RUNWAY GROWTH CAPITAL

2023 Venture Debt Review

PRODUCED BY RUNWAY GROWTH CAPITAL

Contents

Disclosures

Views and opinions expressed are for informational purposes only and do not constitute a recommendation by Runway Growth Capital to buy, sell, or hold any security. Views and opinions are current as of Q4 2023 and may be subject to change, they should not be construed as investment advice.

This material does not constitute an offer or solicitation in any jurisdiction where or to any person to whom it would be unauthorized or unlawful to do so.

Prospective investors should inform themselves as to any applicable legal requirements and taxation and exchange control regulations in the countries of their citizenship, residence or domicile which might be relevant. This material is provided for informational purposes only and should not be construed as investment advice or an offer or solicitation to buy or sell securities.

This material is not intended to be used as a general guide to investing, or as a source of any specific investment recommendations, and makes no implied or express recommendations concerning the manner in which any client's account should or would be handled, as appropriate investment strategies depend upon the client's investment objectives.

This information discusses general market activity, industry or sector trends, or other broad-based economic, market or political conditions and should not be construed as research or investment advice.

Although certain information has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness. We have relied upon and assumed without independent verification, the accuracy and completeness of all information available from public sources.

Forward-looking statements: Certain information contained herein constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "project," "estimate," "intend," "continue," or "believe," or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events, results or actual performance may differ materially from those reflected or contemplated in such forward-looking statements. Nothing contained herein may be relied upon as a guarantee, promise, assurance or a representation as to the future.

Foreword

By Runway Growth Capital

We're pleased to present the latest edition of the Runway Venture Debt Review which has been produced in partnership with Sage Outcomes. The focus of this report is to gauge current market perceptions of venture debt financing, and to understand how the collapse of Silicon Valley Bank in March 2023 has shaped the views of both capital seekers and capital providers.

Our findings are based on a survey of 118 US-based entrepreneurs (within technology, life sciences, and consumer sectors) and venture funding providers from the venture capital (VC), venture lending, and commercial banking communities. Respondents varied from those having no experience with venture debt to those experienced with multiple forms of startup financing. Additionally, five in-depth interviews were conducted with venture funding providers to gain richer insights and complement the survey findings.

While performing research for this Venture Debt Review, we've discovered significant misconceptions about venture debt. Most notably, that it's often mistaken as a form of rescue financing or a tool only to be used when equity isn't an option – in reality, it is the opposite. Companies that appropriately raise debt are those that can raise equity but choose not to because they want to avoid dilution. Unfortunately, this false notion still prevails among some in the venture community.

Now, why is this? Venture debt is still relatively nascent as an asset class compared to venture equity – and there has been less education about its use case and value proposition. The recent banking turbulence that began with the failure of Silicon Valley Bank (SVB) did little to help clarify misconceptions. While SVB's venture lending practice was not a contributing factor to the collapse, speculation occurred at the time due to the bank's longstanding history of lending to early-stage startups. Early-stage venture debt is vastly different from late-stage growth lending. Even so, the two were (and still are) often conflated although they are distinct businesses – further adding to existing misperceptions.

Fast forward to Q4 2023. The banking crisis has been averted, but venture debt continues to be painted with a broad brush. Fluctuating stock prices, declining valuations, and tightening credit standards have created a challenging environment for deal-making across all stages.

Despite these difficult conditions, demand for venture debt remains high. Companies are pursuing minimally dilutive capital to supplement previous equity raises and extend runway. However, just as lenders are being more cautious, borrowers are also more closely evaluating the trustworthiness of their lending partner(s). We're seeing growing interest in non-bank / specialty finance lenders who are more flexible, faster-moving and able to lend larger amounts than banks.

This evolving dynamic should make for an active and interesting year ahead for venture debt. By sharing our findings, we hope to provide a deeper awareness of perceptions, trends, and nuances in the venture debt community, and help educate borrowers about misconceptions of the asset class.

