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Structuring for Exit

IDB Lab

New Approaches for Private Capital in Latin America

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Structuring for Exit

NEW APPROACHES FOR PRIVATE CAPITAL IN LATIN AMERICA

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LAVCA is the Association for Private Capital Investment in Latin America, a not-for-profit membership organization dedicated to supporting the growth of private capital in Latin America and the Caribbean. LAVCA's membership is comprised of over 170 firms, from leading global investment firms active in the region and local fund managers to family offices, global sovereign wealth funds, corporate investors, and international pension plans. Visit **www.lavca.org** for more information.

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Introduction

OVERVIEW OF PRIVATE CAPITAL IN LATIN AMERICA

Private capital fund managers have deployed USD100b in Latin America since 2008, when LAVCA began tracking investment activity in the region (see Figure 1). Peak fundraising cycles in 2010-11 and 2014 highlighted investor enthusiasm for a region characterized by a rising consumer class, linguistic commonalities, increasing digitalization, low entry multiples, and natural resource wealth. However, macroeconomic and political crises and currency volatility, most recently associated with the outbreak of COVID-19, have shaken investor confidence and created headwinds for fund managers. Throughout the peaks and troughs, the private capital landscape has evolved in important ways. Regulatory changes facilitating pension fund commitments and local family offices' appetite for alternative investments have supported the emergence of domestic ecosystems. Meanwhile, international investors have expanded in the region, with prominent global firms such as General Atlantic, SoftBank Vision Fund, and CVC Capital Partners joining early pioneers such as Advent International.

In the private equity (PE) space, fund managers have developed more sophisticated approaches to value creation in their portfolios. Increasingly, investors have targeted specific sectors, applying the team's operational expertise to key industries such as healthcare and energy. At the same time, venture capital (VC) investment in the region's burgeoning technology ecosystems has grown exponentially, reaching USD4.6b in 2019. Latin America-focused investors managing direct lending funds have also helped drive the recent rise in private credit activity, replicating a trend in other markets such as Emerging Asia.

Private capital activity in Latin America is still nascent compared to developed markets. The region has a five-year private capital penetration rate of only 0.18% compared to 1.86% in the United States.[1] Still, private capital has had a meaningful effect on Latin American businesses, including social and/or environmental impact enterprises. Some of the fastest growing and most influential companies across the region are backed by private capital investors, such as Prisma Medios de Pago in Argentina, XP Investimentos in Brazil, Rappi in Colombia, and Kavak in Mexico. In a region where access to bank lending is scarce, private capital has a vital role to play in providing businesses with long-term financing to address local consumer and industrial demand.

Latin America Private Capital Fundraising and Investment, 2013-2019 (USDb)

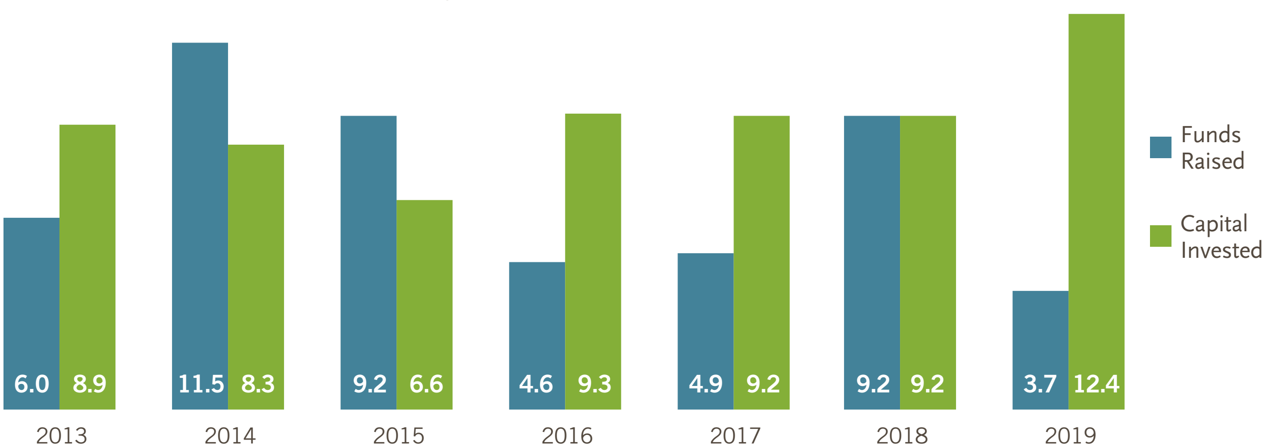

Figure 1. Source: LAVCA. Data as of 30 June 2020.

1 Methodology: Annual private capital investment divided by annual gross domestic product (current prices).
Sources: Latin America: LAVCA (data as of 30 June 2020). United States: PitchBook (data as of 30 June 2020). All GDP Data: IMF World Economic Outlook Database, October 2019 (IMF estimates are used for 2018 GDP figures).

THE PATH TO EXIT

Many innovations in fund strategy, deal structuring, and value creation reflect adaptations by investors to a persistently challenging exit environment in Latin America. In the 2020 edition of EMPEA's *Global Limited Partners Survey*, produced in collaboration with LAVCA, 22% of respondents cited concerns about the exit environment in Latin America as a deterrent to investing in the region, a number that has remained steady throughout the past few years of the survey.[2] Although total exit value in Latin America increased to USD6.5b in 2019, totals have been driven by a few large deals (see Figure 2), and the number of reported exits has remained relatively steady, year over year. Even with these landmark exits, reported distributions remain below the volume of investment activity, which reached USD12.4b in 2019, reflecting a proportion of subpar exit outcomes and trapped capital (see Figure 3).

Latin America Private Capital Exits by Deal Size 2012-1H 2020 (% of No. of Exits)

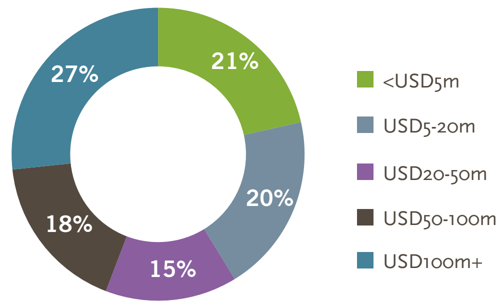

Figure 2. Source: LAVCA. Data as of 30 June 2020. Excludes write-offs and transactions for which deal size is not disclosed.

Latin America Private Capital Divestments by Exit Type, 2012-2019

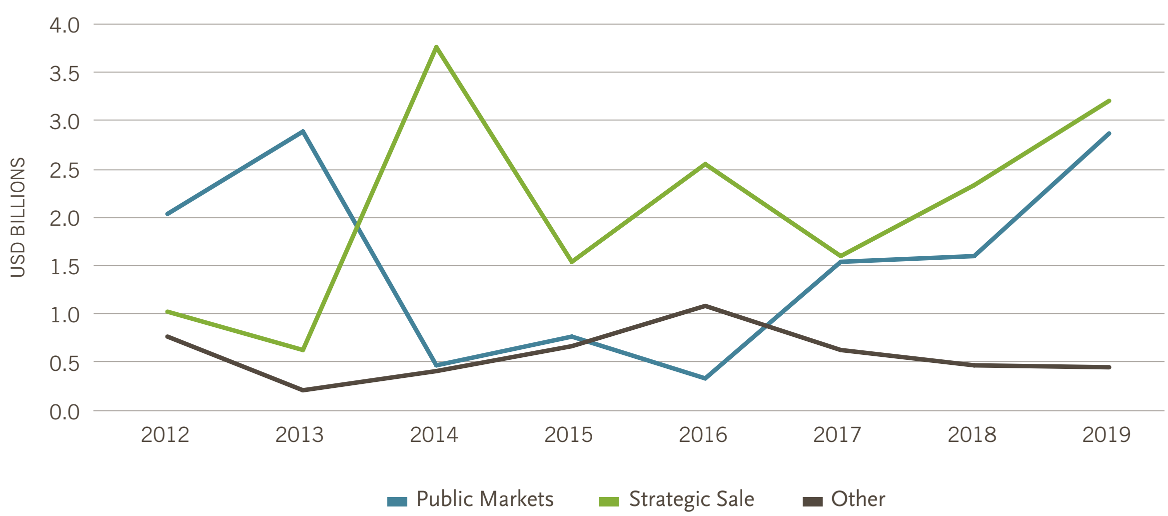

Figure 3. Source: LAVCA. Data as of 30 June 2020. Excludes write-offs.

2 Survey responses refer to Latin America excluding Brazil. Only 12% of respondents indicated that a weak exit environment represented a deterrent to investing in Brazil.

KEY MARKET DRIVERS FOR STRUCTURED FINANCING SOLUTIONS AS AN ALTERNATIVE TO TRADITIONAL PE AND VC

Traditional PE and VC financing structures pose inherent challenges for fund managers investing in Latin America, as noted below:

FEW EXIT AVENUES — Shallow local capital markets, as well as the smaller scale of many private companies, mean that strategic sales and public market exits, especially outside of the region's largest economies, are often challenging. Traditional PE and VC investors therefore face fewer opportunities for traditional equity liquidity events than investors in developed markets.

TIMING EXIT WINDOWS — Due to cycles of economic and political uncertainty in Latin America, investors have difficulty timing exits, since exit windows may not align with the growth trajectory of a company (see Figure 3). GPs managing fixed-term funds have a limited timeframe to liquidate their positions and return proceeds to LPs. If conditions are not right for an exit or a company has no clear exit path, GPs may have to either extend the holding period to the detriment of IRR or accept unfavorable exit terms in exchange for immediate liquidity.

NARROW POOL OF VIABLE INVESTMENTS — Not all companies are viable candidates for the traditional PE and VC model. Private capital investors tend to target companies with exponential growth potential or large businesses with room for operational efficiency improvements, leaving out profitable SMEs with moderate growth prospects. A narrow focus on these types of opportunities creates a funding gap for companies that cannot access financing from banks and are not compatible with traditional PE and VC investors. Enterprises with innovative business models are more likely to experience these difficulties, since scaling too quickly can sometimes challenge financial and/or impact goals over a longer time horizon. Social and environmental impact companies are also more exposed to these challenges because they often operate in sectors less frequently targeted by strategic and public markets investors.

Similarly, there are considerations for business owners and startup founders seeking capital through traditional PE and VC or bank financing:

AVOIDING DILUTION/LOSS OF CONTROL — Founders usually prefer to avoid dilution and maintain control over their companies. This issue is particularly relevant for family-owned businesses, which represent more than 70% of Latin American companies.[3] Founders may have an appetite for financing instruments that do not require investors to take an equity interest in the company.

AVAILABLE FINANCING ALTERNATIVES OFFER LITTLE FLEXIBILITY — Bank loans with fixed interest rates or strict collateral requirements may be unattractive for companies with cyclical revenue streams or asset-light balance sheets. Moreover, the limited tenors on offer from banks cannot support medium- and long-term growth initiatives. Strict bank lending requirements create an opportunity for firms offering flexible financing solutions with provisions generally not offered by banks (e.g., grace periods, seasonal payments, longer terms, variable payment models, etc.).

LACK OF ALIGNMENT WITH BUSINESS GOALS — Not all businesses will scale sufficiently within the life of a typical fund for traditional PE and VC investors to secure an attractive return on equity. Alternative financing structures can serve as a catalytic resource for growing businesses, including environmental and social impact companies. Likewise, these structures can assist companies with modest levels of growth or longer growth time horizons to reach financial, social, and environmental goals as well as prepare for future rounds of fundraising from traditional investors.

3 According to data compiled in 2017 by *Family Firm Institute,* 70% of Colombian companies are family-owned, with family-owned companies representing a larger portion of enterprises in other Latin American markets such as Mexico (82-90%) and the Dominican Republic (96%).

THE STRUCTURED FINANCING OPPORTUNITY

DEFINING STRUCTURING FOR EXIT — ***Structured financing solutions*** encompass a range of investment approaches that provide liquidity to investors without the need for a traditional equity exit event, such as a strategic sale, sale to another financial investor, or public market listing. Structuring mechanisms across the debt-to-equity spectrum determine the exit terms of the deal, therefore providing considerable downside protection to investors.

Structured financing solutions are an incipient but increasingly important set of tools for investors active in Latin America to address the financing gap for companies that lack access to bank financing and are not attractive targets for traditional PE and VC players.

Many investors employing these strategies are in an experimental phase, reporting new lessons learned with each deal completed. Impact investors have been among the top drivers of these structuring innovations, as they have grappled with the additional limitations associated with the straight equity model for environmental or social enterprises. However, the use of structured financing is by no means restricted to the impact investing space. Fund managers have invested USD4b in private credit deals in Latin America since 2018, more than the previous ten years combined. PE and VC investors have also increasingly employed quasi-equity and debt instruments. ACON Investments, for example, has employed mezzanine structures in several deals from its latest funds. Brazil-focused venture capital firm SP Ventures has recently begun investing from its debut venture debt fund. Growing experimentation by fund managers demonstrates the opportunity for investors across ticket sizes, strategies, and the impact-to-commercial spectrum. The structures discussed and the case studies highlighted in this report contain some of the major lessons applicable to a wide group of private capital investors in Latin America targeting certain and timely exits with consistent returns.

METHODOLOGY

Between August and October 2020, the LAVCA and EMPEA research teams interviewed approximately 30 investors active in emerging markets, ranging from mid-cap private equity to small impact fund managers, as well as fintech companies backing local entrepreneurs and company management teams that have received structured financing. While interviews were concentrated among investors active in Latin America, the team also spoke to fund managers operating in Africa, India, Southeast Asia, and the Caucasus to identify opportunities for cross-border comparisons and learning. The goal was to identify common pitfalls related to traditional PE and VC investments, as well as alternative financing structures currently being deployed by fund managers in markets where exits are challenging.

