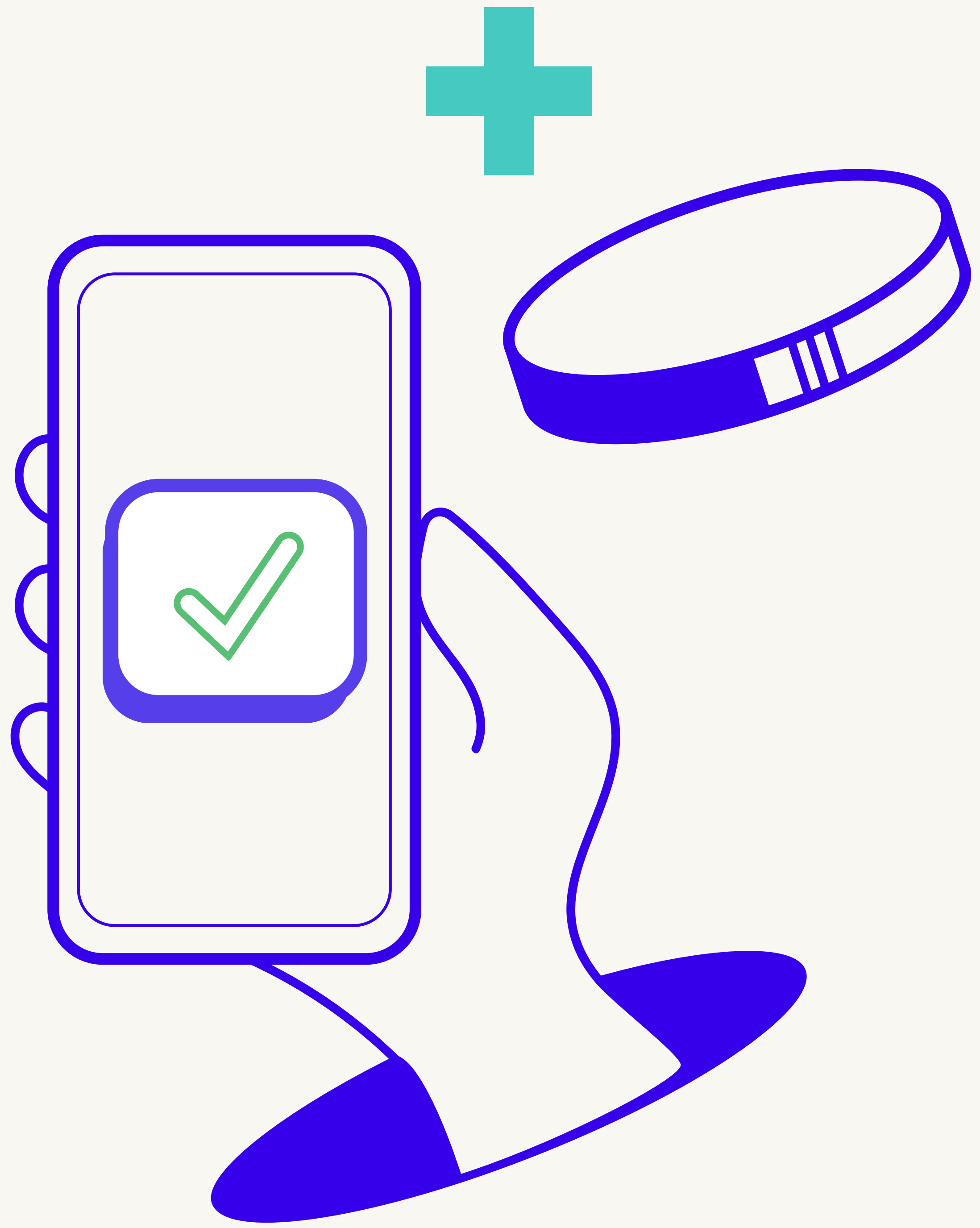

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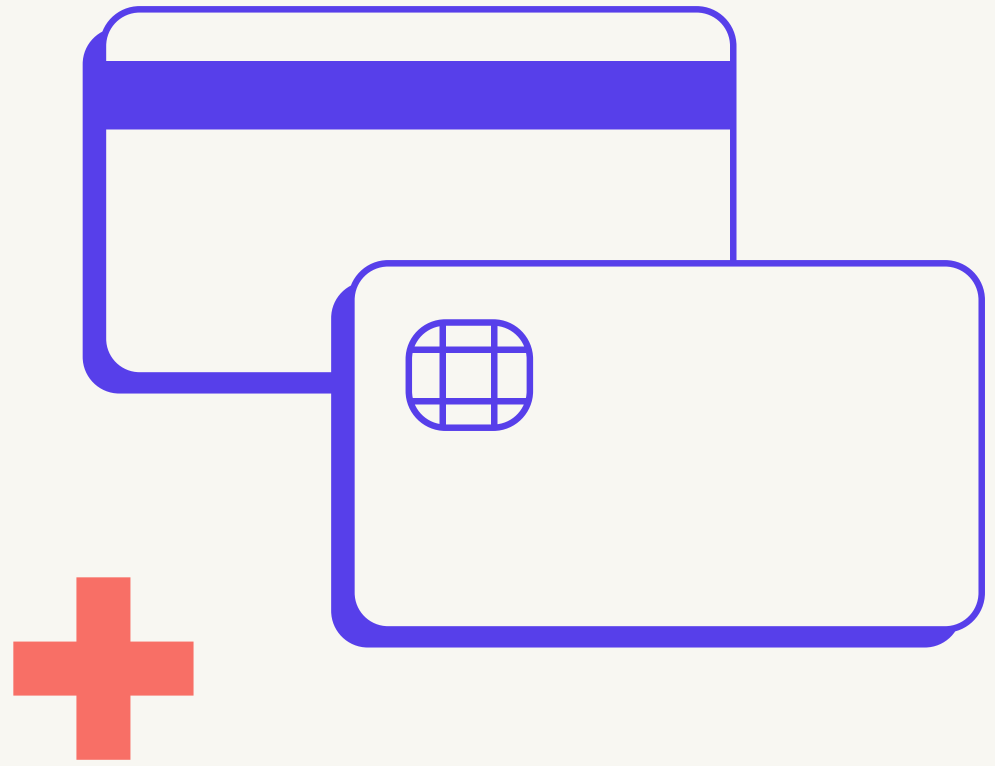
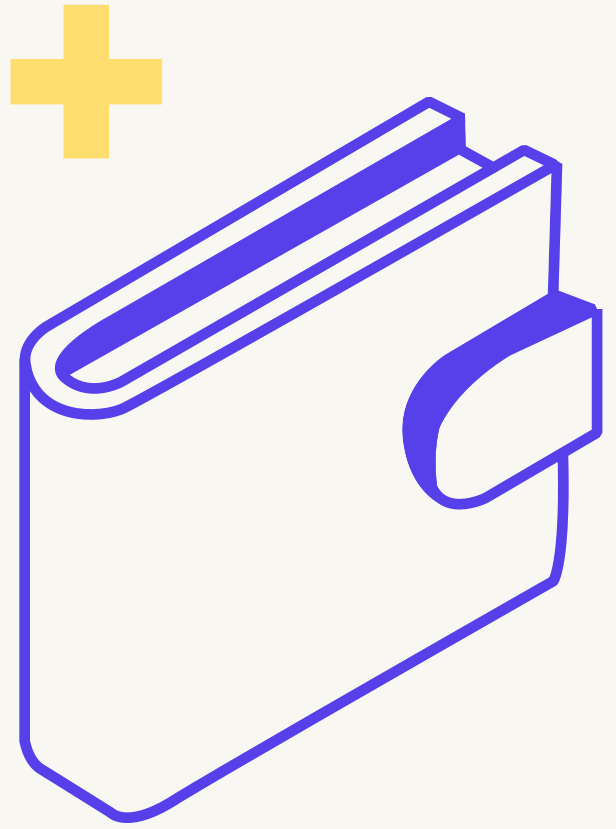
The State of Alternative Lending

A 360-degree view of the alt lending space for DTC brands, through the lens of VC and finance experts.





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The State of Alternative Lending

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Introducing

The State of Alt Lending

> More and more folks are getting into the game to provide young businesses with whatever they need to grow from the credit side to the equity side.
>
> Jackson Gates

Here at Tydo, we're excited to share our insight into the alternative lending space for DTC brands. Given the market climate, there's less equity available from VCs, making debt and alternative financing a more attractive option and potentially the only other route.

