Mezzanine Financing: Challenges for Tech & Communications Companies

The majority of business loans are secured loans based on cash flow and the security interest of business assets likes accounts receivable and equipment.

If a company needs funding that exceeds the value of their current assets but does not want to give up a large equity stake, adding a Mezzanine note could be something to consider. However, the borrower must have enough cash flow to support both the senior secured loan and the additional mezzanine note.

What is Mezzanine Financing?

Mezzanine financing is a unique lending option that sits somewhere between senior debt and equity financing. This hybrid form of financing requires no collateral from the borrower, and in most cases principal payments do not have to be repaid until the loan term ends. In addition, mezzanine loan debt is treated as equity on a company's balance sheet and interest payments are tax deductible.

However, mezzanine loans present more risk for the lender. Mezzanine loans are considered junior loans, meaning that mezzanine lenders do not get repaid until senior lenders are paid in full. Because of the higher risk to mezzanine lenders, mezzanine loans come with higher interest rates and often afford the lender the right to convert the balance to equity interest in the case of default.

The addition of a mezzanine loan makes sense when a company needs access to capital beyond what their fixed assets will allow. However, acquiring a mezzanine loan can be challenging – especially for the unique needs of technology and communications focused companies.

Mezzanine Loans Under $2,000,000 Are Hard to Come By

Mezzanine loans require more risk on the part of the lender. And most mezzanine lenders focus on loans of $5,000,000 or more, as they view the interest gained on smaller loans unequal to the risk.

In general, communications and technology companies are often looking to add only $500,000 to $2,000,000 in mezzanine financing – which falls well below the minimum loan target of the majority of mezzanine lenders.

There are a small number of mezzanine lenders that will take on smaller loans for the right company– they are just in the minority.

Smaller Mezzanine Loans Usually Come with a Shorter Time to Pay

Smaller mezzanine loans often come with a shorter time to repay. The average term for loans under $2,000,000 is 18 to 24 months, which is staggeringly shorter than the standard 5 to 7 year timeframes afforded on larger loans. Negotiating a longer term is a possibility, but takes skilled negotiation.

Inter-Creditor Agreement Woes

There must be an inter-creditor agreement between the senior lender and the mezzanine lender. These agreements are notoriously hard to navigate and negotiate, and this hard line negotiation makes sense. In general, a mezzanine lender does not receive a return on their investment until the senior lender has been fully paid, and this leaves the mezzanine lender in a riskier position.

The mezzanine lender will want to negotiate some rights in the event of default, which will require the established senior lender to agree to certain terms that could include a stand down agreement. As the senior lender already has their deal in place, working out something amicable to all parties can be taxing. However, having an inter-creditor agreement in place is vital.

Negotiating The Best Deal

Due to their high-risk nature, Mezzanine loans require a higher percentage of interest and in some cases require an equity component. This is why it's important to make sure that you find an advisory partner who understands the communications industry to help negotiate the best possible arrangement.

How can Thermo Credit help secure additional Mezzanine Financing?

At Thermo Credit, we focus exclusively on funding well-run communications and technology companies. We have experience creating hybrid loan strategies that combine asset-based loans with additional mezzanine financing.

We work in an advisory capacity to help our clients weigh both the risks and benefits of additional mezzanine financing. By completing a full analysis of both the current valuation and the 3-year projected evaluation, we are able to help our clients determine if adding mezzanine financing is more advantageous than adding equity financing.

Thermo Credit has also developed a network of partners that are willing and able to compliment our asset-based loans with mezzanine loans under $2,000,000. Our experience with communications companies and additional mezzanine financing allows us to negotiate the best rate and loan term possible as well as help navigate any necessary inter-creditor agreements.