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Structuring Approaches and Instruments

Structured financing solutions used by fund managers in Latin America can be broken down into three main categories: pure debt instruments, mezzanine debt—which comprises a loan structure and one or several equity kicker components—and redeemable equity.

Most investors have adopted a flexible strategy, with deal terms adapted to the company's business model, risk profile, ticket size, and potential exit upside, as well as local tax and financial regulations. While solutions can be tailored to address these variables, more complex deal structures may generate additional costs associated with negotiation, deal structuring, and investment monitoring. Fund managers stress the importance of striking a balance between customization and simplicity.

Structuring Approaches and Instruments

DEBT		MEZZANINE		REDEEMABLE EQUITY	
Pure Fixed-Rate or Flexible Loan		*Term or Revenue-Based Loan + Equity Kicker*		*Equity Investment with Mandatory Redemption by Entrepreneur*	
LOAN STRUCTURES		**EQUITY KICKERS**		**REDEMPTION SCHEMES**	
Term Loan	Revenue-Based Loan	Royalty:	Income Participation	Gradual	Single-Transaction
			Cash Payout		
		Conversion Option:	Balance Conversion		
			Convertible Notes		
		Equity:	Participation Rights		
			Direct Stake		

DEBT

Some investors have chosen to utilize pure **debt instruments** to back companies that either lack access to bank financing or require more flexible loan terms than traditional banks.

Investors use one of two broad lending models: Term Loans—which deliver early and predictable returns and incur fewer structuring and monitoring costs than the revenue-based model, but provide less repayment flexibility for entrepreneurs—and Revenue-Based Loans—which require a more extensive negotiation and deal-structuring process. Revenue-based models allow for increased alignment of expectations and interests with entrepreneurs while also increasing the time and costs associated with each transaction. Entrepreneurs benefit from low payments during low-revenue periods, with the structure particularly attractive to companies with fluctuating seasonal revenue, such as schools or agribusinesses. However, high interest rates during high revenue cycles pose risks for entrepreneurs looking to reinvest in the business. Furthermore, local regulations that cap interest rates in markets such as Colombia and Costa Rica can pose legal challenges for interest collection in high-revenue periods.

ARCHITECT CAPITAL

Investment Mandate: Venture-backed fintech and proptech companies in Latin America, Southeast Asia, and Africa

Deal Structure: Term loans collateralized with tangible assets held by company (i.e. loan books, consumer loans, real estate)

a55

Investment Mandate: Brazil- and Mexico-based SaaS and e-commerce companies seeking growth capital

Deal Structure: Fixed-rate term loans, revenue-based revolving credit lines

Architect Capital and a55 Employ Debt Instruments

Private debt investors in Latin America have also experimented with deal term variations:

- Debt Instruments
- Grace Periods
- Loan Security
- Repayment Accounts
- Prepayment Conditions
- Currency
- Disbursal Schedule

TYPICAL COMPANY PROFILE

- Businesses unattractive to bank lenders (i.e. asset-light, unprofitable, risky business model, small)
- Bankable businesses seeking more patient, tailored capital

ADVANTAGES AND RISKS

	Investor	Entrepreneur
+	• Early, predictable returns • Partial capital recovery in case of bankruptcy	• Growth capital without equity dilution • More flexible conditions than bank financing (i.e. loan tenor, covenants, collateral, payment schedules)
-	• Variable risk profile based on strength of collateral and debt position in the company's capital stack • Capped return on investment • Potential regulatory restrictions as a debt investor • Higher portfolio monitoring costs than straight equity instruments	• High annual interest rates relative to bank financing • Not a substitute for equity on balance sheet. Insufficient equity can make it difficult to raise capital in the future • High prepayment provisions can deter incoming investors

MEZZANINE

Most structured financing transactions completed in Latin America comprise one of the loan structures discussed above with one or several additional equity 'kickers'. These structures are used for companies with similar profiles to those receiving pure debt financing. Investors can incorporate an equity component in order to align interests with the entrepreneur, secure loan obligations, and potentially achieve an additional equity payout. **Mezzanine debt** is generally subordinated to senior debt but sits below common equity in the capital stack.

ANTERIS

Investment Mandate: Venture-backed and sponsor-less Mexico-based companies at Series A, B, or C stage

Deal Structure: Fixed-rate term loan with one of three performance participation components: warrants, sales-based royalty, or cash payout

VIWALA momentum capital

Investment Mandate: Mexico-based, women-led companies that create a positive social impact and have at least MXN50k in annual revenues

Deal Structure: Term loans with revenue-based royalties

Anteris Capital and Viwala Employ Mezzanine Instruments

Equity kickers can include:

- Income Participation Royalties
- Convertible Notes
- Cash Payout
- Participation Rights
- Balance Conversion Rights
- Direct Equity Stakes

TYPICAL COMPANY PROFILE

- Businesses unattractive to bank lenders (i.e. asset-light, unprofitable, risky business model, small) but with a clear business model and path to profitability
- Bankable businesses seeking more patient capital

ADVANTAGES AND RISKS

	Investor	Entrepreneur
+	• Early, predictable returns • Partial capital recovery in case of bankruptcy • Alignment of interests with entrepreneur • Potential to strengthen loan covenants • Upside return potential • Senior position to equity shareholders • Possible additional legal protections as an equity investor	• Growth capital without equity dilution • More flexible conditions than bank financing (i.e. loan tenor, covenants, collateral, payment schedules) • Alignment of interest with investor • In some cases, lower interest rates relative to pure debt instruments in exchange for equity component or rights such as board participation • Can increase company book value (i.e. in the case of equity conversion option) and draw future investors
-	• Risk of unfavorable exit price and terms, especially if conditions are not preset • Generally (but not always) junior position to company's senior lenders • Higher portfolio monitoring costs than straight equity instruments	• High prepayment provisions can deter incoming investors • Risk of unfavorable exit price and terms, especially if conditions are not preset • Risk of loss of some control upon loan default or investor conversion to equity

REDEEMABLE EQUITY

In **redeemable equity** deals, investors purchase a direct equity stake in the company, which the entrepreneur is contractually obligated to repurchase. Investors generally use this structure to invest in either mature, cash flow positive or high-growth, nearly profitable companies seeking equity in their capital structures. Investors can structure a redemption obligation, sometimes referred to as a put option, as a primary targeted exit route or as a secondary exit mechanism in case a traditional equity exit is not achieved. In some cases, only a portion of the stake acquired by the investor is subject to a redemption obligation. The exit value may be decided in advance based on a multiple of invested capital (MOIC) or may be determined based on valuation at exit. Redeemable equity can be repurchased through a Gradual Redemption Scheme or Single-Transaction Redemption, and investors can choose to utilize a redemption pool to collect company receivables or revenue for the purposes of repurchasing the equity.

INVERSOR

Investment Mandate: Colombia-based SMEs seeking growth capital

Deal Structure: Flexible debt instruments, including term loans with growing amortizations, EBITDA- or revenue-based payments, or interest rates tied to performance goals; redeemable equity

ALIVE
Acumen LatAm Impact Ventures

Investment Mandate: Early-to-growth-stage companies in Latin America, with a primary focus on Colombia and Peru

Deal Structure: Flexible straight equity to structured financing, including redeemable equity and convertible debt

Corporación Inversor and ALIVE Employ Redeemable Equity Instruments

TYPICAL COMPANY PROFILE

- Profitable or high-growth companies with substantial retained earnings but uncertain exit prospects (i.e. no public or secondary markets)
- Profitable or high-growth companies with substantial retained earnings seeking growth capital with entrepreneurs averse to dilution

ADVANTAGES AND RISKS

	Investor	Entrepreneur
+	• High upside potential • Less risk of trapped capital at end of investment period relative to traditional equity • Potentially favorable local tax and regulatory conditions as equity investors	• Growth capital without equity dilution • Equity on balance sheet may be more attractive to future investors
-	• Risk that entrepreneur lacks sufficient liquidity to repurchase shares • In gradual redemption, loss of upside potential throughout investment period • Risk of unfavorable redemption return if price is not preset or if price is set below stake valuation at exit • Junior position to company's creditors. Limited recovery in the event of bankruptcy, with higher risk in single-transaction structures • Higher portfolio monitoring costs than conventional equity instruments	• Risk of loss of control if unable to repurchase shares • Risk of redemption pool contributions limiting reinvestment in business • Risk of unfavorable redemption cost if price is not preset

Case Studies

This section contains six examples of structured financing solutions utilized by investors across sectors and geographies. LAVCA and EMPEA spoke to both the fund managers and the entrepreneurs regarding deal sourcing, instrument structuring, investment management, and, where relevant, exit processes for the following exited and active investments, distilling the key takeaways from each deal. Two of the six case studies feature deals from outside of Latin America in order to draw insights from comparable markets that can be applied to the region.

INVESTOR	COMPANY	LOCATION(S)	DEAL STRUCTURE	KEY TAKEAWAYS
Adobe Capital	Provive	Mexico	Convertible revenue-based loan	- Mitigating Regulatory Risk - Relationship with Equity Investors - Projections and Payment Scheme Flexibility - Payment Schedule Flexibility - Exit Timing and Return Tradeoffs
Adobe Capital	Puntored	Colombia	Convertible revenue-based loan with special preferred share	- Milestones - Impact Goals - Considerations of Local Regulations - Variable Repayment Models - Conversion Options
LAFISE Investment Management	Grupo STT	Costa Rica	Five-year convertible mezzanine term loan	- Educating the Entrepreneur - Repayment Accounts - Term Flexibility
Trifecta Capital	NephroPlus	India	Three-year term loan with partly paid CCPSs and participation rights	- Streamlined Term Sheets - Convertible Note Instruments - Company Track Record - Legal Rights for Equity Investors
Pomona Impact	Yellow Pallet	Costa Rica	Seven-year term loan with potential cash payout upon sale of factory	- Grace Periods - Collateral - Late Fees - Cash Payout Incentive
Gazelle Finance	Dr. Rödger	Georgia	Five-year term loan with income participation royalty	- Currency - Tranched Disbursement Schedules - Prepayment Fees

COMPANY PROFILE

COMPANY NAME: Comunidades Que Renacen (Provive)

INDUSTRY/SECTOR: Real Estate

LOCATION(S): Mexico

ENTREPRENEUR: Antonio Diaz

DESCRIPTION: Provive aims to rebuild and revitalize communities by refurbishing foreclosed homes and promoting social participation.

INVESTMENT

DATE: August 2015

AMOUNT: MXN40m (USD2.3m)

INSTRUMENT: Convertible revenue-based loan

EXIT

DATE: April 2019

OUTCOME: Prepayment after refinancing from bank for a 2.35x MOIC and 32.5% gross IRR in MXN terms

INVESTOR PROFILE

FUND NAME Adobe Social Mezzanine Fund I (ASMF I)

INVESTMENT OFFICER Rodrigo Villar Esquivel

FUND SIZE USD20.2m

TOTAL AUM USD50.5m

Adobe Capital is an impact investment fund manager focused on supporting the early growth of small and growing businesses with a specific emphasis on companies focused on solving pressing social and/or environmental issues. Adobe Capital invests in innovative companies that have potential to scale and be financially profitable, while delivering products and services which impact the quality of life of a critical mass of people and/or the environment.

ADOBE SOCIAL MEZZANINE FUND I

FUND OVERVIEW

ASMF I is Adobe's first mezzanine impact investment fund launched in 2012. The fund achieved a final close in 2014 with total commitments of USD20.2m targeting a 2.5x MOIC. Major LPs in this fund included DEG, Proparco, the IDB, Fondo de Fondos, and CAF.

ASMF I was the first fund in Mexico to offer a mezzanine investment structure. The fund completed its first investment in 2013, investing in student loan provider FINAE. The fund invested in a total of eight companies in Mexico including Provive.

COMPANY PROFILE

Provive began operations in 2010, buying foreclosed and abandoned homes in planned communities mostly in cities along the Mexico-US border including Ciudad Juárez, Mexicali, and Tijuana. The founder, Antonio Diaz, had years of financial experience within the Latin American operations of Santander bank. Mexico underwent a government-funded housing boom in the 2000's in which seven million homes were constructed in *fraccionamientos,* which are planned subdivision neighborhoods. Many of these neighborhoods fell into disrepair, were abandoned by their occupants, or were taken over by squatters in the ensuing years. Antonio saw an opportunity to buy, refurbish, and resell these homes for a profit given the large inventory. However, Antonio realized that these homes would only be resalable if investments were also made in the community. Provive aims to refurbish and resell homes while also investing in community development to ensure the safety, value, and longevity of these neighborhoods and homes.

BACKGROUND

The *Instituto del Fondo Nacional de la Vivienda para los Trabajadores* (INFONAVIT) is a Mexican state agency tasked with providing affordable and reliable housing for Mexico's formal lower-income workforce. INFONAVIT is funded through payroll contributions and provides low-interest mortgages and credit subsidies to Mexican workers seeking to purchase homes. In the early 2000's INFONAVIT began a reorganization process, which incorporated private real estate developers. In the past, INFONAVIT utilized a slower, more incremental construction process which relied on a mortgage-to-build model. Private developers constructed millions of homes, including new *fraccionamientos* in the ensuing decade, and these homes were sold primarily to lower-income formal employees who applied for housing through INFONAVIT. INFONAVIT, as result of this public-private partnership, became the largest mortgage lender in Latin America and financed the construction of more than seven million homes from 2004-2014.[4]

The housing and financial crisis of 2008 hit the new *fraccionamientos* especially hard, resulting in a drastic increase in unemployment due to Mexico's close linkages to the US market. Many home buyers defaulted on their mortgages. Hundreds of thousands of homes entered the foreclosure process or were outright abandoned. The 2008 financial crisis dovetailed with an escalation of the Mexican drug war, as the government ceded more ground to the drug cartels who saw their ranks increase partially due to chronic unemployment.