Executive Summary

01

Lender reputation is more important following the SVB collapse.

Lender reputation has become crucial in the current market. Among entrepreneurs looking to raise venture debt, reputation is a top three consideration when deciding on a capital provider. Previously, entrepreneurs ranked this as the sixth most important factor (out of ten). Additionally, lender reputation is also now viewed more significantly by VCs, moving from seventh place to fifth. As a result of the banking turmoil and continued uncertainty, capital seekers are understandably more cautious when pursuing a lending partner.

02

Venture debt remains a desirable form of financing.

Demand for venture debt remains high as companies seek minimally dilutive growth capital to extend runway amidst a challenging environment. Survey findings indicate that borrowers and VCs are just as willing to utilize venture debt now as they were before the collapse of SVB, with 88% of VC respondents reporting that their portfolio companies still plan to pursue venture debt in the next 12-18 months.

03

Interest in non-bank, specialty finance lenders on the rise.

Borrowers are moving away from banks. There is now more interest in non-bank and specialty finance lenders. A third (33%) of entrepreneurs stated that in their opinion, venture banks have become less trustworthy since the collapse of SVB, with 19% reporting that they were not willing to raise venture debt with a bank at all. Conversely, 67% stated that they were willing to raise venture debt with a non-bank or specialty finance lender. Similarly, 23% of VCs felt that venture banks have become less trustworthy following the collapse of SVB.

04

Many hold inaccurate or narrow views of venture debt, suggesting education about the asset class is more important than ever.

Despite demand for venture debt remaining high, 16% of VCs had a negative view of the asset class which is likely due to misunderstandings around how and when debt should be used. The difference between early-stage and late-stage financing is not always clearly understood and there is a need for further education to correct inaccurate beliefs.

Venture Ecosystem in 2023

Startups have faced many challenges in 2023 that have required both adaptability and innovation. Among them, securing funding has been perhaps the most difficult. The record venture investment seen in recent years has slowed significantly. As valuations decline and economic uncertainty remains, VCs are being more selective in how they deploy capital and lenders have tightened their standards in the wake of recent bank failures, particularly that of SVB.

Many of the companies that raised equity capital in 2021 and 2022, did so at historically high valuations, providing them 24 to 36 months of runway. And while some of these businesses seemingly have managed their burn rates and continue to demonstrate healthy cash positions, they will ultimately need capital to fund growth in the coming quarters. With venture equity scarce and expensive, founders are looking for alternatives to traditional venture capital. It is likely that management teams will consider non-dilutive venture debt to supplement their previous raises, to avoid a down round and buy time until the market turns.

While difficult, this environment also creates a unique opportunity to build stronger, more resilient businesses. The companies who are able secure capital now will have endured a selection process designed to eliminate the weak, with those most likely to prosper receiving funding. These survivors will be well positioned to succeed.

