Corporate Financing Strategies
For Emerging Companies

HAUSWIESNER KING LLP

What is Corporate Finance?

- The process by which companies raise capital, especially to fund growth, acquisitions etc.
- The primary goal of corporate finance is to enhance corporate value while reducing the firm's financial risks.
- Crucial for every kind of business from start-ups to large publicly listed companies

Debt versus Equity

- **Debt Financing**: Loans from private, commercial or institutional lenders; corporate bonds

- **Equity Financing**: Money that is received in exchange for a share of ownership in the business which typically amounts to additional shareholders in your company

Debt Financing

- Private or Commercial loans
- Loans from government agencies (SBA loans)
- Obligation of your company to pay interest as well as the amount borrowed.
- Lenders do have certain rights to financial or other information from your company

Debt Advantages

- You remain full managerial control of your company.
- You do not have to give up any ownership or future profits of your business. All that a lender can require is for you to pay back your loan.
- Using borrowed money to obtain business assets will allow you to keep your business profits in the company or use those profits to pay a return to the owners of the company.
- Interest paid on the loan is generally tax deductible.

Debt Disadvantages (1)

- Your company must have sufficient cash flow to repay its loans.
- In most cases you will be using your cash profits to pay back the loans.
- The riskier the loan is, the higher the interest rate will be (problem for many startups)
- Most lenders will require small business loans to be co-signed or guaranteed by the owner(s) of the business.

Debt Disadvantages (2)

- Loans usually require collateral to secure the loan. If you cannot repay your loan, the lender has a right to seize your collateral.
- In case of bankruptcy, bondholders and secured lenders have preference over shareholders when the assets of the company are liquidated.
- Too much debt may impair your credit rating and your ability to raise money in the future.

Small Business Administration

- "Established to aid, counsel, and protect the interests of the small business community."

- Works with banks, intermediaries, and other lending companies: SBA guarantees loans and makes loans to small businesses unable to obtain debt financing through regular lending channels.

- Number and types of loan programs are constantly changing

SBA – Loan Guaranty Program

- One of SBA's primary lending programs
- Program operates through private-sector lenders that provide loans which are, in turn, guaranteed by the SBA -- the Agency has no funds for direct lending or grants.
- A maximum loan amount of $2 million has been established. However, the maximum dollar amount the SBA can guaranty is generally $1 million. Small loans carry a maximum guaranty of 85 percent. Loans are considered small if the gross amount is $150,000 or less. For loans greater than $150,000, the maximum guaranty is 75 percent.

SBA – LowDoc Program

- Once a small business meets the lender's requirements for credit, the borrower completes a one page application and the lender requests a LowDoc guaranty from the SBA.
- Program calls for a response from the SBA within 36 hours of receiving a complete application.
- LowDoc allows for a SBA guarantee for loans up to $150,000.

Virginia Department of Business Assistance (VDBA)

- Offers a variety of services to business and industry including financing assistance, counseling, and training.
- Administers the programs of the Virginia Small Business Financing Authority (VSBFA) by providing loans, guarantees, insurance, and other assistance to small business.
- VSBFA targets the financing needs of businesses which are not being met by other public or private sector programs.

Virginia Economic Development Loan Fund (VEDLF)

- Provides loans up to $1 million or 40% of project cost, whichever is less, to bridge the gap between private debt and private equity for projects that will result in job creation or retention.

Virginia Loan Guaranty Program

- Designed to reduce the risk to lenders thereby increasing the availability of short-term capital for small businesses.
- VSBFA guarantees up to $300,000 or 75%, whichever is less, of a bank loan.
- Typically used to finance accounts receivable and inventory and short-term loans for working capital and fixed asset purchases.

Virginia Capital Access Program (VCAP)

- A loan loss reserve is established at each participating bank financed by enrollment premiums paid by the borrower and matched by the Virginia Small Business Financing Authority (VSBFA). The reserve is available to offset potential loan losses. VCAP participating banks are published on the VDBA website

Equity Financing

- Issuing of equity securities to investors
- Possible investors are friends, angel investors, VC funds, corporate investors (strategic investors), buyout and turnaround funds
- This means that investors obtain some form of ownership in your company (equity)
- VC market is booming in the nation and the region (new funds, plenty of $$$ available)

The VC Industry Overview 2006

- VC funds invested $25.5bn in 3,416 deals
- 10 percent increase in deal volume
- Highest level of investments since 2001
- In Metro DC: $1.12bn in 204 deals and 177 companies; up from $998.6m in 2005 (29 firms)
- Outlook: Positive since 95 new funds were closed totaling $24.33bn (fewer than in 2005)
- Funds larger than ever: 16% larger than $500m