Many of the *fraccionamientos* were very hastily constructed as suburban extension communities, not fully integrated or connected to the cities they surrounded or to other neighborhoods. As state investments in these neighborhoods fell off during the financial crisis, many *fraccionamientos* lacked basic infrastructure and services. Due to the proximity of these communities to the US-Mexico border during an escalation of the Mexican drug war, many vacant homes were occupied by criminals and gangs. These communities became dangerous, and the streets were filled with garbage due to reduced services. This deterioration resulted in the decline in market value of homes in these communities and fueled further abandonment. Some of these communities had abandonment rates of 70%. With a very limited secondary market in Mexico, many of the homes remained vacant for years.

PROVIVE'S STRATEGY

Revitalize — Provive promotes active participation by investing in community centers, training programs, and neighborhood beautification projects to ensure the safety and long-term viability of its communities. Provive conducts much of this activity through its sister foundation TÚ + YO, which receives 2% of Provive's revenue.

Repurchase — Provive acquires foreclosed homes directly from banks or in bulk through auctions conducted by INFONAVIT.

Refurbish/Renovate — Provive fixes and renovates the abandoned or vandalized homes in preparation for resale.

Resell — Provive resells the homes primarily through INFONAVIT, receiving payment from the agency while its low-income customers receive 15-to-20-year mortgages with interest rates as low as 4%.

4 Lina M. Salazar Ortegón, "Abandoned Houses Prove Golden Opportunity in Mexico," *Inter-American Development Bank Private Sector Blog*, July 24, 2014, https://www.idbinvest.org/en/blog/abandoned-houses-prove-golden-opportunity-interview-antonio-diaz-founder-and-ceo-provive.

OPPORTUNITY

PROVIVE'S FOUNDING

As the foreclosure and resale process for homes in *fraccionamientos* became more defined in the 2010s, several competitors entered the market seeking to capitalize on the massive inventory of abandoned homes. Antonio Diaz saw an opportunity and proposed a counter-cyclical business model to begin the purchase, renovation, and resale of these homes, founding Provive in 2010. Provive's edge over its competitors was its focus on community development and revitalization. In 2012, the company began to work with *Fundación Hogares,* a collaboration which allowed Provive to gain expertise in community development. The partnership allowed Provive to develop the know-how to eventually create its own foundation called TÚ + YO, which works in tandem with Provive to revitalize communities.

TAQUIZA STREET SMARTS

Antonio Diaz of Provive organized Taquiza or Taco buffets for the *fraccionamientos* in which Provive had purchased and resold homes to help strengthen these communities. At one of these first offerings, a resident warned Antonio that the homes he resold would likely be abandoned again due to the crime and disrepair that existed within the neighborhood. This conversation helped Antonio realize that Provive would need to prioritize community development to ensure the long-term viability of the homes and neighborhoods where Provive planned to invest.

ADOBE AND PROVIVE

Adobe Capital met Antonio Diaz at a housing event in Mexico City and he was later on invited to New Ventures's *Foro Latinoamericano de Inversión de Impacto* in 2014. By this time, Provive was growing and acquiring progressively more housing inventory for resale. Adobe Capital began to evaluate Provive for a potential investment in 2014. A variety of factors impressed Adobe. Provive's Trailing Twelve-Month (TTM) revenues at the time of analysis by Adobe were MXN104.6m (USD8.3m), with significant room for growth due to the massive inventory of homes owned by INFONAVIT. Three million of the seven million homes built through the INFONAVIT public-private partnership in the early 2000s had been foreclosed upon, vandalized, or abandoned. Adobe was also impressed by Diaz, a graduate of the Wharton Business School who had fine-tuned his financial and entrepreneurial expertise working for Santander bank in Latin America. Lastly, while there were other competitors in the space also acquiring homes from INFONAVIT, Provive was the only one that emphasized community development as a pillar of its business thesis.

Prior to Adobe's investment, Provive had received a USD2.5m equity investment from Mexican fund manager IGNIA Partners in 2011 for a 75% stake, with the founders holding the remaining 25%. Provive had also received a small loan in 2013 from Altum Capital but was in need of another investment to fulfill working capital requirements and add additional housing inventory. In 2014, Provive began analyzing options for investment but realized the company was small and the founders did not own a large enough stake to be attractive to equity investors. They also did not have the required inventory to utilize as collateral to qualify for a loan from Mexican financial institutions. Additionally, the company had run into obstacles continuing to develop its inventory due to a lack of working capital.

Adobe identified some risks that could impact its investment. Provive was heavily influenced by the political cycle, since most of its inventory was purchased and then resold through the state agency INFONAVIT. As a result, Provive was almost completely dependent on government auctions and regulation. Any change in the regulations or political leadership could negatively affect Provive's viability and growth. Provive had also stretched its debt and equity options by accepting capital from IGNIA and Altum, leaving it with limited balance sheet maneuverability. Lastly, the company was at an impasse, requiring more capital within a short window to fund inventory expansion and operational expenses to avoid downsizing. Adobe felt Provive's value proposition and growth prospects outweighed these investment risks.

DEAL TERMS

DEAL STRUCTURE: REVENUE-BASED CONVERTIBLE LOAN

Adobe first provided a USD2.3m senior convertible loan in 2015 with revenue-based monthly payments until receiving a 2.5x MOIC.

Grace Period — The loan provided Provive with a one-year grace period. The loan was later restructured to provide Provive with an additional three-month grace period.

Loan Payments — Provive was required to make monthly payments after the end of the grace period. Payments were calculated as a variable percentage of revenue and tiered based on whether EBITDA performance was above or below management projections. Payment percentages gradually increased, as reflected in the loan payments table below, based on the number of months post-investment until Adobe achieved a 2.5x MOIC. A non-payment clause was included stipulating that three consecutive months of non-payment would generate a default event.

Currency — The loan was funded in MXN.

LOAN PAYMENTS

Months Post-Closing	% of Total Revenue (equal or above 70% of EBITDA projections)	% of Total Revenue (below 70% of EBITDA projections)
0-12	0% (Grace period)	0% (Grace period)
13-24	Increasing % over time	Increasing % over time
25-36		
37-48		
49-60		
61-72		
73+	7%	9%

CONVERSION RIGHTS

Adobe had the right to convert any outstanding balance of the total repayment amount into an equity interest in Provive in the case of a default or a liquidity event after a 36-month grace period, or to request that any remaining balance of the loan be prepaid. This mechanism provided Adobe the option to minimize its losses in case of a default or ensure its 2.5x MOIC in case of a liquidity event.

Conversion due to liquidity event — In the case that Provive shareholders sold a stake in the company, Adobe would have the option to convert the unpaid loan balance into equity. The stake after conversion would be determined based on Provive's pre-money valuation at the time of the liquidity event, defined by the price per share paid by the new third-party investor or acquirer minus a 20% discount.

Conversion due to default event — In the case that Provive defaulted on its loan payments, Adobe would also have the option to convert the unpaid balance to equity. If the company had met or exceeded management's growth projections in the previous calendar year, the valuation upon conversion would be based on the larger of either (i) 2x the company's TTM total revenues or (ii) 8x the company's EBITDA. If the company had performed below management projections in the previous calendar year, valuation would be determined by the larger of either (1) 1.5x the TTM total revenues or (ii) 6x the company's EBITDA.

KEY MAN CLAUSE

As mentioned above, Adobe was particularly impressed by Diaz and believed that his unique perspective, experience, and business acumen would drive Provive's success in the long-term. They therefore included a key man clause in the contract stipulating that Diaz continue to run Provive for six years following the investment and not join or found a competitor for five years if he were to depart Provive.

RENEGOTIATION AND FOLLOW-ON INVESTMENT

Provive ran into three major issues affecting its liquidity. First, a housing subsidy embargo was declared in Ciudad Juárez due to the risk of flooding, complicating Provive's ability to sell homes in this key market. Second, Provive expended considerable capital to acquire a large tranche of auctioned homes in anticipation of a cancelation of the federal housing auction process by the incoming Andrés Manuel López Obrador administration. Lastly, Provive faced important loan maturity payments from its other lenders during Adobe's holding period.

As a result, the company had difficulty making timely payments. During the renegotiation, Adobe reworked the payment schedule around total company revenues as opposed to management EBITDA metrics, replacing the two-tiered royalty schedule based on EBITDA with a fixed royalty calendar. Adobe canceled three monthly overdue payments and granted an additional two-month grace period for September and October 2018. The renegotiation updated the promissory notes and included a bullet payment clause necessitating final payment of any outstanding portions of the loan in August 2021.

It also shortened the non-payment clause that would trigger a default from three consecutive months to two consecutive months and added a delayed payment penalty equivalent to 20% of the annual interest of the loan. Adobe wanted to be flexible to ensure the company could survive and continue to grow.

EXECUTION

BOARD SEAT

The original transaction documentation guaranteed Adobe one seat on the Provive Board, which was occupied by managing partner Rodrigo Villar Esquivel. While Board participation is unusual for private credit investors, Adobe viewed it as a valuable way to collaborate with Provive and achieve further growth. Board representation ultimately presented some challenges for Adobe, as some key Board decisions or votes that were good for the long-term growth of the company also endangered short-term liquidity and therefore the repayment of Adobe's investment. However, the Board seat was a valuable tool, as Adobe fine-tuned the balancing act of its role as both an investor and a strategic business advisor.

EXPANDING INVENTORY

Provive primarily invested the capital it received from Adobe to increase its housing inventory. During Adobe's investment period, 2015 through 2019, Provive increased its housing inventory by 5,471 units and refurbished more than 6,600 homes. Provive also increased sales, with over 1,000 homes sold in 2015; and surpassed 2,000 homes sold in 2017, the year that Adobe followed on. 2018 was Provive's best year by far, with 2,192 homes sold. By the end of Adobe's investment holding period, Provive had sold more than 8,500 homes, and to date, the company has sold over 10,000 homes in Mexico.

EXPANSION OF OPERATIONS

Provive also increased its operational capacity as a result of Adobe's financing, which was ultimately vital to the company's survival. During Adobe's holding period, Provive increased in size from 50 to 200 employees and expanded within its major operating markets in Tijuana, Mexicali, and Ciudad Juárez. In 2016, a year after receiving Adobe's investment, Provive expanded into the new market of Hermosillo in the state of Sonora.

SOCIAL IMPACT

Provive benefited greatly from Adobe's investment, expanding its operations and providing more housing options for lower-income families in a housing market suffering from scarcity. Provive had refurbished 1,944 homes when Adobe originally invested and by the time Adobe exited, Provive had refurbished 8,591 homes, a more than 4.4x increase. The number of individuals housed in Provive homes also increased by slightly more than 4.4x, from 7,594 individuals housed when Adobe invested to 33,594 upon Adobe's exit.

The investment also allowed Provive to expand the operations of its foundation TÚ + YO. Since the foundation receives 2% of Provive's revenue, it continued to scale, helping more families and communities, as its operating budget grew with Provive. The foundation specialized in three lines of action. Firstly, it began offering trainings and workshops for the community, teaching core competencies such as math and trades like carpentry. It also invested heavily in the recovery and renovation of public spaces. Graffiti was removed, parks were cleaned, public lawns were maintained, trees were planted, and regular community events were planned for these public spaces. Lastly, the foundation took responsibility for educating the communities on how to properly organize and ensure the maintenance of the *fraccionamientos*. The number of volunteers involved in TÚ + YO's different programs increased from 14,431 to 63,840 volunteers with 399,001 volunteer hours expended during Adobe's holding period.

TÚ + YO helped these communities establish their own rules, regulations, and housing stipulations to ensure community commitment. They helped organize community meetings and community boards, which helped create local governing bodies that would maintain the safety and viability of these neighborhoods. Due to the successful renovation and increasing safety of the communities where Provive invested, most of the homes it has resold have increased in value, with some of them doubling in value only a few years after resale. Provive's main customer base is lower-income families in Mexico purchasing starter homes, and Provive's community development emphasis has provided these families with real assets of appreciating value.

FLEXIBILITY

As stated, Provive encountered challenges in liquidity and cyclicality during the investment. Adobe was flexible, granting Provive an additional grace period and later renegotiating the investment terms. Adobe wanted to ensure that Provive could survive and continue to achieve its growth metrics, while still paying off the loan.

This active management allowed Provive to continue to expand unencumbered by issues over which management had limited control. In addition to constant technical assistance, when Provive required additional support outside of Adobe's areas of expertise, Adobe frequently connected the company with other members of its network.

EXIT

Provive had its best year in 2018, drastically increasing its inventory and selling 2,192 homes. Credit Suisse approached Provive in 2018, impressed by its performance as well as its growing inventory of homes. After considering an equity investment, Credit Suisse offered a USD100m loan to Provive collateralized by its housing inventory. The investment allowed Provive to pay off its loan from Adobe. Adobe agreed to lower its MOIC target from 2.5x to 2.35x in exchange for a bullet prepayment, which was completed in March 2019.