In many ways, alternative lending is more important than ever before.

In this report, we'll:

1. Provide background on why alternative financing matters in bull markets
2. Introduce our six experts who will offer their insights and perspectives
3. Dive into the three most relevant alternative lending tools

As VC equity dries up across industries, we know that consumer brands will continue to be hit especially hard.

Public market CPG company multiples are declining, and consumers are now less likely to spend on new, non-essential purchases. Unfortunately, DTC brands now face a triple header of uphill battles.

Keeping all these shifts in mind, debt has become an even more important tool. It's a way to scale without relying on equity.

By exploring the three best alternative lending options, we hope to give founders a better sense of what they can do and where they can go for advice.

The founders who know how to navigate alternative credit and financing options will win in the long run. Armed with new financial solutions, these founders—those who can weather the hard times while continuing to grow—will reap the rewards for years to come.

Our Experts

To gain a holistic view of the current alternative financing landscape, we gathered a set of industry veterans with deep experience across finance, startups, and ecommerce.

Will Hawthorne

Will Hawthorne is a GP at Sugar Capital where he helps lead investments in the future of commerce.

Hawthorne's broad experience in finance includes:

- 11 years leading internet and digital media M&A teams at JPMorgan
- 10+ years as an advisor, partner, and board member across funds and companies

Anthony Rosen

Anthony Rosen is a CFO at Propeller Industries, where he provides CFO, business strategy, and outsourced accounting services for early-stage venture-backed growth companies.

His track record includes:

- Global experience leading finance, operations, and strategy
- Management and advisory roles across industries including ecommerce and CPG

Jackson Gates

Jackson Gates is a managing GP at Manresa Ventures, a fund that invests in early-stage teams across fintech, payments, small business formation, ecommerce, and privacy.

Gates has built his wealth of experience as:

- An entrepreneur in residence and venture founder
- The cofounder and CEO of a personal finance startup
- VP of partnerships and business development at Pandora and Affirm

Brian Carroll

Brian Carroll is a partner and the head of finance at M13, where he helps young companies build the proper financial and operating foundation for rapid growth.

He honed his skill set in the consumer tech space over:

- 20+ years in finance, strategy, and operations
- Multiple tenures as CFO and COO at both startups and established companies

Shane Feldberg

Shane Feldberg is a GP at Feld Ventures, a fund that empowers early-stage companies to reach their full potential.

Feldberg's experience in and understanding of startup financing stems from:

- Years providing strategic growth capital to help grow ecommerce and SaaS businesses
- Assisting founders to make sure that precious equity isn't wasted on inventory or marketing

Adrianna Saman

Adriana Saman is a principal at Clocktower Technology Ventures, where she helps increase financial inclusion by funding and investing in underrepresented founders.

Her unique perspective on financing comes from:

- Years as an investment banking analyst with a specific focus on consumer payments
- Her integral role in investing in fintech startups in the US, Europe, and LatAm

Which Alternative Lending Tool Is Right For Your Brand?

Our panel of experts in VC and finance highlights the three best lending tools:

- Credit Lines
- Payments-based lending
- Merchant Cash Advances

Credit Lines

Even in good markets, investors are often turned off by DTC ecommerce brands that fund working capital (i.e. inventory) through equity (traditionally the most expensive option).

Using equity to fund working capital can quickly kill the potential upside of equity for founders and early investors. Will Hawthorne suggests using a debt product for two reasons:

1. It’s far cheaper and runs more efficiently
2. It sets up your business for long-term success

For Anthony Rosen, the new normal involves debt, which can take many forms, such as a term loan, revolver, or working capital facility with revenue-based fines.

In our state of credit lines piece, Hawthorne and Rosen offer their unique perspectives and advice on:

1. Differences between paper rates vs. final payments
2. Best practices for credit shopping and negotiations
3. Red and green flags to consider while financing

Payments-Based Lending

In the new age of fintech lending across the DTC ecosystem, there are more options than ever before. The payments space is filled with BNPL tools, term loans, inventory, and accounts receivable lenders, to name a few.

The right financial growth plan and supportive tooling are critical. The tricky piece is figuring out which option is the right fit for your business.

