diffusetap
Virtual Event Series

Venture Debt Reimagined

Guest Speaker:

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Hosts:

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DiffuseTap: Venture Debt Reimagined

In our session featuring **Guy Kurlandski, Managing Partner for North America at Liquidity Capital**, we covered common myths and misconceptions around venture debt, the perfect size of a company to use this kind of leverage, and how to apply for one.

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DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas) … straight from your armchair like a boss.

Meet the Speaker

Guy Kurlandski is a serial entrepreneur and a veteran in the finance industry, having worked with companies of all sizes across multiple industries, both in funding and leading them through to exit. Aside from his Managing Partner role at Liquidity Capital, Guy is also a member of the Forbes Business Council, Board member at Allective, and joint owner at Lucky Player Brands.

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About Diffuse®

We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information, visit www.diffusefunds.com.

KENNY ESTES: The format here is about three-quarters networking in small groups, and then every week we have somebody come in and speak about something we think will be interesting. Today, that expert is Guy Kurlandski. I am terrible with introductions, so I try to avoid them. So, Guy, do you want to do a brief introduction on yourself?

GUY KURLANDSKI: Yes, sure. Hi, everybody. I am the managing partner of a company called Liquidity, and we run a fund called Liquidity Capital. We are both a VC and a fintech, where we actually have a platform called Liquidity Dynamics that analyzes private companies. We use it ourselves in Liquidity Capital and a couple of our sister funds – including Mars Growth Capital, which is a joint venture with MUFG and NMO, which is a Dubai based fund - to provide venture debt. Our platform allows us to analyze companies in depth at speed using machine learning and various tools that allow us to understand the opportunities within a company.

My background, personally, is I'm a serial entrepreneur. I've taken a few companies through to exit. I've also had a few failures along the way, learned my lessons in how to fund and how not to fund companies successfully. And I'm based in the USA, residing in Miami, Florida.

KENNY: Succinct. You hit on all the main points; I love it. So, for the next 15 minutes or so, we're gonna do questions. To the audience, if you have any questions please chuck them into the chat and we will pick them up if and when we can, or when we get around to it. My partner in crime is Ayla Kremb. So, Ayla, do you want to kick off with the first question?

AYLA KREMB: Yeah, happy to. You know, one of the big things about venture debt, specifically, is there is a bit of a stigma around the word “debt” in general for startups. Would you be happy to maybe debunk that? Should there be a stigma? Or is it actually different with the venture debt that that you offer, or that is available these days, and it doesn't deserve that original stigma?

GUY: I think it's a really good point. Actually, I think the stigma is there maybe because there was always a sort of deep misunderstanding between debt and modern tech-based companies, and it's interesting. Traditionally, companies were built quite frequently on debt. People would maintain their ownership and they wouldn't sell part of their ownership as they were building and constructing their company. They'd use their own cash flow.

And as they had sufficient cash flow, if they were expanding or trying to grow their company quicker, they would take debt on. The speed in which tech companies grow has changed that and unfortunately the debt market did not evolve quickly enough, leaving a bit of a taint, because a lot of the debt providers typically have not known how to secure themselves. Debt has been the same for so many years? What can we secure ourselves on? What can we put liens against?

Well, if you have, let's say, a tech SaaS company that hasn't got any assets other than IP and its sales, they don't know what to secure themselves on. So, you end up typically with very draconian contracts, full of covenants, restrictions, accelerators, and cause and effect issues that a lot of people don't understand. And in not understanding them, they've been misunderstood effectively in the market.

Also, the size of facilities being offered is often not sufficient to really push a company as hard as it needs to be pushed at that point in time as tech companies grow faster than traditional companies in most cases. What has changed, and I believe what we are at the forefront of it (not trying to do an advertorial here), is the technology to be able to understand the blue sea of opportunity within a company and hook the debt against other matters.

So, to understand there is an opportunity here, that these are the variables we need to monitor, is equivalent to the ability to actually be able to monitor what a private company is doing in real time, or close to real time. And that enables debt providers today (or at least, some) to be a little bit more open in terms of facility size and start removing some of the restrictive covenants.