STATUS UPDATE

After the election of Andrés Manuel López Obrador in December 2018, INFONAVIT placed a freeze on its auctions of foreclosed homes and reduced the number of parties it partnered with to sell homes. This political change negatively affected Provive, resulting in a fall in housing sales to 1,885 homes in 2019. Since then, Provive has continued to face significant difficulties, which have complicated its plans to accelerate growth. COVID-19 introduced further uncertainty and challenges for the company, and it was forced to downsize its operations in 2020.

However, Credit Suisse agreed to convert a portion of its debt to an equity stake, acquiring 100% of the company in late 2020 from management and IGNIA Partners, a deal which will allow the company to survive and continue operating. The terms of conversion allow for company management to reacquire a stake in the future, and INFONAVIT will begin auctioning houses in its inventory again starting in the first quarter of 2021.

OUTCOMES

FINANCIAL — Adobe exited through loan repayments and Credit Suisse refinancing with a 2.35x MOIC and 32.5% gross IRR in MXN terms.

Provive's TTM revenue increased 5.1x in MXN terms during the investment holding period.

SOCIAL IMPACT — During the investment period, the number of houses refurbished and individuals housed by Provive each increased by 4.4x to 8,591 houses and 33,594 individuals, respectively.

Company employment increased 4x to 200 employees.

Provive increased its TÚ + YO activities, with close to 400,000 volunteer hours completed during the investment holding period.

As a result of the company's home renovations and community engagement activities, crime rates in the communities where Provive was active decreased and quality of life improved.

Key Takeaways

MITIGATING REGULATORY RISK

Structured financing solutions can help investors avoid the risks associated with backing companies dependent upon government contracts or programs. While traditional equity investors may have a hard time achieving a favorable exit in the event that regulatory changes challenge the company's business model, structured financing tools can help insulate investors from this uncertainty.

RELATIONSHIP WITH EQUITY INVESTORS

Other investors in the company, particularly those holding traditional equity positions, may be initially averse to or unfamiliar with the terms of structured financing instruments. Investors utilizing structured financing tools may need to work with equity investors to explain the deal terms and the value of the proposed financing solution for the company and equity shareholders.

PROJECTIONS AND PAYMENT SCHEME FLEXIBILITY

Payments based on financial performance projections can become burdensome if a company regularly falls short of meeting projected revenue or EBITDA. Investors and entrepreneurs may benefit from a payment scheme renegotiation if initial projections prove overly ambitious.

PAYMENT SCHEDULE FLEXIBILITY

Companies affected by inventory shortfalls or other market disruptions may require more flexibility on repayment schedules. Investors may use tools such as interim grace periods on loan repayments during the investment holding period to allow the company to recover.

EXIT TIMING AND RETURN TRADEOFFS

Investors may accept a discounted MOIC in exchange for a bullet payment in the event the company raises additional external financing. An early exit at a moderately lower MOIC can help businesses achieve their growth plans after exit and help investors secure a stellar IRR.

puntored
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COMPANY PROFILE

COMPANY NAME: Conexred (Puntored)

INDUSTRY/SECTOR: Financial services

LOCATION(S): Colombia

ENTREPRENEUR: Andrés Alban

DESCRIPTION: Puntored is a fintech company that provides financial services and products through mobile applications ('apps') to independent and small business owners, which in turn offer financial services to isolated communities.

INVESTMENT

DATE: December 2019

AMOUNT: COP21b (USD6m)

INSTRUMENT: Convertible revenue-based loan with special preferred share

EXIT

DATE: Projected 2021- 2025

OUTCOME: Projected 2.5x MOIC in COP terms

ADOBE CAPITAL

INVESTOR PROFILE

FUND NAME Adobe Mezzanine Fund II (AMF II)

INVESTMENT OFFICER Paula Giraldo

FUND SIZE USD30.3m

TOTAL AUM USD50.5m

Adobe Capital is an impact investment fund manager focused on supporting the early growth of small and growing businesses with a specific focus on solving pressing social and/or environmental issues. Adobe Capital invests in innovative companies that have significant potential to scale and be financially profitable, while delivering products and services which significantly impact the quality of life of a critical mass of people and/or the environment.

ADOBE MEZZANINE FUND II

FUND OVERVIEW

AMF II is a mezzanine fund that reached a final close in August 2019 with total commitments of USD30.3m and targets a 2.5x MOIC. Major LPs in this fund include DEG, Proparco, Fondo de Fondos, the IDB, Capria, and Auria Capital.

AMF II made its initial investment in early 2018 via mezzanine financing in Mexico-based physical therapy education provider geared towards low-income students and patients Instituto Profesional en Terapias y Humanidades (IPETH). To date, the fund has also invested in Mexico-based Kuepa University and renewable energy company HEG, as well as Puntored. AMF II is still in the investment period, with more than 50% of its committed capital yet to be deployed.

PUNTORED

COMPANY PROFILE

Puntored began operations in 2004 as a digital network for prepaid airtime top-ups at a time when most prepaid mobile providers relied primarily on the sale of physical scratch-off cards. Mauricio Hoyos and Andrés Alban saw an opportunity to innovate in this antiquated segment while providing additional income sources for small business owners. Today, Andrés is the CEO of the company, which has evolved into a fintech company providing technological solutions to small businesses, including mom-and-pop shops, that enable them to act as a one-stop shop for all kinds of basic financial services (e.g., wire transfers, insurance, online shopping, payments, etc.).

PUNTORED'S BUSINESS UNITS

Puntomarket — Prepaid services and product marketplace (prepaid phone plans and add-ons, car insurance, e-commerce, and prepaid videogame credits)

Puntobank — Correspondent banking for Colombia's major financial institutions (payment of utilities, credit card payments, deposits and withdrawals, government subsidies)

Puntopay — New payment solutions for microenterprises and SMEs (QR payments, payment terminals)

Mercatiendas — E-commerce solutions for microenterprises and SMEs (e-commerce portal, inventory management)

Servipunto — Intelligence solutions for small businesses (POS systems, data collection)

VALUE PROPOSITION AND IMPACT THESIS

Puntored's competitive advantage and impact thesis rely on the company's ability to increase access to financial services while supporting the growth of small businesses. The Colombian market is ripe for innovation, since (i) financial inclusion in the country is still weak outside of major urban centers, (ii) moderate internet penetration means that many users still need to rely on a physical location for most transactions, and (iii) cash remains the most utilized payment method in the country.

First, while overall financial inclusion in Colombia has improved over the last decade, there is still a great disparity between urban and rural areas. According to Colombia's National Planning Department (DNP) and Banca de las Oportunidades, the percentage of Colombian adults with at least one financial product increased from 55.5% in 2008 to 85.9% in June 2020.[5]

Much of this growth, however, has been buoyed by increasing penetration of financial services in cities. Only 57.2% of Colombians living in dispersed rural areas had at least one financial product in June 2020, compared to 94.1% of Colombians living in cities.

In terms of internet penetration, according to the 2018 Quality of Life Survey conducted by Colombia's National Administrative Department of Statistics (DANE), 35.9% of Colombia's population (approximately 16 million)[6] aged 5 or older had not used the internet in 2018. When broken down by geographical area, 72.4% of Colombians living in urban areas aged 5 or older used the internet, compared to merely 35.8% living in dispersed rural areas. Thus, while digitalization has helped to increase access to financial services, there is still a significant portion of the Colombian population that relies on brick-and-mortar locations for simple financial transactions.

Finally, cash accounts for 88.1% of all financial transactions and 87.4% of total transaction value in Colombia.[7] This preference for cash, however, is more prevalent among low- and middle-income families. When broken down by socioeconomic status, 92.5% of those making between one and two times the current legal monthly minimum wage (SMLV) prefer cash as their main method of payment, compared to 37% of people earning more than five times SMLV. With more businesses transitioning towards e-commerce and digital offerings, finding ways to integrate those who use cash as their preferred method of payment is essential to ensuring financial inclusion.

5 Financial products include credit cards, consumer or commercial loans, microcredits, mortgages, and savings, checking, investment, and electronic deposit accounts.

6 Quality of Life Survey used a sample of 89,522 households. The total number of Colombians that have not used the internet is based on Colombia's 2018 population projections published by Colombia's National Administrative Department of Statistics (DANE).

7 Banco de la República, June 2020.

Puntored addresses these challenges by providing small business owners with technological tools that turn their brick-and-morter shops into access points for various essential financial services, especially for people at the bottom of the pyramid. Supporting the growth of small businesses is at the core of Puntored's value proposition: whereas many affiliate networks charge business owners for access to their services, the Puntored model allows affiliates to earn additional income through fee-sharing agreements. The Puntored network reaches 92% of the national territory and is comprised of nearly 65,000 mom-and-pop stores, small businesses, and supermarkets spread over 920 municipalities in Colombia.

OPPORTUNITY

Independent workers constitute most of the workforce in Colombia. According to the OECD, self-employed workers in Colombia accounted for 50.1% of total employment in 2019, compared to 31.9% in Mexico and 6.1% in the United States. Through its affiliate network, Puntored noticed that many of these independent workers, especially small business owners, were not being served by financial institutions. The company already offered a line of correspondent banking that acted as a bridge to most major Colombian financial institutions, but Andrés recognized that some merchants feared high transaction fees and still preferred cash payments. With more than 70,000 small business owners already in its network, Puntored saw an opportunity to fill this need and enter the digital payments space.

In 2019, Puntored formulated the creation of Puntopay, a new business unit that would provide technological tools for small business owners to process digital payments. Launching this new business line would require investing in the technological development of payment-processing tools, purchasing Point of Sale (POS) terminals, and acquiring new customers. The company had relied primarily on organic growth since its founding. However, developing and launching this unproven concept required a significant investment, so the company decided to seek an external partner.

Puntored was already profitable and had a proven track record with its other business units. The company received offers from traditional PE and VC firms to fund the development of Puntopay, but Andrés sought a partner that would not only provide financing but also align with the company's impact goals. In addition, Andrés wanted to avoid equity dilution and needed sufficient time for the business unit to grow before making any repayments. Andrés was also attracted to the idea of having a predefined exit based on revenues, as this would give the company clear milestones for the development of its new business unit.

Adobe Capital had launched AMF II, its second mezzanine debt fund in late 2017 and was looking to expand its investment portfolio outside of Mexico. Puntored's growth prospects, robust financial performance in existing business units, and focus on financial inclusion made it the ideal candidate for the fund's first investment outside of Mexico. In addition, Adobe was already familiar with Puntored's management team, which facilitated the negotiation and due diligence process.

DEAL SOURCING

Adobe was first exposed to Puntored through the New Ventures network. Andrés participated in the first batch of the I3 LATAM accelerator in 2015, an initiative of the Swiss Agency for Cooperation and Development, Ashoka, New Ventures, and Hystra.

While Puntored stood out as an attractive investment opportunity at the time, the geographic mandate of Adobe's debut fund was limited to companies in Mexico, and Puntored did not have an immediate need for additional external financing.

DEAL TERMS

DEAL STRUCTURE: REVENUE-BASED CONVERTIBLE LOAN

Adobe's investment in Puntored is structured as a USD6m (in COP at the prevailing exchange rate, representing approximately COP21b) senior convertible loan with revenue-based monthly payments until receiving a predetermined MOIC of between 1.3x and 2.5x. Adobe's MOIC will depend upon the amount of time Puntored takes to repay the loan, with the firm securing a higher MOIC the longer the loan balance is outstanding (see table below). In addition, Adobe acquired a special preferred share that gives the firm preferential dividends and a seat on the company's Board of Directors.

LOAN PAYMENTS

Months Post-Closing	% of Total Revenue
0-12	0% (Grace period)
13-24	Increasing % over time
25-36	
37-48	
49+	9%

TOTAL REPAYMENT AMOUNT

Months Post-Closing	MOIC
0-12	1.3x
13-24	Increasing MOIC over time
25-36	
37-48	
49-60	
61+	2.5x

Currency — The loan was denominated in local currency (COP) to match a customer base that is exclusively Colombian.

Loan Payments — Monthly payments are calculated as a variable percentage of total revenues. The percentage increases each year, starting with a one-year grace period with yearly increments until reaching a maximum of 9% of total revenues in year five. This revenue-based payment structure means that the company pays based on performance.

Grace Period — The one-year grace period gives Puntored time to put capital to work and acquire customers for its Puntopay unit before any payments are due.

Multiple of Total Invested Capital — The MOIC also varies over time, starting with a 1.3x MOIC during the first year with yearly increments until reaching a 2.5x MOIC during year six. Any outstanding balance may be repaid in full without penalty if the corresponding MOIC is met.

CONVERSION RIGHTS

Adobe has the right to convert any outstanding balance of the total repayment amount into an equity interest in Puntored in case of a default or a liquidity event. This mechanism gives Adobe the option to minimize its losses in case of a default and reap an additional upside in case of a strategic sale or public offering.

Conversion under Liquidity Event — Adobe may choose to (i) remain a creditor to the company, (ii) convert outstanding balance into an equity interest pursuant to the MOIC set forth in the Total Repayment Amount shown in the table to the left, (iii) require immediate prepayment, or (iv) require the full repayment upon a purchase by a third-party buyer.

Conversion under Default — Adobe may (i) request immediate prepayment of the total repayment amount or (ii) exercise its right to convert the outstanding balance using a 2.5x MOIC. Default conditions are mutually agreed upon at the time of investment and include but are not limited to failing to make two consecutive payments, becoming legally insolvent, failing to meet key clauses of the loan agreement, and significantly changing the company's ownership structure without prior consent from Adobe.