Our piece on the state of payments features Brian Carroll and Jackson Gates and will cover best practices around:

1. How to avoid financial risk by hiring well and offloading ops
2. Optimizing your network for relevant, veteran advice
3. Popular funding options such as embedded lending

Merchant Cash Advances

Once limited to established, capital-intensive businesses, merchant cash advances are now offered to a broader range of companies, including early-stage commerce ventures.

Merchant cash advances are a great form of credit that don’t require credit checks and tick all the boxes as quick, easy to use, repeatable, and scalable.

A merchant cash advance can help early-stage businesses overcome common cash flow obstacles that frequently require upfront investments with delayed ROI.

Shane Feldberg and Adriana Saman break down the best ways for startups to use cash advances as a ramp for growth and scale in this report. The pair break down:

1. Evolving sub-sectors of financial support for brands
2. How to seek financial advice from peers and funds
3. The ABCs of merchant cash advances for young merchants

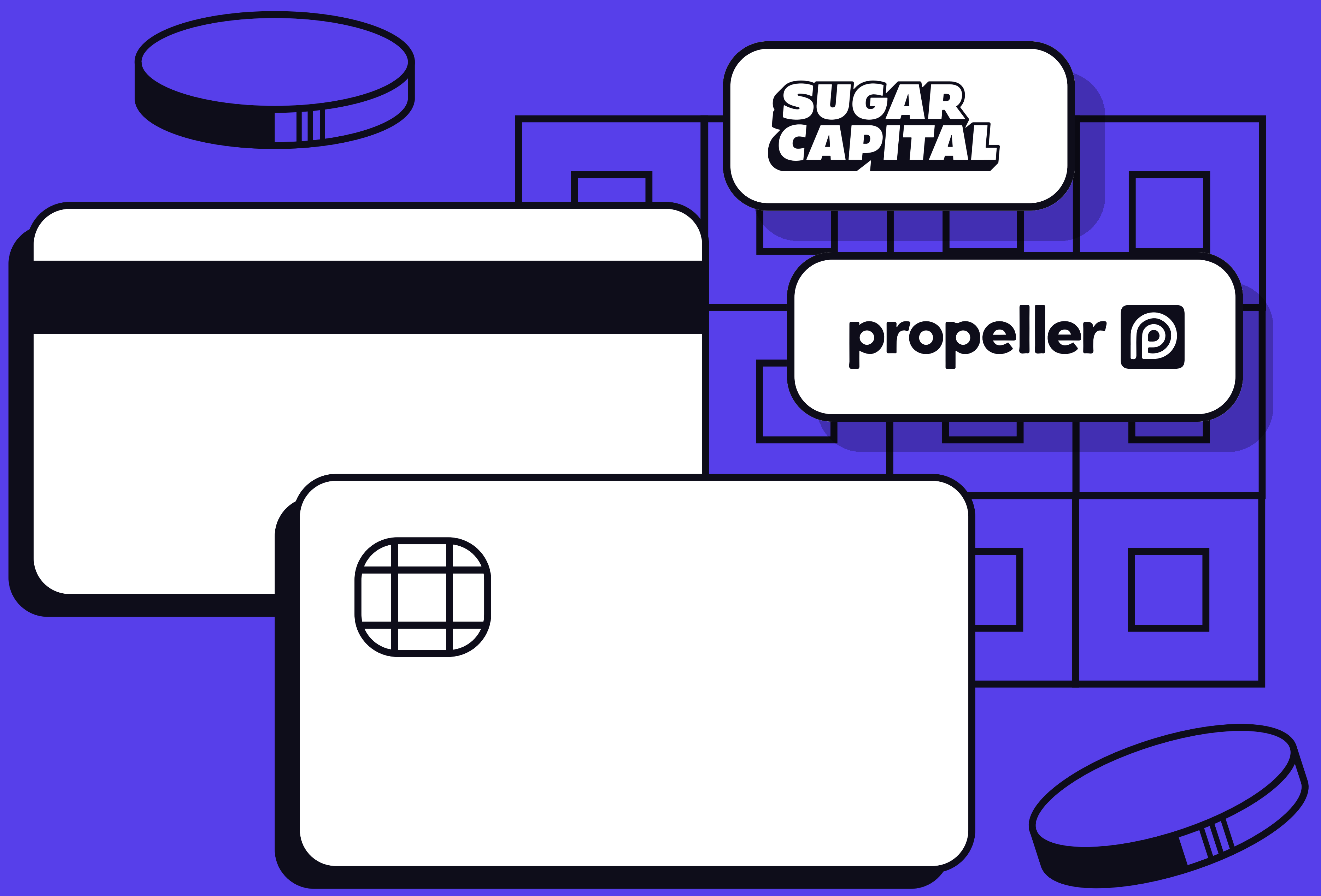
The State of Credit Lines

The finance landscape for young companies is shifting rapidly and relentlessly.