Angel Investing Overview 2006

- A total of 51,000 entrepreneurial ventures received angel funding with total investments of $25.6 billion (3% increase)
- The number of active investors in 2006 was 234,000 individuals
- Angels are the largest source of seed and start-up capital, with 46 percent of 2006 angel investments in the seed and start-up stage

Equity - Benefits

- Access to capital will increase, since you can contact more potential investors.
- Your company may become more widely known.
- You may obtain financing more easily in the future if investor interest in your company grows.
- Business angels and VCs can offer their business advice, professional experience and business network
- Your company may be able to attract and retain more highly qualified personnel if it can offer stock options and other equity incentives.

Equity – Disadvantages

- You’ll likely be giving up some amount of managerial control (depends on investor)
- Obligation to keep shareholders informed about the company's business operations, financial condition and management, incurring additional cost and new legal obligations.
- Potential liability because of new legal obligations.
- You may lose some flexibility and privacy in managing your company's affairs.
- Your private or public offering will take time and money to accomplish (consultant & legal fees)

Preliminary Questions

- Amount of money you need to raise
- Number and type of investors necessary to raise that amount (angels less than $1m)
- Costs for professional services of lawyers and accountants
- The affinity group(s) that would be interested in investing in your business
- The liability and management responsibilities to investors

Legal Aspects

- Securities regulations
  - Mainly relevant when offering securities
  - Way of offering and number of investors
- Corporate and tax issues
  - Relevant when investors have been located
  - Structuring the transaction
  - Dealing with investors after the closing

Securities Laws

- All issuers of securities must comply with both federal and state securities laws.
- These laws are intended to protect investors while still providing a mechanism for capital formation and economic growth.
- In Virginia, like many other states, a security must be registered with the state securities division, exempt from registration, or a federal covered security in order to be sold to investors in the state.

SEC & VA Regulations

- Some offerings are reviewed carefully by both the Securities and Exchange Commission (SEC) and the states, while others are reviewed only at the state level, or not at all.
- It is necessary for the sales representative, "agent of the issuer" or broker-dealer that is conducting securities sales transactions in Virginia, to be registered or qualify for an exemption from registration.

Preliminary questions

- Where are securities offered?
  - Locally or nationally?
- What is the amount that will be raised?
- Who are the potential investors?
- Form of offering?
  - Private or public?

Securities Registration Exemptions

- Private Offerings
  - No general advertising
  - Purchaser has intimate knowledge of issuer and finance experience
  - Agrees not to resell or distribute securities to the public for 12 months
- SEC Regulation D, Rule 504
  - Allows a company to sell up to $1 million worth of securities without a review by the SEC.
  - Registration with the Virginia Division of Securities and Retail Franchising is necessary

Equity Fundraising – Steps (1)

- **Step One: Funding request**
  Funding request is presented to the investor: This ranges from a one or two paragraph email to the investor introducing your company and the funding opportunity at hand.

- **Step Two: Request for further information**
  If investor is interested, he or she will reply and request further information about the deal. This is the time to send over a business plan or other information that the investor has requested.

- **Step Three: Due diligence**
  Investor conducts due diligence on the investment opportunity to be sure that they agree with your

Equity Fundraising – Steps (2)

- **Step Four: Term sheet**
  If opportunity looks like a good fit, the investor will present you with a term sheet: Contains details of the deal that they are proposing.

- **Step Five: Negotiation process**
  Start of the negotiation process. The entrepreneur and investor need to agree on the amount of equity that will be exchanged for a certain amount of funding in the deal. They will also need to agree on other details regarding the role that the investor will play in the business. This is a long process.

- **Step Six: Closing**
  If it all works out, a deal will be made and the entrepreneur will now have funding plus an additional

Useful Links

- **Banking**
  - www.sba.gov
  - www.dba.state.va.us
- **Angel Investing**
  - www.gobignetwork.com
  - www.venturevest.com
  - www.newvantagegroup.com

Useful Links

- **Venture Capital**
  - www.mava.org
  - www.nvca.org
  - www.fairfaxcountyeda.org/venture.htm
  - www.nvtc.org/index.php

Contact Us

Florian Hauswiesner
HAUSWIESNER KING LLP
8200 Greensboro Drive; Suite 900
McLean, VA 22102
Tel: 703-462-5478
Email: florian@hausking.com
www.hausking.com