In both scenarios, the company's pre-money valuation for conversion was mutually agreed upon at the time of investment as a predefined multiple of either TTM revenue or TTM EBITDA (whichever is higher).

INTEREST RATE CAPS

The existing interest rate cap pursuant to Colombian legislation presents a challenge for investors utilizing a revenue-based loan structure in the country. Art. 305 of the Colombian Penal Code makes it a criminal offense to charge interest rates above an interest rate cap defined by the Financial Superintendence of Colombia. Since the interest rate of revenue-based financing varies depending on the payment structure, the effective interest rate risks surpassing this cap in high-revenue periods. By purchasing a special preferred share in the company, Adobe could use the resultant dividend payments to maintain its repayment schedule without exceeding the interest rate cap.

DISBURSEMENTS AND MILESTONES

The loan was split into three disbursements. The first two payments represented approximately 60% of total invested capital and were disbursed automatically within the first six months. The final tranche can be disbursed after 18 months, subject to the achievement of three milestones:

- Reaching at least 20,000 active merchants affiliated to Puntopay.
- Reaching TTM Gross Merchandise Value of COP100b with Puntopay (total monetary value of transactions made through the Puntopay digital payment system).
- Reaching TTM revenue of COP12b through Puntored's banking correspondence business unit.

Should Puntored not reach these milestones, Adobe may still choose to approve the disbursement of the last tranche subject to approval by the investment committee.

PAYMENT MECHANISMS

Puntored may repay the total outstanding balance through a combination of (i) a minimum monthly interest payment at an effective annual rate of 4.5%, (ii) additional interest payments, (iii) preferred and special dividends, or (iv) principal amortization payments.

SPECIAL PREFERRED SHARE

Solely as a creditor, Adobe would not reserve the right to receive dividends, monitor financial performance, or contribute to the company's governance. This conflict was resolved as Adobe received a special Class A preferred share, which gave the firm (i) preferential rights to company dividends over ordinary shareholders, (ii) a seat on the Board of Directors, and (iii) preferential voting rights over issues that pertain to Adobe's investment and major strategic or financial decisions (e.g., bankruptcy filings, fiscal auditing, M&A, the creation of new business lines, public offerings, etc.).

NOTE ON TERM LENGTHS OF REVENUE-BASED LOANS

While financial projections are made for revenue-based loans to estimate a target term length, the actual loan term will vary depending on how quickly a company grows. For simplicity, let us look at the hypothetical scenario of a company with monthly revenues of USD1m that receives a loan of USD1m with the same terms established for Puntored (i.e., identical monthly revenue percentages and MOICs that define the total repayment amount).

If the company's monthly revenues remained constant and the management team decided to make only the minimum payments required, the company would take 53 months to fully repay its debt. If all other conditions remained equal, a 1% monthly revenue growth would reduce the time needed to repay the loan to 43 months, and a 2% monthly growth would reduce it to 39 months (see chart below). Conversely, this also implies that a decrease in monthly revenues would extend the time needed to repay the loan.

Months Needed to Repay a USD1m Revenue-Based Loan for a Company with USD1m Monthly Revenue

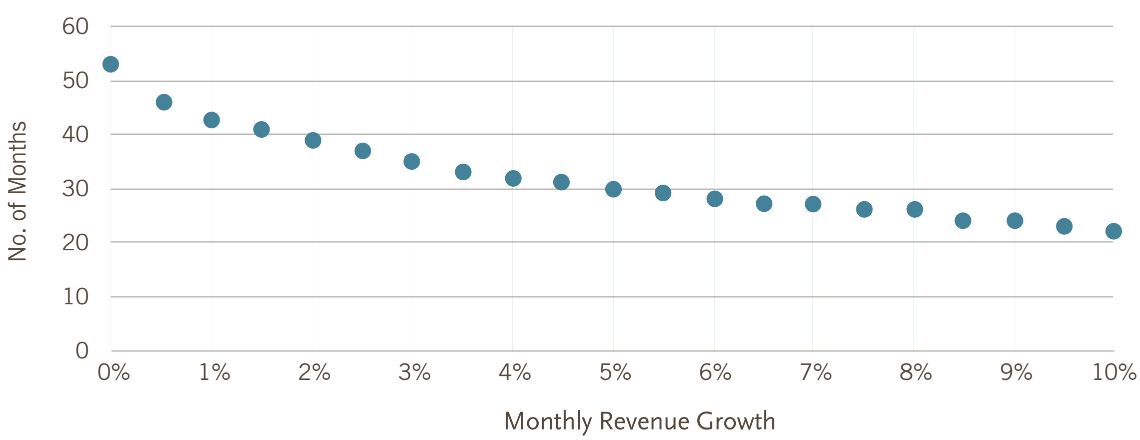


Figure 4

EXECUTION

LAUNCH OF THE PUNTOPAY BUSINESS UNIT

Following Adobe's disbursement of the first two tranches, Puntored invested in the development of its digital infrastructure and launched the Puntopay business unit. Business owners can now process digital payments either using debit or credit cards on a physical POS terminal or completely online through the mobile app. The app allows users to generate unique payment links or QR codes that can be shared with customers via WhatsApp or text message to accept virtual payments, pay public utilities and business suppliers, and purchase prepaid airtime and TV packages.

CONSOLIDATION OF PUNTORED'S CAPITAL STRUCTURE

Puntored also used the new capital to consolidate the capital structure of the company and acquire the participation of minority shareholders.

IMPACT ON SMES

Adobe requires Puntored to report key social impact metrics on a quarterly basis, such as the number of small business owners affiliated with its network, additional revenue generated for affiliates, and the number of SMEs who now have access to virtual payments through Puntopay. In addition to small merchants who benefit from commissions and increased professionalization, Adobe sees the ultimate beneficiary of this investment as the underbanked population who has gained greater access to the country's formal financial system.

INTERIM OUTCOMES

FINANCIAL — The company is still in the loan grace period and is not currently making payments. Adobe projects a 2.5x MOIC in COP terms.

SOCIAL IMPACT — Puntopay downloads have exceeded 10,000 on the App Store and Google Play as of November 2020. Over 6,800 SMEs are now using the Puntopay product to accept digital payments.

As of September 2020, nearly 65,000 small merchants were affiliated to the Puntored network, resulting in an additional USD2.7m in revenues for these companies. These merchants provide essential financial services to people at the bottom of the pyramid, contributing to improving financial inclusion in Colombia.

Key Takeaways

MILESTONES

By structuring investments to be contingent upon performance goals, investors can align interests with business owners around key business objectives.

IMPACT GOALS

Instruments that do not require a traditional liquidity event can be preferable for businesses with social impact goals, as founders can concentrate on meeting those goals and may not have to give up control in the long run.

CONSIDERATIONS OF LOCAL REGULATIONS

Fund managers need to consider local regulations when structuring financial instruments. Deal structures do not necessarily translate across different markets, so fund managers need to be flexible and work with local counsel to make necessary adjustments and comply with all applicable legislations.

VARIABLE REPAYMENT MODELS

Fund managers deploying revenue-based loans may choose a fixed or variable MOIC model. A variable model may provide additional flexibility to portfolio companies in case of an early repayment of debt, while also ensuring consistent returns for fund managers.

CONVERSION OPTIONS

Structuring an investment as a convertible loan gives investors a guarantee over a company's shares should the company fail to fulfill its obligations. In companies where a traditional equity liquidity event is possible, having a conversion option allows investors to capture possible upside return from a strategic sale or public offering.

COMPANY PROFILE

COMPANY NAME: Grupo STT

INDUSTRY/SECTOR: Business Process Outsourcing

LOCATION(S): Costa Rica

ENTREPRENEUR: Jeffrey Mora Monge

DESCRIPTION: Grupo STT (supplying total talent) provides outsourced services—including human resources, recruiting, training, and payroll—across 17 countries in Latin America.

INVESTMENT

DATE: May 2012

AMOUNT: USD2m

INSTRUMENT: Five-year convertible mezzanine term loan

EXIT

DATE: March 2018

OUTCOME: Loan repayment with 1.51x MOIC and 14.59% net IRR in USD terms

INVESTOR PROFILE

FUND NAME CASEIF II

INVESTMENT OFFICER Humberto Suarez, Hugo Chaves

FUND SIZE USD29m

TOTAL AUM USD84.4m

LAFISE Investment Management is the private equity arm of Grupo LAFISE, a financial services firm headquartered in Miami and serving Central America and the Caribbean. Through its CASEIF funds, LAFISE provides growth equity and mezzanine financing to small- and medium-sized enterprises (SMEs) with strong cash flow generation potential operating in Central America.

OPPORTUNITY

Business process outsourcing company Grupo STT was founded in 2001 in Costa Rica and, by the time of LAFISE's investment in 2012, had expanded to operate in 10 countries, mostly in Central America. STT's client list includes some of the world's largest multinational companies, including Motorola, HP, and Citibank. As these companies expanded across Latin America, they encouraged STT to build operations in new markets. To support its employee pipeline and improve youth employment rates, the company partners with universities in Honduras, Nicaragua, Panama, and the Dominican Republic to promote English language training, as well as providing scholarships for select high school students to study English and Portuguese.

> Since entrepreneurs are often not familiar with private mezzanine deal terms, LAFISE introduces prospective clients to previous investees to share experiences of working with the firm.

After establishing a presence across Central America, Grupo STT sought financing to pursue expansion in other markets, primarily in South America. The company was already cash flow-positive, with net profits growing 46.8% between January and August 2011, when they began negotiations with the LAFISE CASEIF team. Grupo STT had secured local bank financing to support its Central American expansion, but the team found it increasingly cumbersome to manage multiple bank loans across markets. Local banks also required the company to have either an established presence in the bank's home market or considerable hard asset collateral before providing financing.

LAFISE had previously provided working capital to Grupo STT through its banking arm, which referred the company to investors from CASEIF. As LAFISE's fund management unit, CASEIF would be able to provide more flexible financing and management support to Grupo STT to fuel its growth in South America. The team at LAFISE CASEIF found the Grupo STT investment opportunity attractive: founder Jeffrey Mora Monge had a 12-year track record with a clientele of fast-growing multinational firms, many of which had long-term contracts that provided steady subscription revenue. Aside from the cost of setting up additional offices, the company also had relatively little overhead, so once Grupo STT had established a presence in a new country, it would be able to acquire additional clients without increasing expenses.

LAFISE understood that there were risks in funding STT's expansion. Exponential growth could undermine the company's central value proposition: consistency across markets. Unlike some of its competitors using a franchise model, Grupo STT's centralized management team had maintained a common vision and service quality across its operations. In each new market the company would have to comply with local labor laws and financial regulations. LAFISE saw an opportunity to provide governance and operational support to ensure Grupo STT maintained quality control and compliance as it pursued its growth plans.

DEAL TERMS

DEAL STRUCTURE: CONVERTIBLE TERM LOAN

LAFISE provided a USD2m 5-year convertible loan, subordinated to the company's existing bank lenders, with a 17% net annual interest rate.

Disbursement Tranches — The loan was distributed in three tranches, with the second two contingent upon performance milestones.

- USD300,000 distributed in November 2012
- USD500,000 contingent upon the company achieving an additional sustained consecutive monthly EBITDA growth of USD15,000
- USD1.2m contingent upon the company achieving a sustained monthly EBITDA of USD110,000 for three consecutive months

Grace Periods — Each tranche of the loan was subject to a six-month grace period on the principal, during which only interest payments were due.

Conversion Option — In the event the company's equity shareholders chose to sell a partial or full stake in the company to a third party, LAFISE could exercise the option to convert up to USD1m of the unpaid principal to equity. USD1m would be convertible to 30% in the company, with any fraction of USD1m convertible to a proportionate equity stake. If the liquidity event occurred before the full USD2m was disbursed, LAFISE could choose to disburse the remaining balance to exercise its conversion rights.

LAFISE does not take currency risk in its portfolio, disbursing investments in USD. This was a good fit for Grupo STT, which generates receivables from its multi-national clients in USD.

Currency —The investment was disbursed and payments were due in USD, which was feasible considering Grupo STT's clients pay in said currency.

Prepayment Fees — After four years, the company could prepay the loan for a fee of 1.5% of the unpaid principal.

Repayment Account — To facilitate repayment, LAFISE set up an escrow account to collect Grupo STT's receivables. The bank automatically debited the monthly repayment amount due to LAFISE and distributed the remaining funds to the company.

Collateral — The loan was secured by a second mortgage on Grupo STT's headquarter property in Costa Rica, promissory notes from all subsidiaries, the CEO's life insurance policy of up to USD2m, and the escrow account of company receivables used for repayment.

EXECUTION

LAFISE helped the Grupo STT management team professionalize the business, implementing a comprehensive corporate governance framework. The CASEIF team named a board of directors and helped the company recruit and onboard financial management, operations, and marketing teams, incorporating gender considerations in the hiring process to increase the representation of women in the company. LAFISE supported STT in relocating its legal headquarters to Panama, where it benefitted from local tax incentives and the stability offered by the USD official currency. LAFISE's Humberto Suarez assisted in consolidating the company financials under the International Financial Reporting Standards (IFRS) framework. Through Hugo Chaves' operational support, the company achieved International Organization for Standardization (ISO) certifications.