We sat down with Will Hawthorne, GP at Sugar Capital, and Anthony Rosen, CFO at Propeller Industries, to jam on the present-day credit market and financing options for startups.

Read on to learn more about:

1. Differences between paper rates vs. final payments
2. Best practices for credit shopping and negotiations
3. Red and green flags to consider while financing



It's a lot like telling your kid to get a credit card to establish a solid credit history for later down the road. The same is true for companies.

Will Hawthorne

Today’s Credit Market for Merchants

In Hawthorne’s experience, investors are often turned off by DTC ecommerce brands that fund working capital (i.e. inventory) through equity (the most traditionally expensive option).

After all, it’s an easy way to quickly kill equity for founders and early investors. Instead, he recommends supplementing equity with a debt product for two reasons:

1. It’s far cheaper and runs more efficiently
2. It sets up your business for long-term success

Innovations in the Lender Space

Throughout Hawthorne’s time at Sugar Capital, he’s seen several innovations in the credit space, which allow lenders to be far more aggressive in tracking, monitoring, and reporting.

Five years ago, it would’ve been nearly impossible to accrue debt pre-launch.

Today, lenders can connect to new systems for ensuring repayment. As such, lines of credit are now frequently extended to very early-stage companies.

Cyclical Aggression from Lenders

Anthony Rosen has seen a similar diversification of options for financial structuring.

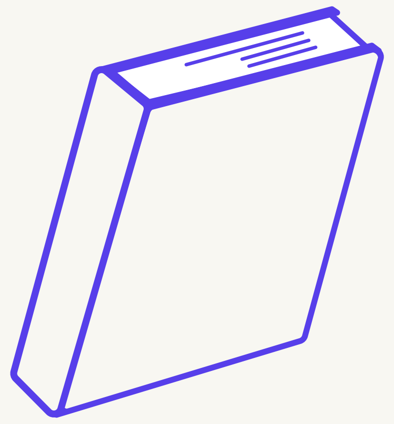
For instance, brands no longer default on long-term loans at early stages. Instead, the new normal is revolving credit lines based on inventory and revenue-based fines.

This trend can be explained by, again, aggressive lender practices.

Lenders are beginning to trend toward conservative approaches, often pulling back on offers relative to the proposals we’ve seen over the last 12 months.

However, Rosen also notes that all trends ebb and flow. Banks may run through cycles of aggressive pursuit and then pull back if they get burned.

> By taking out debt early and proving that you can meet payments and grow your business, you’ll set yourself up for better terms and larger loans.
>
> **– Anthony Rosen**



The Credit Playbook

When advising brands on how to broach credit, Rosen reminds them that it's only one slice of the overall financing strategy.

In other words: Don't hyper-fixate on credit. Look at equity raised and longer-term equity plans.

He asks several questions to help clients focus on the big-picture approach, including:

- How much capital will your business need?
- Is there a seasonal cadence to your capital needs?
- Is there a more permanent need for capital to grow inventory?

Pros & Cons of Legacy Banks

For post-Series A brands, the answer might be big banks, which offer the cheapest interest rates on the market and typically only work with more mature businesses. In Rosen's experience:

- Banks are usually tied to a formula-based assessment of an equity raise
- Transitioning from a venture line to a bank requires a large Series A or extensive Series B

For Hawthorne, shifting reliance to a big bank can look like the following:

- Lower interest
- Higher inventory coverage
- Supplementing lines of credit for working capital
- Smoothing seasonal fluctuations in inventory and revenue

Overall, larger banks can offer better, cheaper term debt, but Hawthorne doesn't recommend going with the larger players early on.

Revenue-Based Financing & Extensions

Young startups regularly look to venture debt lenders for working capital on roughly 12-month lines. That debt can take on many forms, such as a term loan, revolver, or working capital facility.