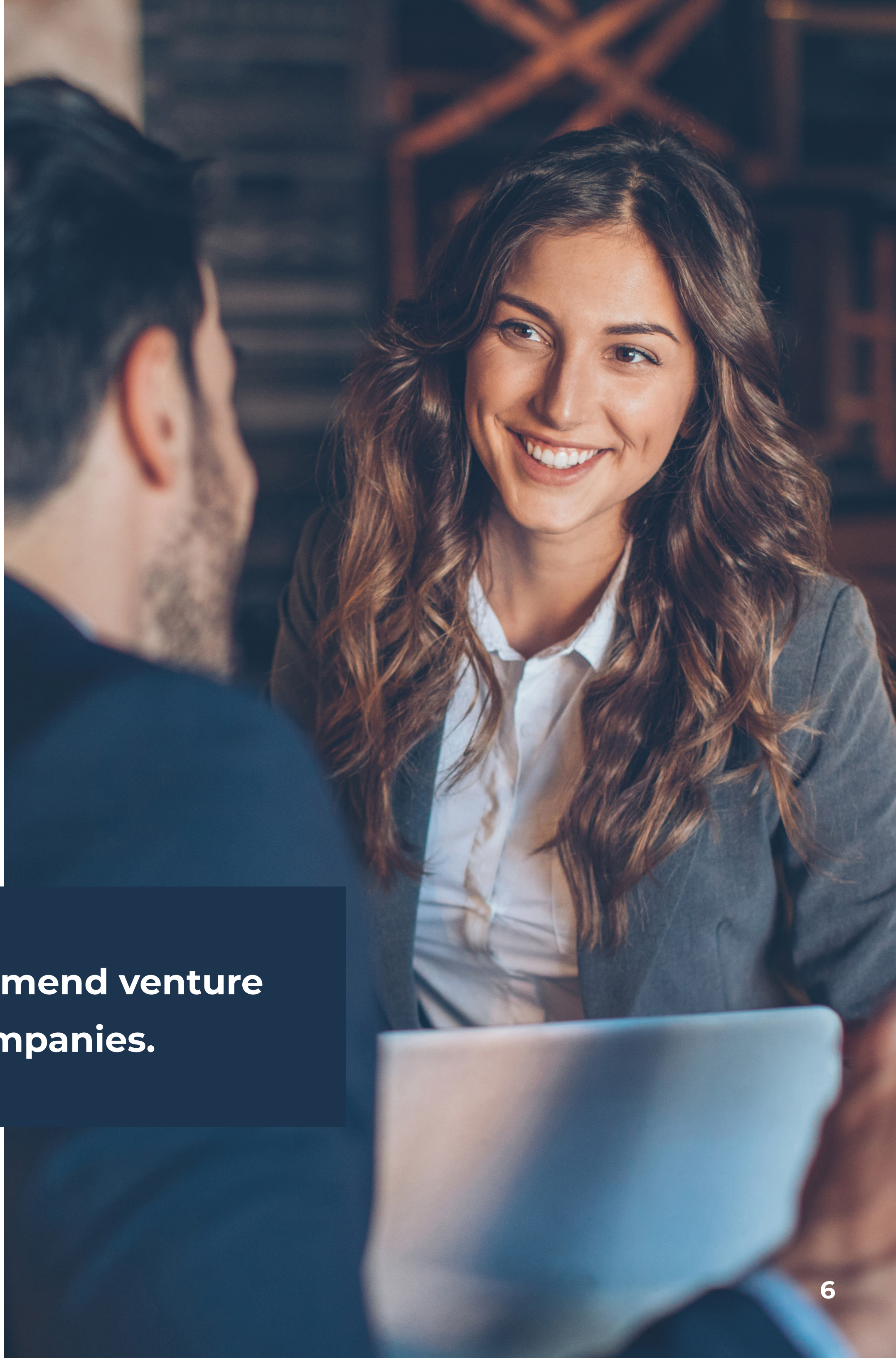
> **I think everyone's trying to find a way in this economic environment to grow, and alternative funding options are coming more into the spotlight.**
>
> DIRECTOR, EARLY-STAGE VC

How the Collapse of SVB Impacted Opinions of Venture Debt

More than half (57%) of VCs stated they are likely to recommend venture debt to their portfolio companies, and the majority stated their view of the asset class remains positive – a clear indication that venture debt has not lost its appeal even amid economic uncertainty.

Entrepreneurs seeking debt financing are largely undeterred in the wake of the SVB collapse: 56% of survey participants indicated they were willing to raise venture debt with a bank while 67% stated they were willing to raise venture debt with a non-bank lender.

57% **of VCs are likely to recommend venture debt to their portfolio companies.**



The Shifting Landscape for Bank and Non-Bank Lenders

Historically, banks have dominated the early-stage funding landscape as their loans tend to be significantly less expensive than private debt funds. However, traditional banks are no longer the primary source of debt financing and specialty finance lenders have become a popular choice for late and growth-stage companies due to their speed, flexibility, and ability to offer tailored solutions to entrepreneurs seeking minimal, or non-dilutive, growth capital.