The company used the capital and governance improvements to pursue expansion in key markets across Latin America, opening new offices in Peru, Colombia, Chile, the Dominican Republic, and Jamaica, facilitating the entrance of several multi-national companies into these markets for the first time. In addition, through the ISO certifications, the company was able to open offices in the United Kingdom and, after LAFISE had exited, Spain and the United Arab Emirates. These European and Middle East offices were established primarily for client recruitment purposes, with Group STT's main focus remaining Latin America and the Caribbean. LAFISE helped the company navigate cycles of low cash flow as the company pursued its rapid growth plans. In 2014, one of Grupo STT's largest clients defaulted on its payments. To provide the company with additional runway, CASEIF extended an interim grace period on principal payments for the calendar year of 2015, during which the company was only required to make interest payments.

EXIT PROCESS

Due to the interim grace period granted in 2015, at the end of the loan term in late 2017, the company still had an outstanding balance due to LAFISE although its cash position was strong. Aided by an additional equity infusion from an individual investor to fuel Grupo STT's continued expansion, the company completed a final bullet payment of the outstanding principal to CASEIF to pay off the loan.

OUTCOME

FINANCIAL — LAFISE CASEIF exited through company refinancing for net IRR of 14.59% and 1.51x MOIC in USD terms.

SOCIAL — Company call center and other subcontractor employment grew nearly 6x to 2,975 people.

Company management staff nearly doubled from 78 to 141 people.

- Of the total employees at the end of the investment period, 38% were younger adults (aged 18-30).
- Women made up 56% of all employees and 60% of upper and middle management.

Key Takeaways

EDUCATING THE ENTREPRENEUR

Making the entrepreneur comfortable with the deal terms of structured financing instruments can be time-consuming and a potential obstacle to investment. Experienced investors can facilitate this process by introducing prospective clients to business owners from past or present investee companies.

REPAYMENT ACCOUNTS

Escrow accounts with automatic debits can be an effective way to ensure repayments from fast-growing companies that experience cycles of low cash flow. These accounts can be costly, so investors should weigh the value of this form of repayment assurance against the expenses associated with setting up and managing the account.

TERM FLEXIBILITY

By remaining flexible to renegotiating loan terms such as the amortization date, fund managers can help companies manage unexpected challenges during the investment period, fueling company growth while maintaining or improving the return on investment.

nephroplus
dialysis made easy

COMPANY PROFILE

COMPANY NAME: Nephrocare Health Services Private Limited (NephroPlus)

INDUSTRY/SECTOR: Healthcare

LOCATION(S): India

ENTREPRENEUR: Vikram Vuppala, Kamal Shah

DESCRIPTION: NephroPlus operates a chain of standalone and in-hospital dialysis care centers, currently operating in 22 states in India, with recently launched clinics in the Philippines and Nepal.

INVESTMENT

DATE: December 2015

AMOUNT: INR60m (USD900,000)

INSTRUMENT: 3-year term loan with partly paid CCPSs and participation rights

EXIT

DATE: November 2019

OUTCOME: Loan repayment and sale of converted equity to Investcorp for 22.5% gross IRR and 1.5x MOIC in INR terms

TRIFECTA CAPITAL

INVESTOR PROFILE

FUND NAME Trifecta Capital Fund I

INVESTMENT OFFICER Advik Sharma

FUND SIZE INR4.64b (USD70m)

TOTAL AUM INR12.5b (USD168m)

Investing since 2015, Trifecta Capital is one of the first venture debt providers in India. The firm targets Indian technology-enabled companies across sectors that have already raised one or more equity rounds from VC fund managers. Trifecta's venture debt products provide companies with working or expansion capital while allowing them to defer dilutive later-stage VC equity investment rounds. The firm has helped to educate the market on the additive role of venture debt in the Indian startup ecosystem.

OPPORTUNITY

Founders Vikram Vuppala and Kamal Shah established NephroPlus in 2010 to fill the gap in treatment options for kidney patients in India. At the time, dialysis treatment was concentrated in hospitals in Tier One cities. Due to a lack of physical access and the costs associated with treatment, only an estimated 15-20% of patients in need of dialysis were undergoing therapy. Of the patients receiving treatment, 30% reported cross-infections due to inadequate hygiene standards at centers. Vikram and Kamal set out to establish a chain of dialysis centers that would make treatment of kidney disease accessible, safe, and affordable. Within its first year, the company established a presence in several Tier Two and Tier Three cities, where access to specialized healthcare services such as dialysis is especially scarce.

The company aims to improve the patient experience and increase awareness of kidney disease. Kamal has undergone treatment for kidney failure and writes a widely read blog on dialysis treatment to educate the public and support patients. Through the Aashayein Kidney Foundation, the company also assists low-income patients with treatment and associated costs, as well as running two patient education events: 'Dialysis Olympiad' and 'Aashayein — Let's celebrate life'. While expanding, the company identified a lack of a sufficient number of healthcare professionals trained in kidney care to staff its clinics. To address this shortage, NephroPlus management founded Enpidia, an academy that trains dialysis nurses and technicians, placing graduates in positions at NephroPlus clinics.

To cover the upfront costs of setting up new dialysis centers, the company raised external capital early in its development. Global VC firm Bessemer Partners invested USD4.25m in the company's Series A round in 2011 and joined International Finance Corporation (IFC) in the USD10m Series B in May 2014. These equity investments allowed NephroPlus to open a total of 66 centers, but the company sought additional capital to continue the pace of expansion throughout India. The founders wanted to avoid further equity dilution and raise capital at a lower cost than offered by VC investors, who typically look for at least a 2x MOIC. NephroPlus looked into raising debt financing, but although several of its centers were profitable, the company overall was still cash flow-negative and could not raise capital from local banks or non-banking financial companies (NBFCs).

Having recently reached a first close for its debut fund, Trifecta was introduced to NephroPlus through a contact at Bessemer. Trifecta valued the quality of NephroPlus' preexisting investors and agreed that the company had high growth potential as an early entrant to the disorganized and underserved dialysis treatment segment. As a first-time fund, Trifecta also valued the opportunity to secure its investment in NephroPlus with hard assets such as the treatment centers and equipment, as this would offset higher risk, asset-light startups that would make up the bulk of the fund's portfolio.

As the first deal from Trifecta's debut fund, the NephroPlus investment required a month-long negotiation and deal-structuring process. The NephroPlus team reports that the proposed deal terms had been more straightforward than the term sheets it had viewed across its equity fundraising rounds. Trifecta has since further simplified its deal-structuring documentation and reduced the time it takes to close a deal.

VC activity in India has skyrocketed over the past 15 years, reaching nearly USD7b in capital invested in 2019. Venture investors have supported a generation of disruptive startups aiming to make traditional industries such as healthcare, agriculture, and financial services more efficient and widely accessible.

In India, established businesses have access to debt financing from banks and NBFCs, but funding options for cash flow-negative technology startups have usually been restricted to equity from VC firms. Venture debt provides complementary capital to VC-backed startups providing technology-enabled solutions to social problems.

VC activity in Latin America has also seen rapid growth over the past few years, with investment reaching USD4.6b in 2019, still below the volume of activity in India for that year but surpassing the USD4b invested in Indian VC in 2018.

Venture debt providers are now emerging in Latin America. Mexico-based Anteris Capital has been investing from its MXN440m fund since 2016; Silicon Valley Bank and Partners for Growth recently closed a joint fund targeting Latin America; and Brazil-focused VC firm SP Ventures has begun investing from its debut debt fund.

DEAL TERMS

DEAL STRUCTURE: TERM LOAN WITH CONVERTIBLE NOTES AND PARTICIPATION RIGHTS

Trifecta provided a INR60m (USD900,000) 3-year term loan in the form of non-convertible debentures with a 15% annual interest rate paid monthly on the outstanding principal.

Grace Period — The principal and interest payments were subject to a six-month grace period.

Trifecta often purchases **Partly Paid CCPSs** to secure a potential additional equity return on its investments. Under the investment structure, Trifecta pays a nominal fee of INR1 (~USD0.01) for each CCPS. The value of the shares is not set at the time of Trifecta's investment but is determined by the company's pre-money valuation at its next funding round. Trifecta then has the option to redeem the CCPSs for common equity by paying the remaining share price, discounted at a rate determined by the date the company has closed this subsequent investment. Alternatively, the firm can sell the CCPSs directly to other investors in place of converting them.

Many Indian VC and PE investors use CCPSs in place of common equity, sometimes tying the share valuation and time of conversion to company performance milestones. However, owners of CCPSs are not afforded the same rights as common equity shareholders under the **Companies Act 2013**. Foreign investors also face legal restrictions on their use of the instrument.

Prepayment Conditions and Fees — Since the company was gearing up to launch its Series C equity round, repayment of the loan was not permitted within the first year of the investment. After this time, the company could prepay the loan with a 2% fee on the outstanding principal.

Collateral — Trifecta secured the loan through a first claim on all current and future assets of select dialysis centers owned by the company. The market value of the assets held by these centers at the time of investment was to equal 1.5x the loan value.

Partly Paid CCPSs —Trifecta also purchased **Partly Paid Compulsory Convertible Preference Shares (CCPSs)** at a nominal value of INR1 (~USD0.01) each. Within five years, Trifecta could redeem the shares at a discounted price determined by the company's Series C pre-money valuation. The discount rate would be 20% if the Series C closed before the end of June 2016 and 40% if it closed thereafter.

Participation Rights — Trifecta had the right but not the obligation to invest up to INR10m (USD150,000) in the company within seven years, subject to the same terms, conditions, and pricing as future equity investors.

Common Equity Share — The investor also purchased one common equity share in the company in order to secure legal protections granted to equity shareholders under India's **Companies Act 2013**, such as access to company financial statements and voting rights.

EXECUTION

The team at Trifecta Capital took a hands-off approach to the NephroPlus investment, relying on the company's management to maintain growth momentum. Through Trifecta's investment, the NephroPlus team opened new clinics while avoiding dilution by delaying its Series C equity round. With the Trifecta loan, along with a Series C investment from SeaLink Capital Partners, the company opened more than 70 additional in-hospital and standalone dialysis centers by the end of the Trifecta investment holding period. As a result, the company more than tripled its annual revenue and achieved profitability.

EXIT PROCESS

After the company paid off the loan, global private capital firm Investcorp began conversations with the company for an equity investment. Trifecta played a role in Investcorp's diligence process, providing the firm with information on the company's growth trajectory, governance procedures, and history of timely repayment. Trifecta paid the discounted share price to convert the CCPSs to common equity and sold the stake to Investcorp as part of the latter's INR3.16b (USD44m) investment in NephroPlus.

OUTCOME

FINANCIAL — Trifecta exited through loan repayments and the sale of redeemed CCPSs to Investcorp for a 22.5% gross IRR and 1.5x MOIC in INR terms.

SOCIAL — During the investment period, the number of dialysis centers more than doubled to 141 as of June 2018, providing expanded access to treatment including for low-income, rural, and semi-urban patients.

STATUS UPDATE

As of the end of 2020, NephroPlus has more than 230 centers in India, providing about 150,000 monthly treatments. The company has also recently opened its first clinic in the Philippines and plans to continue its domestic and international expansion, bringing affordable dialysis treatment to other markets in Asia where the procedure is even more costly.

Key Takeaways

STREAMLINED TERM SHEETS
Straightforward term sheets are easier for the entrepreneur to understand and help reduce deal-structuring time and costs.

CONVERTIBLE NOTE INSTRUMENTS
For companies that are expected to raise equity in the future, convertible notes such as CCPSs can diminish the burden of company valuation for structured financing investors.

COMPANY TRACK RECORD
For cash flow-negative companies unable to raise debt from traditional lenders, structured financing solutions can allow a company to establish a track record of debt repayment to draw future investors.

LEGAL RIGHTS FOR EQUITY INVESTORS
Fund managers should consider the legal protections granted to equity and debt investors. Structuring an equity component to loans can provide investors with not only upside potential but also additional shareholder rights without compromising the downside protection provided by the structured financing instrument.

COMPANY PROFILE

COMPANY NAME: Yellow Pallet

INDUSTRY/SECTOR: Agribusiness, Logistics

LOCATION(S): Costa Rica

ENTREPRENEUR: Hein van Opstal, Gert Kema

DESCRIPTION: Yellow Pallet is a producer of transport pallets made out of a combination of banana fiber and wood.

INVESTMENT

DATE: November 2016

AMOUNT: USD180,000

INSTRUMENT: Seven-year term loan with potential cash payout upon sale of factory

EXIT

DATE: Projected July 2022

STATUS: 1.08x MOIC on invested capital to date with projected 25.4% gross IRR in USD terms

INVESTOR PROFILE

FUND NAME Pomona Impact Fund I

INVESTMENT OFFICER Richard Ambrose

FUND SIZE USD2m

Pomona Impact makes growth investments in Central America, Colombia, Mexico, and Ecuador, with a focus on agriculture and basic services such as education, health, energy, housing, and water. Pomona targets investments that generate both a market-rate financial return and significant social and environmental impact. In addition to its fund management business, Pomona runs an accelerator program for agtech companies in Central America.

OPPORTUNITY

Hein van Opstal and Gert Kema founded Yellow Pallet in the Netherlands in 2012 with the goal of developing a technology that could produce transport pallets from the inedible stems of banana plants. Export markets like Costa Rica have a high demand for shipping pallets, and the founders saw an opportunity to disrupt the wood pallet industry. In Costa Rica, half of the wood used to produce pallets is imported from Chile, with the other half linked to domestic deforestation and illegal logging. By replacing 30% of the wood in shipping pallets with banana fiber, Yellow Pallet utilizes the waste produced by the banana industry and provides an additional source of income for banana farmers. Manufacturing Yellow Pallet's product is up to 75% less expensive and produces 18-38% less CO^2 than traditional wood pallets, dependent on how much wood is replaced by banana fiber.