I think debt is certainly not something that I would advise anybody to take pre revenue. But once you have revenue, you're a strong company that's just started reaching that growth stage, and you can understand that revenue, and you have a track record, a year or two-year track record, positive unit economics, you understand whether the company has the affordability to grow with some debt, then it's time to start considering putting some debt on the financial stack, and not just selling equity. I hope that helps answer the question.

KENNY: That's great, yeah. And as a follow up on a couple things you touched on, I'm gonna do a double-barreled question. First, to refresh, what's the check size and what's the size of the fund? Because you mentioned that a lot of people just don't have enough firepower for the debt to really get them where they want to go. And then, Dennis (Chookaszian) also asked a question. Obviously, you are pretty automated and technical, but how long does it actually take you to evaluate the application for a venture debt pitch?

GUY: In our case, evaluations last about a week, once we receive all the data that we require.

KENNY: Okay, and that's largely automated.

GUY: Yes, it is. It is very much an automated process. But I would say, look, automation, machine learning technology doesn't replace the human aspect of it. There are still some human elements there, in our approach, to how we operate, etc. We have a UI, we collect data through the UI and it's simple, it's drag-and-drop. Once we receive all the data we need, our system can start analyzing it, modeling it out. But we also have analysts that are specialists in certain sectors that work with the analysis. But also, a little bit of in-depth and human interaction also takes place.

AYLA: What kinds of companies will you be looking for, in terms of the size, or the type of company, etc.? Is there a certain amount of ARR that they would have to have? Or is there a certain level of funding that they would ask from you? What's the ideal profile of the company for you?

GUY: Happy to share with you what our minimum requirements are. When we get to speak to companies, it's a good way for us to effectively decide whether it's time to move on to actually inviting them to the platform and start to do the underwriting or not. The minimums are, we always want to see $3 million of ARR nett, if it's not recurring revenue.

Now, with that said, we could be looking at a company that has 2.5, but monthly, it hits 250. So that could work. In terms of growth, our minimums are 30% year-on-year growth. Again, you know, we want to see 2.5% month-on-month, but some companies are lumpier than others. So, if we say 30% year-on-year, we do always need to seek institutional investments. We do not take board seats. We do not get involved in the management of a company, so we want to know that there's somebody within the company that is external, and has an interest.

And normally, we're looking for companies that have at least $2 million of institutional investment, which can include family offices on their cap table. And another important one is six months' OPEX runway. That's very important and we always want to see that.

And those are pretty much our minimums. Now, if I break it down to the ideal profile, we're looking for growth stage companies that have typically 18 to 24 months of track record, that are in growth stage. Our typical deal sizes are a little bit bigger than the $3 million minimum, but that's not for any particular reason than just effectively what is coming our way.

KENNY: That makes a lot of sense. And that's very clear. It's nice to have nice, tight guardrails there. That always makes it easier for people that want to talk to you. One thing that came out of the chat is that rev share financing seems to be kind of another flavor of venture debt that is all the rage at the moment. What are your thoughts on revenue-based financing? Do you do any revenue-based funding? Are you exclusively on the debt side? What are your thoughts?

GUY: We're not revenue-based finances. Is there a purpose for that instrument? Certainly. But it's not something we do specifically. And I'm certainly not an expert about revenue-based financing, decides whether or not it's a fit, but I will say that it depends on the stage of the company. We're coming in at the growth stage, and we're there to maintain trajectory, growth of a business, or even accelerate it. So, using our platform and the ability to understand the blue sea of opportunity - and I clearly say this - we will often be able to provide a significantly larger funding round size than more traditional venture debt or revenue-based financing options. So, it's different. On one side, it's a way to maintain some cash flow, and on the other, it's really a way to accelerate a company's growth.

AYLA: Digging into a little bit of the details, someone in the audience asked how is that structured and priced? Wasn't the covenants part of that debt? Could you share a bit more on the nitty-gritty fine print on how the actual instrument works?