Over a third (37%) of entrepreneurs stated that since the collapse of SVB they are now more likely to raise debt with a non-bank lender.

Another reason for the growing preference towards specialty finance lenders could be attributed to less trust in the banking system following the recent failures in March 2023. Roughly 23% of VCs and 34% of entrepreneurs believe that venture banks are less trustworthy after the collapse of SVB. This lack of confidence, coupled with the rise (and appeal) of specialty finance providers, has resulted in more startups seeking non-traditional financing methods.

It’s likely there will continue to be a further shift away from legacy banks that cannot meet the needs of the modern entrepreneur.

> **Pick the right partner that understands your business and your situation. And make sure to do reference checks to see how they deal with volatility.**
>
> BOARD MEMBER,
> TECHNOLOGY COMPANY

Misperceptions of the Asset Class Remain

Given the media coverage surrounding the collapse of SVB there's now a much greater awareness of venture debt financing; however, the nuances of the asset class are not always fully understood.

While debt has a vital and strategic role to play in the capitalization for both early and late-stage companies, their needs are very different and it's important to make clear that early-stage venture debt is not the same as growth lending. In fact, early-stage and late-stage venture lending are two very different things.

Early-stage venture debt is much more dependent on the financial backing of a company and its equity investors' willingness to continue funding over the long-term. In contrast, late-stage venture debt looks more closely at a company's fundamentals – including its financials and path to profitability. SVB financed early-stage companies, which are very sponsor dependent, but in the wake of the collapse, news reporting often conflated early-stage and late-stage lending which led to widespread misconceptions and consequently, negative assumptions about the asset class.

> **"Venture debt has been around for a long time, but still serial entrepreneurs aren't very familiar with this space."**
>
> DIRECTOR, EARLY-STAGE VC

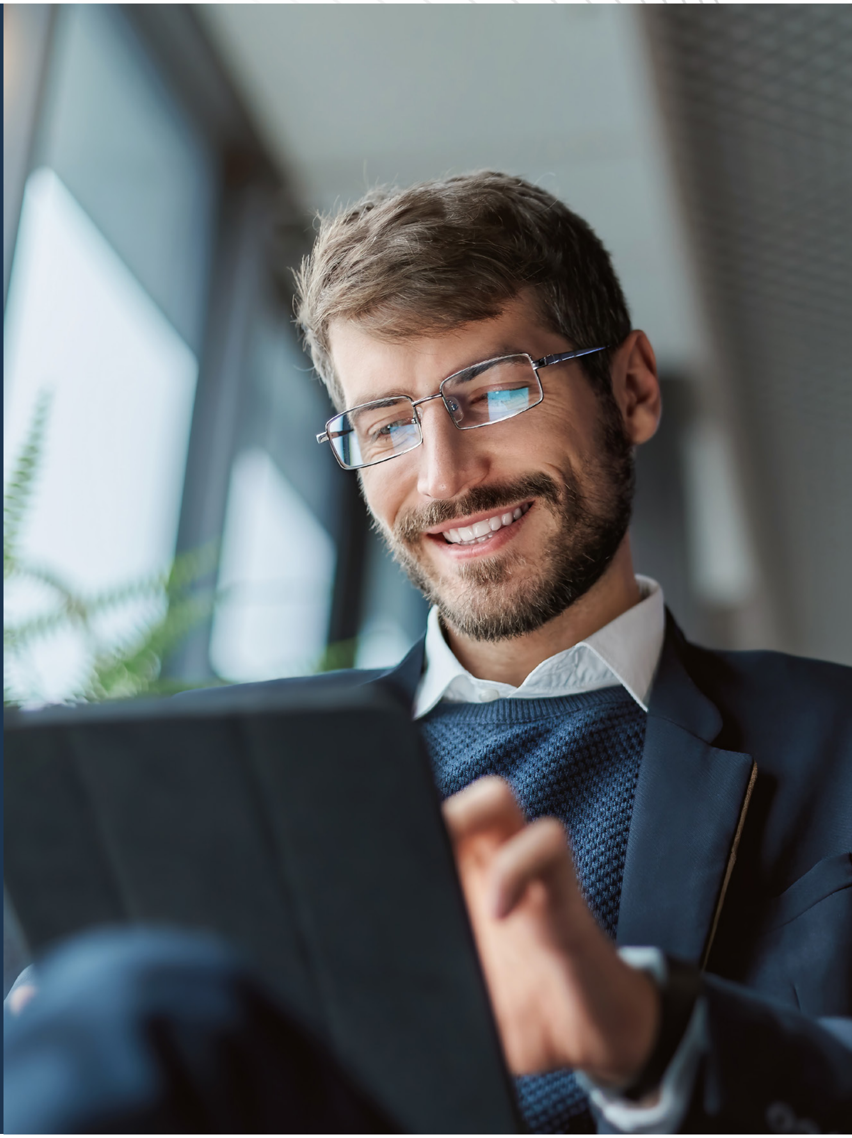
> **"One of the things that can help the industry as a whole is more press... because for every 15 to 20 VC articles, you might get one on venture debt, or maybe less than that.**
>
> DIRECTOR, EARLY-STAGE VC