> Since agricultural commodities for export are generally priced in USD, investments in agtech companies incur little to no currency risk.

> Due to Costa Rican usury laws, Pomona can only charge a 15% annual late fee, as opposed to the 4% monthly late fee that was originally discussed with Yellow Pallet.

Yellow Pallet had successfully developed their banana fiber pallet technology in a lab at Wageningen University in the Netherlands using their proprietary Yellow Mix resin; however, they had yet to prove the concept could be applied at scale. They discussed developing a test factory with potential partners in banana growing countries, eventually establishing a relationship with a Costa Rican producer of wooden pallets. Yellow Pallet and the joint venture entity Tarimas de Fibras Agrícolas sought financing to develop a pilot pallet factory in Siquirres on land owned by the Costa Rican joint venture partner.

Pomona became familiar with Yellow Pallet through a contact at its agtech accelerator program. The company was in the process of shoring up a round of equity financing from a consortium of angel investors but needed additional funding to develop the pilot plant. As a capacity builder and investor in the Central American agtech space, Pomona would also be able to provide the company with local industry knowledge and access to its network, which would be instrumental in the company's long-term expansion plans. Although there were considerable risks associated with backing a new technology, Pomona was drawn to the social and environmental impact thesis baked into the company's business model.

DEAL TERMS

DEAL STRUCTURE: CONVERTIBLE TERM LOAN WITH CASH PAYOUT

Pomona provided a seven-year USD180,000 subordinated term loan with fixed principal and interest payments and a potential USD100,000 cash payout equity kicker.

Grace Periods — The loan is subject to a two-year grace period on interest payments and a four-year grace period on principal payments. The long grace periods allowed the company to put all capital into building the pilot plant and launching factory operations.

Payment Schedule — The company makes annual bullet payments towards the interest and principal following the grace periods.

Currency — The loan is disbursed and payments are due in USD.

Collateral — The loan is secured by promissory notes from both Yellow Pallet, which holds the banana fiber pallet intellectual property rights, and Tarimas de Fibras Agrícolas, which owns the pilot plant property, machinery, and other physical assets. The resale value of the plant's industrial machinery was an estimated USD1.5m at the time of the investment.

Late Payment — Payments are subject to a 15% annual late payment penalty, and Pomona is granted access to the company's books if the payments are more than 15 days late. The full repayment amount is due to Pomona in the event of a loan default.

Capital Position — As a lender, Pomona is senior to the company's equity investors in the company's capital stack.

Equity Kicker — Pomona will receive a USD100,000 cash payout if Yellow Pallet sells the factory in Siquirres by 2025, even if the sale occurs after the loan tenor.

EXECUTION

PILOT PLANT CONSTRUCTION

The construction of the pilot plant incurred substantial unexpected delays. Namely, the Yellow Pallet team had to experiment with and refine the machine technology so that it would be able to produce pallets that would meet the quality standards of the European Pallet Association (EPAL). One particular sticking point was fine-tuning the resin levels to ensure the pallets remained resistant to moisture in the humid Costa Rican climate. In addition, the local joint venture partners, which owned the land on which the factory would be built, experienced a liquidity crunch that slowed construction when customers such as Dole and Chiquita extended payment periods from 30 to 90 days. As a result, the company nearly lost the land to the mortgage lender until one of the company's equity investors purchased the plot. During the project delays, Yellow Pallet required additional financing to increase its runway before it could produce and sell pallets. Pomona introduced company management to a wide range of investors, helping it to secure an additional USD300,000 in debt without affecting Pomona's debt seniority.

CUSTOMER ACQUISITION

Pomona supported Yellow Pallet in closing purchase agreements with the country's largest fruit producers. These companies have agreed to purchase a percentage of their total pallet inventory from Yellow Pallet, which will ideally increase over time.

IMPACT IN THE PALLET SUPPLY CHAIN

Pomona Impact requires Yellow Pallet to report on key environmental and social impact metrics on an informal basis, and the company is planning to release an annual formal report beginning in 2021. The company is currently filling pallet orders as of 2019, sourcing the banana fiber from Yellow Pallet's own plantation of high-yield, disease-resistant bananas and from waste banana stems from small holder plantations, providing them with an additional source of income. Pomona sees these smallholders as the primary direct beneficiaries of the investment. The company converted former grassland to grow the banana plants, which increase the carbon sequestration of the land to one metric ton per hectare per year, four times higher than wooden forests.

RAMP UP PLANT

The capital and operational support from Pomona helped Yellow Pallet establish the pilot plant, proving the pallets could be produced at scale and setting the groundwork to increase manufacturing capacity. The company is now in the process of closing a USD11m mezzanine investment round to expand the factory in Costa Rica. While the pilot plant can produce 250,000 pallets per year, the expanded plant will have a projected capacity of 1.7m pallets annually, enough to meet 20% of domestic demand.

INTERNATIONAL EXPANSION

Yellow Pallet currently operates the Costa Rican plant, but it intends to sell this factory before developing and selling a network of factories across tropical fruit-exporting markets. Under the envisioned business model, the company will supply the network of factories with the proprietary Yellow Mix resin product and maintain quality oversight over the pallets produced. Pomona has supported these expansion plans by introducing the Yellow Pallet team to interested buyers in Guatemala.

INTERIM OUTCOME

FINANCIAL — To date, Pomona Impact has received a 1.08x MOIC on invested capital and is projected to exit in July 2022 with a 25.4% gross IRR in USD terms.

ENVIRONMENTAL AND SOCIAL IMPACT — The pilot factory is currently producing 4,000 pallets per month, replacing a portion of traditional wooden pallets purchased by fruit exporters and thus reducing CO^2 emissions and deforestation.

By converting grassland to a banana plantation, the company increased the amount of CO^2 captured by the plot of land.

The company has begun acquiring banana stem waste from smallholder farmers, providing them with an additional source of income and reducing food waste.

Key Takeaways

GRACE PERIODS
Long grace periods provide additional runway for companies developing new technologies that might be subject to delays in the innovation process.

ASSET-BACKED GUARANTEES AND CAPITAL POSITION
Guarantees from companies backed by hard assets with resale value can secure risky investments in new technologies. By occupying a senior position in the capital stack relative to equity investors, fund managers can help prevent competing claims on hard assets by other investors in the company.

LATE FEES
Late fees need to take local regulation into account to prevent the risk of violating local usury laws.

CASH PAYOUT INCENTIVE
Cash payouts granted upon the achievement of company milestones further align investor and entrepreneur interests around key business growth goals.

COVID-19 IN FOCUS

The Costa Rican government had a swift response to COVID-19, implementing lockdowns in major population areas. However, since Yellow Pallet's plant operates in a rural area outside of the infection hotspots, production was relatively uninterrupted by the pandemic. In response to the risk of transmission, the company implemented additional safety precautions to protect its factory workforce. Since the company's customers are fruit growers and exporters, which saw no drop in global demand during the height of the pandemic, Yellow Pallet did not experience any reduction in pallet orders. Even as the company's prospective investors have faced travel restrictions and a shift towards remote due diligence, there have been no significant delays in the company's ongoing USD11m funding round.

INVESTOR PROFILE

COMPANY NAME: Dr. Rödger Laundry Service

INDUSTRY/SECTOR: Industrial Services, Hospitality

LOCATION(S): Georgia

ENTREPRENEUR: Lado Chelidze

DESCRIPTION: Dr. Rödger is a leading supplier of cleaning products and laundry services, serving hotels in the country of Georgia.

INVESTMENT

DATE: May 2018

AMOUNT: USD400,000

INSTRUMENT: Five-year term loan with income participation royalty

EXIT

DATE: July 2019

OUTCOME: Exit through bank refinancing for 1.3x MOIC and 29% gross IRR in USD terms

INVESTOR PROFILE

FUND NAME Gazelle Fund I

INVESTMENT OFFICER Giorgi Jobava

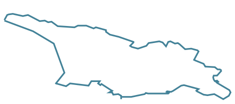
FUND SIZE USD42m

Gazelle Finance is a fund manager that provides quasi-equity and mezzanine capital to high-growth SMEs, defined as less than USD15m in both annual revenues and assets and fewer than 300 employees, in the Eurasia region. The firm provides a range of self-liquidating instruments, including term loans with equity kickers and structured equity investments redeemed gradually through puts to the business owner. Gazelle has invested in over 30 companies with an average ticket size of USD1m and has achieved five exits.

OPPORTUNITY

Founded in 2003, Dr. Rödger had established itself as a leading supplier of cleaning and hygiene products to hotels and healthcare facilities in Georgia. Founder Lado Chelidze had secured local bank financing to help grow the company, and in 2016, he looked to expand into complementary business verticals. His hospitality sector clients had voiced dissatisfaction with laundry service subcontractors, so Lado set up a small laundry unit to test this potential business line. After a successful trial period, Lado looked to build a new facility and purchase additional machines in order to expand laundry operations. The business had a capacity of two tons of laundry per day, and profitability would be achieved at eight tons per day. Local banks offered Dr. Rödger a line of credit but required collateral equal to approximately 200% of the loan value, more than the company or founder could provide. Additionally, the bank loan terms would require repayments beginning the first month, before the new facility would be built.

Gazelle Finance had identified hospitality as a key sector focus in the Georgian market, growing at approximately 20% per annum, and sought exposure to companies serving the hotel industry. Gazelle investment officer Giorgi Jobava was referred to Lado through a business contact and identified an opportunity in Dr. Rödger's new laundry service. The company's successful track record in cleaning supplies served as evidence of Lado's capacity as an entrepreneur and a customer base that could be targeted for the laundry unit. However, Gazelle understood the considerable risks associated with developing an entirely new business line. The team therefore underwent a thorough evaluation process to determine the competitive landscape, market size, ESG considerations, and expansion and operational costs before entering negotiations with Lado.



In Georgia, traditional banks generally require loans to be secured by hard assets equal to at least 100% and typically 150% of the total loan value and are averse to backing new technologies or business lines. There are few private equity investors active, so most SMEs in the country have no access to equity financing.

There are few paths to exit for investors: Georgian companies have limited access to local or international stock exchanges and there is little M&A activity in the country.

SMEs in Latin America face similar challenges. Access to bank financing is scarce, and outside of the region's largest economies, the pool of private equity investors is small. Similarly, relatively shallow capital markets and narrow exit windows limit investors' opportunities to exit through a traditional liquidity event.

DEAL TERMS

DEAL STRUCTURE: TERM LOAN WITH INCOME PARTICIPATION ROYALTY

The investment was structured as a USD400,000 five-year term loan with a 13% annual interest rate on the unpaid disbursed principal.

Grace Period — The principal payments were subject to a two-year grace period to allow the laundry services unit time to build the new facility and establish a client base.

Disbursement Tranches — The investment was distributed in two tranches of USD200,000 each: the first would finance the construction of the new laundry facility, and the second would be distributed upon completion of the facility to fund the purchase of new equipment.

Currency — The loan was distributed in USD, with both repayments and the income participation fee to be paid in USD.

Prepayment Fees — Gazelle anticipated that the company might be attractive for refinancing during the loan term, so the loan was subject to a prepayment fee

Gazelle structures all of its investments in USD terms in order to eliminate currency risk in its portfolio. Company revenue and repayment projections take local currency depreciation into account.

In the past, Gazelle has used cash sweep accounts and direct access to client bank accounts to ensure timely repayments. However, given Lado's bank financing and business track record, the Gazelle team chose a lighter-touch approach, monitoring company financials and implementing a late payment fee per calendar day.

equal to 1% on the unpaid loan principal, plus 1% of the budgeted floor revenue for the outstanding loan term.

Collateral — Gazelle secured the deal through a first-tier pledge on the new facility and newly purchased laundry equipment, as well as a second- tier pledge on the company's existing equipment, subordinate to the company's existing bank lender. Other guarantees included a share pledge equal to 100% of the equity shares of Dr. Rödger.

Income Participation Royalty — To compensate for the additional risk associated with backing a new business line, Gazelle received an income participation (IP) fee of 1% of the laundry service's monthly revenues, locked in with a floor price.

EXECUTION

THE NEW FACILITY

Gazelle helped Dr. Rödger set up a separate legal entity for their laundry business line called Dr. Rödger Laundry Service. Gazelle met monthly with the founder to help manage the construction of the new laundry facility and the installation of new laundry machines and wastewater treatment equipment.

CUSTOMER ACQUISITION

The firm also assisted the company in acquiring customers for its new business line. Many of the target customers, such as Holiday Inn and Marriot, were Dr. Rödger's existing cleaning supply clients; however, some hotel chains were already in existing contracts with competing laundry service companies. Gazelle conducted formal trainings on approaching potential clients with the management team and encouraged the company to join the local chapter of the American Chamber of Commerce (AmCham). The company was able to build new customer relationships through Gazelle's network of clients in the hospitality sector and AmCham Georgia.

FINANCIAL ADVISORY

Throughout the investment period, Gazelle provided financial advisory services both directly and through the U.S. DFC (formerly OPIC), one of the fund's limited partners, to assist the company in the development of financial management, controls, and reporting.

ENVIRONMENTAL UPGRADES

Dr. Rödger already used a biodegradable and phosphate-free detergent in its small laundry unit; however, as a condition of investment, Gazelle required the company to implement a new wastewater treatment process to mitigate the environmental risk of the expanded facility. Gazelle helped the company adopt the water treatment system, which includes both water sedimentation and an aeration process that accelerates chemical decomposition. The firm also assisted the company in reducing overall primary water consumption in the laundry process.

