

## 'New' trend, old name: borrowing

### Startups turn to 'debt financing' as VCs turn tight

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Two Ottawa startups are using American financing tactics to open the wallets of wary venture capitalists and raise much-needed funds.

Both Innovance Networks and Tropic Networks have come forward with multimillion-dollar debt-financing arrangements over the past week. On Friday, Innovance secured \$26.5 million; last Wednesday Tropic secured \$15 million. Both companies got their financing through two consortiums. The GATX/MM Venture Finance Partnership of Toronto was involved with each.

Debt financing is used by larger start ups to buy new infrastructure such as computers and testing equipment. It stretches their existing equity financing when new money is scarce. The companies use property as collateral, in effect taking out a massive mortgage from a venture capitalist.

"The capital funding thing is a plum," said Gord Wyse, chief financial officer of Tropic.

"Only the best companies, the strongest companies, the ones with the best business plans, will be getting debt financing."

Before a start up can consider debt financing they must have sufficient assets to use as collateral.

"You have to have a well funded company," Mr. Wyse said. "If you ask why this has not been predominant in Canada, it's because in the past we haven't had well funded companies."

Both Tropic and Innovance have secured hundreds of millions in venture capital (VC) over the past year, and they have now grown to a point where they can use the American method of debt financing to raise more cash.

"It's a new trend to Canada, but it's very much part of the capital equation to start-up companies in the States," said Ron Patterson, partner with MM Venture Partners.

"Ottawa now has companies at the same calibre of the startups you are seeing down in the valley or in Boston, and the management teams are now understanding to create wealth you must manage your share dissolution very carefully."

Through traditional VC funding, a company would receive money and then that company would give up a percentage of its ownership, or equity, to the lender.

By using debt financing, the creditor assumes a secured debt, and the start-up gets the money its needs without having to hand out any equity.

"I was at another VC fund and we saw a number of circumstances where management teams started with 40 or 50 per cent (ownership) and by the time it got to the point of the initial

public offering, management teams were literally under 10 per cent (ownership)," Mr. Patterson said.

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