Entrepreneurs More Cautious When Choosing a Lending Partner

Entrepreneurs are now, understandably, more careful about who they choose as a lender and there is increased importance placed on lender reputation. While cost of capital and structure of the loan remain the most important factors when considering who to partner with, reputation is now a top three priority. Previously, lender reputation was not a top five consideration.

This should inevitably help the industry as a whole, by motivating lenders to become better partners to those looking to raise capital. In many ways, the changes caused by the collapse of the banks have encouraged everyone in the ecosystem to be more conscious of who they work with and why – a development that can only be viewed as positive.

The distrust in traditional banks has led to more innovative and founder friendly financing options.



Conclusion

The venture debt ecosystem continues to evolve in response to industry disruption. However, demand is strong and it continues to play a large role in the capital stack for entrepreneurs looking to fund growth with minimal dilution.

Looking to the future, we expect to see a growing interest in the asset class and although there is clearly still educational work to be done to clarify the distinction between early and late-stage financing, the outlook for venture debt remains very positive.

> **“Coaching of founders is getting better, they are getting more and more sophisticated about term sheets and financial instruments.”**
>
> **PARTNER, SAAS SPECIALIST INVESTOR**

Methodology

An online survey was conducted in partnership with Sage Outcomes, between April 10th and June 6th, 2023 to understand the current market perceptions of venture debt financing, and how the collapse of Silicon Valley Bank in March 2023 has shaped the views of both capital seekers and capital providers. The study was conducted among entrepreneurs seed series and beyond (within technology, life sciences, and consumer sectors) and venture providers. Respondents were recruited from Pitchbook and Runway Growth Capital's online network.

118 complete responses were collected from the entrepreneur and venture capitalist audiences. Following the survey, 5 interviews with subject matter experts within the Runway Growth Capital network were invited to participate in an online in-depth interview to provide a more qualitative perspective to the findings.

About Runway Growth Capital LLC

Runway Growth Capital LLC is the investment advisor to investment funds, including Runway Growth Finance Corp. (Nasdaq: RWAY), a business development company, and other private funds, which are lenders of growth capital to companies seeking an alternative to raising equity. Led by industry veteran David Spreng, these funds provide senior term loans of $10 million to $100 million to fast-growing companies based in the United States and Canada. For more information on Runway Growth Capital LLC and its platform, please visit our website at www.runwaygrowth.com.