EXIT PROCESS

Although local banks had declined to provide the initial risk capital for Dr. Rödger's laundry services unit, approximately 15 months after Gazelle invested, a local bank approached the company. The bank had been monitoring Dr. Rödger's revenue growth and was interested in providing financing for the laundry business line that was now fully operational. The bank was able to provide local currency financing at a lower interest rate relative to Gazelle's product. Gazelle exited through the bank refinancing, which allowed Dr. Rödger to pay the outstanding loan principal and prepayment fees.

OUTCOME

FINANCIAL — Gazelle exited through the bank refinancing with a 1.3x MOIC and a 29% gross IRR in USD terms.

ENVIRONMENTAL — The company implemented a wastewater treatment process to filter all gray water prior to it entering the local sewage system. Georgia's Environmental Protection Division used the company's system as an example for laundry companies and other businesses with high water consumption.

Key Takeaways

CURRENCY

Due to exchange rate volatility, companies operating in local currency will prefer financing in the same currency to ensure depreciation does not reduce their ability to make repayments. While fund managers may invest in a tradable currency such as USD to avoid currency risk, their investments can provide companies with a bridge to local currency loans.

TRANCHED DISBURSEMENT SCHEDULES

Tranched disbursements linked to project implementation milestones help mitigate investment risk for the fund. These gradual disbursements, combined with principal grace periods linked to the achievement of construction and the initial commercialization phases of a new venture, also reduce the loan servicing burdens on the company's cash flows.

PREPAYMENT FEES

While banks are averse to lending to new business ventures, they may become interested in the company after the business line begins generating revenue. Prepayment fees, including the full term of the contracted income participation fees, ensure the fund manager is adequately compensated for the risk taken in providing the investment.

STATUS UPDATE

The Georgian hospitality sector has been severely impacted by COVID-19 and subsequent lockdowns, challenging the main customer base of Dr. Rödger Laundry Service. However, there is still strong demand for laundry services: while some hotels have temporarily shut down, many remain open and serve as quarantine zones. The government of Georgia has implemented more stringent disinfection standards for hotels, and Dr. Rödger has adjusted its protocols to meet the shift in demand from these clients. In addition, as Dr. Rödger's new procedures meet hospital sanitation standards, the company has been able to take on new clients in the healthcare sector. The pandemic also offers opportunities for consolidation, as the company looks to acquire other distressed market players domestically and in neighboring Azerbaijan.

Conclusions

Structured financing solutions have allowed investors in Latin America and other emerging markets to earn competitive returns amidst a challenging exit environment. Traditional commercial and impact investors have expanded their range of investible opportunities through these structures, backing businesses that require capital but have no clear trajectory to a traditional liquidity event in the medium term. For entrepreneurs, long-term flexible financing tailored to their particular needs can help them capitalize on growth prospects and reach impact goals without being diluted.

NEXT STEPS

Structured financing mechanisms still represent a small percentage of overall private capital investment activity. Despite advantages, these tailor-made tools are not easy to create for either the GP or the entrepreneur. The following steps can help investors to address key challenges associated with structured financing instruments:

EDUCATING LPS — GPs report spending a significant amount of time educating LPs unfamiliar with non-traditional deal structures about the merits of a downside-protected, but capped-upside approach. Investors must be able to **articulate these deal structures and the market need for these instruments** to LPs as part of the fundraising process. Beyond one-on-one conversations with interested partners, industry leaders can also help increase the visibility of these types of structures through **firm communications, participation in industry events, and other open forums.**

COMBATING DEBT AVERSION AND EDUCATING ENTREPRENEURS — GPs also face an education challenge with entrepreneurs. For instance, investors utilizing loan structures might have higher interest rates than bank lenders, since they take higher investment risk and provide more tailored solutions. As a result, sometimes entrepreneurs initially view debt and mezzanine capital unfavorably because they compare the cost of capital to local bank interest rates. In other cases, complex deal terms such as revenue-based repayments or income participation royalties can be difficult to explain to business owners. Entrepreneurs may be especially averse to debt in markets like Latin America, where consumer debt is uncommon, traditional banking is inaccessible, interest rates are high, and there is a painful history of national debt crises. The increasing prevalence of alternative financing in the entrepreneurial ecosystem may help to reduce debt aversion in the coming years, but in the short term, investors must **address business owner concerns about taking on debt during protracted negotiations.** Established investors have developed a **range of communication tools**, including introducing prospective clients to previous investees.

STREAMLINING DUE DILIGENCE AND STANDARDIZING DEAL STRUCTURES — GPs may encounter a lengthier due diligence process than for common equity to ensure the company is on solid enough financial footing to meet the exit expectations, either through loan repayments or a stake repurchase. Investors have sometimes **leveraged relationships with the company's existing or other prospective investors** to reduce their due diligence burden. While one of the key advantages of structured financing solutions is their unique customization, the creation of tailor-made investments often complicates and extends the deal structuring process. The bespoke nature of many structured financing deals means that they can be adapted for different investment opportunities and local regulations; however, more experienced GPs report **developing more standardized term sheets and streamlined processes over time**. In addition, greater regulatory standardization across markets would also help investors scale their strategies within the region and globally.

CLARIFYING EXPECTATIONS OVER EQUITY DILUTION AND CONTROL — Many entrepreneurs who negotiate structured financing investments do so precisely to avoid equity dilution. However, some of the deal structures allow for the GP to secure a significant equity stake at the end of the investment period. In some mezzanine instruments, for example, GPs can secure an equity stake through conversion options, sometimes triggered by a traditional liquidity event or loan default. In redeemable equity deals, if business owners are unable to repurchase the stake, GPs may retain the equity. Confusion about expectations and conditions of a change in equity

control of the company can create conflict between business owners, investors, and other current and potential future shareholders in the company. **Transparency during the negotiation process** is key to ensure any investment is operated as a partnership and to prevent negative outcomes during the investment holding period. Since many entrepreneurs are inexperienced with these instruments, it may be incumbent upon GPs to **contract external legal and financial counsel** so that all parties understand the investment terms and conditions.

ENSURING COMPANIES CAN COVER THE COST OF CAPITAL — Structured financing solutions often have higher interest rates compared to traditional banking and require strong revenue streams to ensure repayment. Investors must ensure that companies are able to pay the high cost of capital without choking company growth. In addition, repayment structures that are tied to company revenue or EBITDA projections can put additional pressure on the balance sheets of entrepreneurs if they face any difficulties in their growth processes. Companies that fail to grow as projected may face harsher penalties including dilution in the case of conversion, the increase of sliding scale payments, or the possibility of litigation due to nonpayment. Likewise, investors may have to navigate a challenging renegotiation process when companies fail to meet projected growth. Investors and entrepreneurs that are **clear and aligned on the growth projections and performance of the company during both due diligence and the holding period** can help reduce the risk of burdensome repayments and default.

THE FUTURE OF STRUCTURED FINANCING SOLUTIONS

EXPANSION IN LATIN AMERICA AND BEYOND — Latin America-focused fund managers, including those featured in this report, are at the forefront of innovation with structured financing tools. Investors have been particularly active in Mexico—where the flexible regulatory regime is especially amenable to self-liquidating instruments—as well as Central America—where impact investors have targeted the region's most undercapitalized markets. There are growing opportunities in other markets in Latin America and globally for these types of structures, but legal restrictions on creditor activities are a key hurdle. The uneven regulatory environment across markets represents the greatest barrier to expansion for investors utilizing structured financing solutions.

THE BOTTOM LINE — The difficulty of achieving timely exits and strong returns has presented a persistent obstacle for investors in Latin America. Relatively shallow capital markets in combination with macroeconomic, political, and currency volatility create a difficult exit environment, which can create a drag on returns and challenge subsequent fundraising cycles and the long-term viability of the asset class. As these dynamics have been exacerbated by the COVID-19 pandemic, the Latin American private capital industry is ripe for innovation. Structured financing solutions that predetermine the terms of exit represent major opportunities for investors across all segments of the private capital landscape.

In a region characterized by limited access to bank financing, fund managers providing senior debt and mezzanine financing can meet local demand for debt solutions from SMEs and large businesses alike. The recent spike in fundraising for dedicated private credit vehicles demonstrates this opportunity, yet traditional small-to-mid-cap private equity investors also have room to experiment with quasi-equity structures in their portfolios. Additionally, as the Latin American technology ecosystem continues to evolve, opportunities for venture debt investors to provide complementary capital to the region's startups will expand in tandem. In the impact investing space, investors using structured financing solutions have the potential to expand the pool of viable investments and multiply impact outcomes.

Across sectors and strategies, GPs in possession of a flexible toolkit can capitalize on a wider range of opportunities in underinvested markets. As the world continues to face crises like climate change and the COVID-19 pandemic, uncertainty necessitates innovative investment approaches and a more consistent path to return in order for the private investment community to continue to grow in emerging and frontier markets.

Definitions of Common Structuring Instruments and Mechanisms

BALANCE CONVERSION RIGHTS — Rights to convert the outstanding loan balance to equity. Conversion may be subject to a lock-up period after the initial investment agreement, before which the investor cannot convert. Conversion rights can be non-conditional or triggered by a default, traditional liquidity event (i.e. sale or IPO), or recapitalization by other investors.

CASH PAYOUT — A lump-sum cash bonus either determined at the time of investment or based on the company's valuation at the end of the investment period. Cash payment agreements are sometimes referred to as synthetic warrants, phantom shares, or commissioning instruments. The valuation strategy can be predetermined or open to negotiation at exit.

CURRENCY — Companies generally prefer investment distributions and repayment obligations in local currency, while investors may disburse in USD or another hard currency to reduce fund-level currency risk.

CONVERTIBLE NOTES — Notes convertible into equity after the loan term, most often issued as warrants. Entrepreneurs may intend to repurchase the shares or the converted equity stake may be purchased by external investors.

DEBT INSTRUMENTS — Investors select debt instruments from among those available in local markets. Debt is generally purchased directly from the company; however, for bankable businesses, investors may also purchase debt issued by a third-party debt provider.

DIRECT EQUITY STAKE — A direct equity stake in the company acquired at the time of investment, to be exited either back to the entrepreneur or through a traditional liquidity event. The shares may grant investors the right to draw dividends during the investment holding period. In some cases, the shares may be structured with a call option, giving the entrepreneur repurchasing rights.

DISBURSAL SCHEDULE — Some investors disburse the full loan amount at one time, while others will disburse across multiple tranches. Disbursal of subsequent tranches may be completed at predetermined time intervals or conditional upon certain performance metrics or other conditions. Multi-tranche disbursals lower interest rates by reducing the amount of unpaid principle and may be preferable for companies pursuing multi-phase growth plans.

GRACE PERIODS — Grace periods are periods of time, often immediately after a loan disbursement, during which the borrowing company is exempt from interest payments, principal payments, or both. Grace periods may allow companies to put the capital to work more quickly towards growth plans and business improvements.

GRADUAL REDEMPTION SCHEME — The repurchase of redeemable equity shares through regular installments throughout the investment period. Repurchase schedules can be fixed throughout the term of the investment or can be variable based on financial performance metrics. Shares are generally repurchased at a price determined at the time of investment, usually equal to a multiple of the original share value.

INCOME PARTICIPATION ROYALTY — A calculated percentage of a financial metric such as revenue, sales, or cash flow distributed to lenders at regular intervals throughout the term of the loan.

LOAN SECURITY — Investors can collateralize loans with a range of tools, including company or entrepreneur hard assets, company bank account control, personal guarantees, share pledges, company receivables, demonstrated past performance, and projected future performance.

PARTICIPATION RIGHTS — Rights to purchase equity in future financing rounds for the company.

PREPAYMENT CONDITIONS — If investors anticipate a company may be eligible for recapitalization before the end of the loan term, they might choose to create prepayment blackout periods or penalties to ensure they receive a return proportionate to the risk taken at the time of investment.

REDEMPTION POOL — An account set up for redeemable equity deals to facilitate and guarantee the accumulation of adequate funds for stake redemption. The pool collects a percentage of company profits, revenue, or receivables into a trust or escrow account. The company uses the redemption pool to purchase shares from the investor at either preset time periods or upon accumulation of a certain pool size.

REPAYMENT ACCOUNTS — To ensure loan repayment, some investors have either secured control over company bank accounts or put company receivables into a trust or escrow account, allowing investors to draw loan payments directly from the account.

REVENUE-BASED LOAN — A loan with variable payments equal to a calculated percentage of company revenue until investors reach a targeted MOIC, generally between 1.5 and 3x. Payments can represent a fixed percentage of revenue throughout the loan term or can increase over time, as the company sees the projected growth resulting from the financing package. The percentage of total revenue may also vary based on whether the company has met growth projections. A loan term may be targeted based on revenue projections, but there is no fixed maturation date. While revenue is the most common metric used, repayments can also be fixed to alternative financial metrics such as sales or EBITDA. The financial metrics used to determine repayment rates can be calculated on a monthly, quarterly, or even annual basis.

SINGLE-TRANSACTION REDEMPTION — Stake redemption through a lump-sum payment at the end of the holding period, either directly by the company or through a recapitalization by future debt or equity investors. The share price can be determined at the time of investment or negotiated at exit.

TERM LOAN — A loan with a predetermined maturation date, payment schedule, and interest rate. Investors utilize either an installment or revolving line of credit structure, and they can have either a straight-line or a growing amortization schedule throughout the loan term. In some cases, interest rates can vary based on the company meeting certain performance goals.