GUY: Okay. So, I can talk about our instrument. We don't have stringent covenants. How we operate is we provide a facility, and the facility is a one-year facility with 12 drawdowns monthly, followed by a second year's facility with the same terms. We look at year three at the beginning of year two, so there's a continuing process on those monthly drawdowns. What we're looking to see is if, in fact, the growth is actually occurring.

And we set that typically at 50% of what was agreed in the business plans to grow, or 2.5% month-on-month. The other thing we want to see is that the six months of the OPEX runway is being maintained at all times, and that our facility is actually being utilized. Some people take debt facilities as something of an insurance policy. We're a growth funder, so we don't put them in that way. We don't charge points upfront. So, we want to make sure that certainly is in use.

And typically, we're going to set that around 15% per quarter is being drawn for the facility. Meet those criteria, conditions, precedent (if you like), you can make your drawdown. If there’s a failure on them, they can't make the drawdown that time, then we can talk again in a month and nothing else changes. What you've drawn down to date stays with the company on the same terms. There's no acceleration, nothing else is going to change.

Repayments. We typically set them at 24 months on a waterfall, that can sometimes be extended to 36 months. And what that means is that when you draw in month one, you're going to repay starting in month two in 24 equal payments. What you draw in month 12, at the end of the year, you can start repaying in month 13 to 36, and so on and so forth.

KENNY: That's great. And then obviously, there's a lot of data, during that monthly drawdown. You need to have all of those metrics and everything. And I know that you have quite a technical solution. And I also know - and I'll give you a chance to plug yourself here - that you're partnering with other VCs to effectively give them or give them access to or license access to your platform on a white label basis. Maybe you may want to talk a little bit about that.

GUY: Yeah, happy to do that. The platform we built is actually a phenomenal platform. It also actually helps the companies, the portfolio companies, because they can use the data room and just drag and drop files on a monthly basis, so we can see what's going on. But there's also the option to actually integrate APIs so they don't have to do any heavy lifting or load on a monthly basis.

In terms of the platform itself, a little background on us, we are Israeli-based. We have the largest asset managers in Israel. We have Meitav Dash, who are one of our backers, our second backers at MUFG, who rolled out Mars Growth Capital together with us based in Singapore.

And third, on our cap table ourselves, is Spark Capital. And that started the conversation with Spark. "Can we use what you've built here? It's phenomenal. Can we use it on the venture side?" We started building it out, then MUFG started rolling it out, as well as MUFG innovation partners, etc. And we actually made the product now available to the VC market.

It's called Liquidity Dynamics. We're actually currently looking for 30 VCs of different sizes, from tier one through to smaller family office VCs and CVCs to become design partners. We're about two thirds of the way of gathering those VCs, as the early-stage design partners. System works — it's not a beater system, right? We deployed hundreds and hundreds of billions of dollars on it on the debt side. They're starting to manage their portfolios on it.

But we're looking for these flow partners to help us better the flow for different sizes and scales of the venture capital market. All the models are built. You can also create your own models on it, etc. So, if that's something of interest, and somebody would like a demo, please, please do reach out to us. I think our Director of Sales, Elise is also on this call, so she's a good person to talk to and reach out about Liquidity Dynamics.

AYLA: Another question that I'd love to ask is, what do you wish you had known about the states before you got started? Because it sounds to me like, you're definitely kind of pioneers in this, and are defining it as you go along. What do you wish you had known before you got started? And where do you see the space going in the next five to 10 years?

GUY: That is actually a very good question. What we would have liked to have known… I think, being quite old at 52, and having come from being an entrepreneur and having built companies, gave us a lot of insight. And as a team, it gave us a lot of insight as to what needs to happen to improve depth for the market.

What we would have liked to have known… I mean, there's so many things we would have liked to have known. But probably, if I'm going to focus on one… it's knowing exactly the right stage of companies to attract. And that's the time when a company starts considering balancing out their financial stack. It took us a little time to understand that scale and that size, and we needed a lot of data. But at the same time, we did need to run through the process of how we ran through it to collect enough data to understand that.

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Corporate Director, CME Group

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VP/Global Head of Tax, Binance.US

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