Venture leasing helps early-stage cash go farther

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"Cash to a start-up is like altitude to an airplane; when the engines sputter, can you really have too much?" That statement attributed to venture capitalist Gerard Langeler speaks volumes to any entrepreneur.

One route to that elusive cash is venture leasing. Chris Fenner, Pacific Northwest region managing director for Portland-based VenCore Solutions, described the practice at the March meeting of the Three Rivers Entrepreneur Network in Richland.

New York attorney and author Jay Hollander defines venture leasing as a hybrid of traditional leasing and venture capital. It is meant for the early-stage company that has received a first round of financing and is aiming toward an eventual buyout or other exit strategy. To conserve as much equity capital as possible, the company wants to avoid diverting cash or having to seek additional funds to acquire equipment and infrastructure.

How does it work?

VenCore is a venture finance company that helps young, primarily technology, companies acquire everything from office, computer and manufacturing equipment, to telecommunication hardware and complete laboratories.

"We help these firms use leasing, a form of debt, to acquire critical equipment and assets," Fenner said. "This allows them to preserve their limited cash equity for things that cannot be financed, such as research and development, payroll, overhead, sales and marketing."

Over the past 2.5 years, VenCore has invested nearly $15 million in more than 30 Washington and Oregon companies, Fenner said. "There are other asset-based lenders. We are unique in that we serve early-stage companies that typically cannot qualify for traditional bank debt."

"Venture leasing is a great way to fund expensive capital equipment," said Michael Dunlop, chief financial officer of IsoRay, the Richland cancer therapy start-up.

Why add debt?

According to Fenner, debt is substantially cheaper for a growing business than spending cash equity. "By adding leverage and giving the company an improved cash cushion, we are not just helping the company, we are helping everyone who invested in the startup, including the founders," Fenner said.

"Investors get more mileage from their original cash investment, and entrepreneurs may gain time to hit more milestones and raise their valuation before going back for more financing," he said.

iSense Corp. of Portland, uses venture leasing in its development of a continuous glucose sensor. The company has a sale/lease-back arrangement in which it literally capitalizes on the value of previously acquired lasers and injection molding machines by selling them to VenCore and then leasing the same equipment.

Chief financial officer Jane Conner said the cash received from selling the equipment can be used for current operations, or to finance the lease of a new piece of equipment for a term that coincides with its actual use by iSense.

The tactic has worked well. "We completed one financing and are doing another one now," she said.

Why pay more for money?

Although bank loans cost less than venture leasing, most early-stage firms can't qualify for a loan without sacrifice, such as giving the bank a blanket lien on all the assets of the company, often including intellectual property, Fenner said.

The leasing company generally uses the equipment being purchased as security, though a variety of special arrangements are available. In addition, there is less risk of obsolescence because the company can walk away from the equipment at the end of a typical lease transaction.

As it gears up for full production, IsoRay turned to VenCore to obtain a $430,000 hot cell for the manufacture of cesium seeds.

"This was a perfect fit," said Dunlop. "They are positioned to take a degree of risk that banks typically can't entertain. And the leasing package we negotiated with VenCore is a better alternative than selling our stock at a cheap price to purchase capital equipment."

What about cash flow?

According to Fenner, companies can access the best of both worlds by using lease financing for equipment and using the bank to fund growth through accounts receivable, inventory and working capital lines of credit.

"If you manage it right, debt won't hurt your cash flow," Fenner said. "In fact, leasing leverages your bank operating lines, permitting you to maintain them for their intended purpose - daily operations - rather than reducing the capacity of the operating line through equipment purchases," he said.

"While funding options generally change and become less expensive as a company grows," Fenner said, "it's important to realize that there is money out there - even for the new kids on the block."