Given this newer breed of revenue-based financing, loans come quick, easy, and with little-to-no due diligence, but remain expensive and require immediate repayment, explains Rosen.

The last financing bucket is the AP Extension, which Rosen recommends for:

- Seasonal businesses
- Businesses that require funding to gain better supplier terms

> Revenue-based financing works well as a short-term bridge, particularly if you're raising money soon and need the funds to get you there.
>
> **– Anthony Rosen**

Read the Fine Print on Rates

To help evaluate potential interest rates and terms, Hawthorne advises looking out for:

- Various add-on fees (from funding fees to payoff fees)
- Concrete loan terms, especially warrants

As a rule of thumb, the interest rate, fees, and warrants should land between 15–17%, says Hawthorne. If they come out to greater than this range, that should be a red flag.

> Most early-stage lenders are trying to drive returns with stated interest rates at 10–11%. But, with everything else thrown in, you should anticipate a 17% rate.
>
> **– Will Hawthorne**

Where to Turn for Advice

Should an early-stage founder turn to VCs? Investors? An outsourced CFO? Other founders? Hawthorne believes all of the above are beneficial in evaluating options. This could mean:

- Asking fellow founders what to expect at a certain bank
- Seeking out solid VCs with extensive portfolios or credit history
- Avoiding lenders who are historically out to seize companies
- Prioritizing funds that handle missing payments more kindly than harsh lenders

For Rosen, he strongly recommends an outsourced CFO like Propeller because they're familiar with standard benchmarks, the ongoing state of the space, current market standards, etc.

At the same time, he recognizes that most young businesses don't have the funds to access a fractional CFO. In that case, he recommends learning from seasoned founders or angels.

> Other founders are the go-to source on everything. They've got experience with lenders, good and bad, and understand how shops react when things go wrong.
>
> **– Anthony Rosen**

Red Flags & Best Negotiation Practices

In terms of warning signs to steer clear of, Hawthorne and Rosen both flag:

- Lenders with automatic sweeps
- Unfavorable covenants and short terms
- Lenders that don't encourage rapid growth
- An entirely "automated" process or project without senior supervision

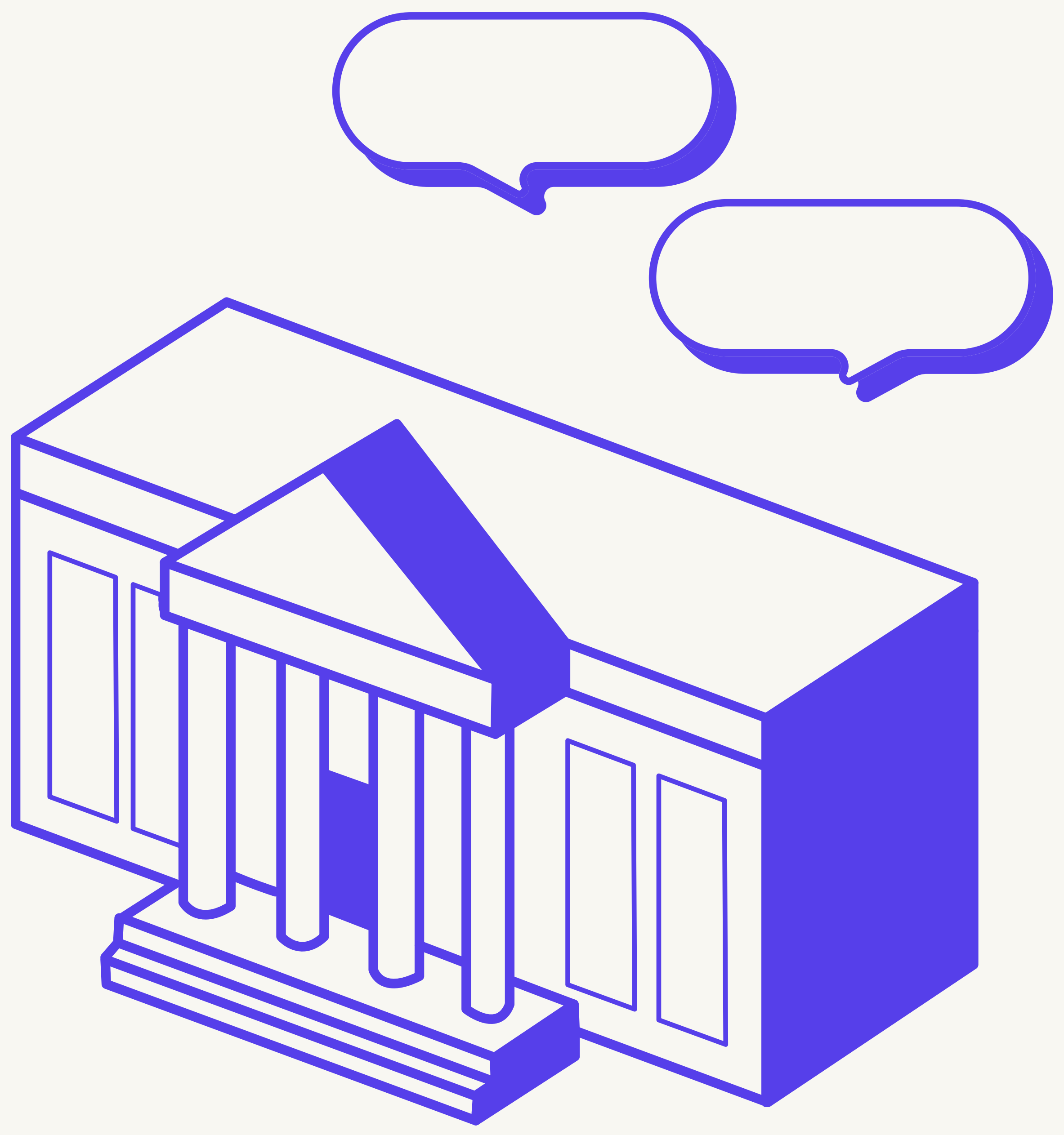
How Many Options Should I Field?

