Raising Start-Up Capital: A Discussion with Diane Woolf of Covington Associates

Start-up funding has become more difficult due to the recent turmoil on Wall Street. Mike Travis spoke with Diane Woolf of Covington Associates, a leading investment bank, to get an expert's assessment of the current situation.

Mike Travis (MT): How do you size up the current environment for companies that are looking for funding?

Diane Woolf (DW): It is a very challenging environment. You have to have something special. It's a buyer's market and there's a lot of inventory.

MT: How has it changed since last year?

DW: The market for early stage capital got a lot tighter in the last couple months. When it became evident that we don't know when this cycle will hit bottom, that's when the VCs changed the standards. It also seemed to coincide with annual partners meetings, which set firm strategy for the coming 12 months. VCs as a group stepped back and tried to put numbers to the additional investment that their existing portfolio companies will need, and those numbers are a lot bigger than they were a year ago. That leaves less capital available to fund new investments. VCs are asking their current portfolio companies to plan very carefully and realistically because the capital isn't going as far as they were originally told it would go.

MT: What other problems are start-ups grappling with?

DW: In the device sector, the exit environment is limited. The public markets are closed. Although M&A exits are still fairly robust, corporate partners have become more risk-averse. The venture debt market has also dried up. GE announced last week that their venture loan business is shuttered, and rates on venture loans have gone up 300 basis points in the last couple months.

In addition, some investors believe that there's more regulatory risk. Some VCs think that 501Ks based on predicate devices are soon going to be obsolete. While the evidence is only anecdotal, there's a general consensus among VCs that more clinical data will be needed to ensure approval and reimbursement, and that additional expense needs to be planned for early in the strategic process, thus increasing forecasted capital requirements. If the FDA process gets even slower, it will make it more expensive to get valuable technologies to market.

MT: I've seen a number of late stage companies go under that expected to exit this year.

DW: In certain situations, it's IPO or bust, because the capital need is so large – 30, 40 or 50 million dollars of proceeds achieve milestones. In lieu of IPOs, I am seeing some big Series D and E deals; those are the survivors, the companies that intended to go public and needed another big infusion of capital and were lucky enough to get it.

MT: Are entrepreneurs looking to non-VC sources of start-up capital?

DW: Yes. I believe the funding gap will have to be filled by angel investors.

MT: What's happening with valuations?

DW: Pricing is lower, although I'm not seeing issuers getting nailed by terms - not yet anyway.

MT: What types of companies are having the most trouble raising funds?

DW: Me-toos are struggling. Companies that aren't creating quantifiable value in the marketplace are suffering.

MT: What can start-ups do to maximize their odds of raising money in this climate?

DW: Companies that can demonstrate traction, acceptance and adoption in the marketplace will do well. Plan realistically and spend efficiently, which may seem obvious, but it's important to stretch out cash as long as possible. When choosing an investment partner, issuers should consider where the fund is in their life cycle, and if there will be cash available for follow-on investing. Even for smaller deals, consider a syndicate of investors, so that additional financings can be spread among several insiders.

MT: Any silver linings?

DW: Deals are still getting done, but even good deals are taking longer. In the long run, the industry will benefit from weeding out the weaker companies. Capital's been going to companies that should have been shut off a while ago. Now they're being shut off, and those funds can be redirected to companies that have a better value proposition. Companies that present strong fundamentals will get funded.

About Covington Associates LLC

Covington Associates (http://www.covllc.com) is a specialty investment banking firm founded in 1991 serving healthcare, business service, consumer, industrial, and technology companies throughout the country. Focused on mergers and acquisitions, debt and equity capital raising, debt and equity restructuring, and strategic advisory assignments for middle market companies, Covington Associates has completed transactions ranging in value from $10 million to over $1 billion for both private and publicly traded companies. Covington Associates has significant expertise in the healthcare industry spanning a wide range of sectors including medical devices and diagnostics, medical product outsourcing, pharmaceutical services, healthcare informatics, distribution, and services.

About Diane Woolf

Diane joined Covington Associates LLC in 2008 to build upon the firm's capital raising capabilities. With nearly 15 years of experience in capital raising and corporate finance, Diane has raised over $1 billion of private equity capital in numerous industries. Prior to joining Covington, Diane structured, negotiated and raised start-up capital for several companies, and served as interim CFO for four start-up organizations. Previously, she was a Principal and Head of Private Placements at Tucker Anthony Sutro. Diane joined Tucker Anthony from the Private Capital Group of Robertson Stephens. She has also been an integral member of the capital raising and corporate finance teams of BancBoston Securities and BNY Associates.