences and Tech sectors)
- Venture Debt or comparable transactions in public company context?
- Venture Debt is regularly a tailor-made financing, often in cross-border settings
- Venture Debt transaction can be challenging and complex, also given the multiparty VC setting
- Venture Debt does not substitute equity funding, but can be an interesting addition
- Documentation
 - Model / standard documentation for Venture Debt?
 - Tailor-made transaction documentation

Outlook: Trends and recent Developments

>> Discussion / Q&A >>



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