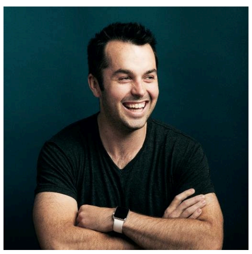
3 Lessons Learned From Raising $17.3 Million in Debt



Chris Savage is the CEO and co-founder of Wistia, a video marketing and analytics platform that helps businesses host, customize, and measure video content.

Recently, my co-founder Brendan Schwartz and I completed a debt raise of $17.3 million for our company, Wistia, through Accel-KKR.

The raise was prompted by an offer to sell the company. After realizing that we didn't want to sell the company, we knew that we would need to take care of investors and employees, who were expecting a liquidity event. That caused us to raise debt and refocus all of our efforts on building a lasting company.

And while we raised debt to buy out our investors, the experience of doing so convinced us that debt is something that could make a lot of sense for startups—especially SaaS businesses—that want to raise money.

Along the way, we've learned a lot:

- How investors look at your business when you're raising debt
- How your financials determine the kinds of terms you're going to get
- How raising debt alters the way that you think about growth and the future of your business.

1. Raising debt means selling yourself as a late stage company

With the amount of venture money sloshing around the ecosystem today, more and more companies are being founded that only have three potential trajectories: go public, get acquired, or die.

Raising debt, however, generally means choosing a more stable, long-term trajectory—and one that means you should prepare to sell yourself the way you would to a late-stage investor, rather than a seed or Series A venture investor.

Your typical VC is looking for companies that have substantial growth potential and a large total market size. They're not necessarily concerned with how their unit economics look today—only how they might look in the future.

Your typical bank or other debt provider is looking for something more reliable. What you're selling is the idea that you have a more predictable business model. If you're a SaaS startup, your subscription revenue is a very powerful way to prove that predictability.

What your lender is underwriting is actually your ability to keep people signed up from month to month. If you can show that you have strong revenue retention and low churn, lenders will want to give you money (assuming your core unit economics make sense).

When we raised from Accel, they looked at our cash flow, revenue, cost of goods and services, all our historical finances, and our growth—but what they were trying to understand, at root, was not whether we would 10x our business in the next several years or otherwise dramatically expand. What they cared about was whether we were likely to be able to pay back our debt.

2. Your financials will determine the quality of your terms

Raising debt can be a great way to finance your business if you don't want to give up any more equity, as long as you have the retention, moderate burn rate, strong cash flow and balance sheet to make it a viable option.

One of the most important factors to keep in mind when you're raising debt is your leverage ratio. A leverage ratio is a financial calculation that measures the relationship between the amount of debt you have and your ability to pay it off. The more favorable your leverage ratio, the more likely you are to get favorable terms.

One of the most common and important leverage ratios is net debt-to-EBITDA ratio.
This is the representation of how long it would take you to pay off your debt assuming your earnings stay steady, and your lender is going to use it to determine the likelihood that you'll default on your debt. They'll also use it to determine whether to lend to you in the first place and what kinds of terms they'll put on the debt.

The closer you can get to a 1:1 ratio of debt to EBITDA, generally, the better off you'll be—and the more likely you are to be able to get your money from a regular bank:

- If you ask for $10 million in debt with $10 million in EBITDA, you're likely to get favorable terms on your interest and repayment.
- If you ask for $10 million in debt with only $2.5 million in EBITDA, your leverage ratio is on the cusp of what a traditional lender like a bank is going to find comfortable.
- If you ask for $25 million with $2.5 million in EBITDA, you'll likely have to work with another kind of debt provider and might want to look into venture or alternative debt.

For capital-light tech startups, all lenders of debt are going to want to see that you have unit economics that make the repayment of your debt feasible. If you're raising your debt from a bank or other more traditional lender, they're also likely to want to see at least 2 years of financial data and evidence of profitability.

The less consistent and reliable your financials, the more likely your lender is to manage the risk that you won't repay your debt using covenants, though virtually all debt deals will include some kind of covenants written into the agreement.

Covenants are agreements between the lender and the lendee that force the lendee to take (and not take) certain actions while under the terms of the debt. Covenants might restrict a borrower from taking on additional debt, such as by selling assets or paying cash dividends. Covenants might also enforce that a borrower maintain the balance of a certain leverage ratio (like net debt-to-EBITDA) or generate audited financial statements for their lender. A common type of covenant called the cash covenant requires that the borrower of the debt keep a certain amount of cash on hand.

At the end of the day, anyone offering you debt is foreclosing on any kind of long-term appreciation through growth because you're offering them something different: a reliable, sound investment. If your financials don't strongly suggest that you are a reliable, sound investment, then you're much more likely to have onerous terms on your debt.

A debt investor chooses to forgo the long-term appreciation potential of your business in exchange for what is perceived to be a reduction in risk due to certain structural features of a debt investment. Namely, they have senior claim on the assets and cash flows of that business (or some predetermined subset of them).

3. Debt forces you to make different kinds of decisions about your business

Running a company with debt forces a level of rigor into your decision-making because you no longer have the "luxury" of running at a loss.

We can't spend a lot or hire ahead of our budget to juice the company's growth. Instead, we have to grow sustainably and focus on the long-term.

At Wistia, we've kept a healthy margin around our revenues, so we're more empowered to take those kinds of creative, long-term risks that have always been our lifeblood as a business. At the same time, we do have to think about whether our decisions have the potential to cut our margin closer down the road.

Debt can be an incredibly advantageous form of fundraising from the perspective of the lendee.
If the debt is paid off properly, it provides a guaranteed return to its providers. If that debt generates upside to the business in terms of sales or subscriptions, the business captures all of the resulting upside with none of it lost to equity investors.

To achieve this, though, you have to be comfortable with being and selling yourself as a more reliable, consistent business—and you have to be comfortable operating at a profit.

Cutting the knot

Raising debt could be a great option for startups that are planning to build for the long-term and don't want to play the growth-at-all-costs game. I think it's likely we'll see more and more startups choosing this path in the future.

The moment we decided not to sell Wistia was eye-opening. We knew exactly where we wanted to go with the business, and we understood that we were in it for the long haul. But like a lot of companies, we had outside investors—and outside investors and long-term businesses (that don't anticipate a sale or IPO) don't mix.

For us, raising debt allowed us to cut the Gordian knot. We were able to give our investors a healthy return on their equity, while at the same time, giving control over the company back to us and our employees. We couldn't be more excited about what the future will bring.