As for how many credit options a brand should approach at once, Rosen suggests:

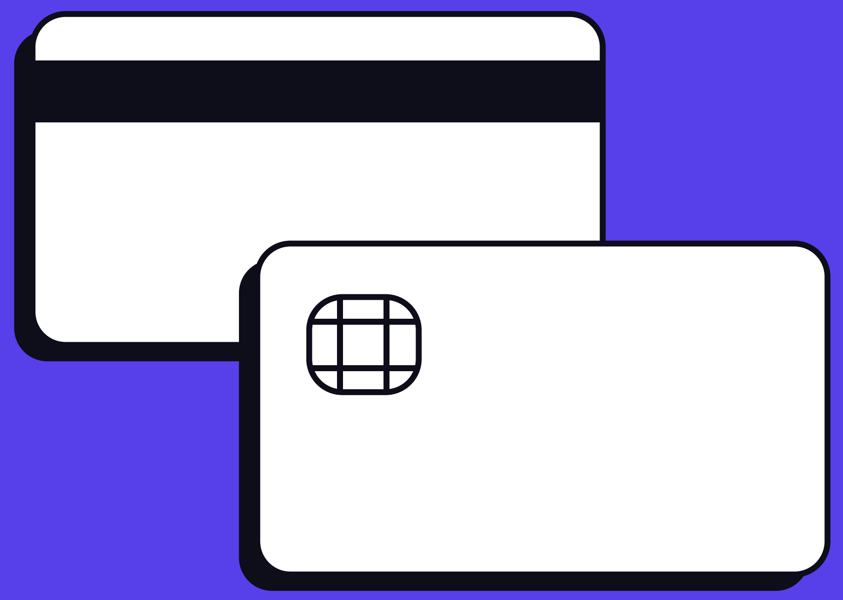
- Researching and approaching the best potential fit
- Avoiding the time suck of courting shops or banks that you know won't pan out
- And, in many cases, combining more than one financing option at a time

Ultimately, the two experts consider it best to:

- Get a few test offers
- Gauge who will close quickly
- Consult trusted advisors on your options
- Negotiate deals

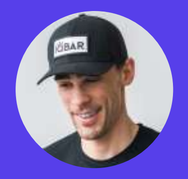


> There are limited hours in a day. Get all your options, but don't seek out 15 people. They're not mutually exclusive offers. And, never accept first offers.
>
> **– Will Hawthorne**



"The credit landscape for DTC brands is rapidly changing.To put it bluntly, consumer product founders need to know how to seamlessly navigate the credit ecosystem."

Will Nitze
Founder & CEO, IQBAR

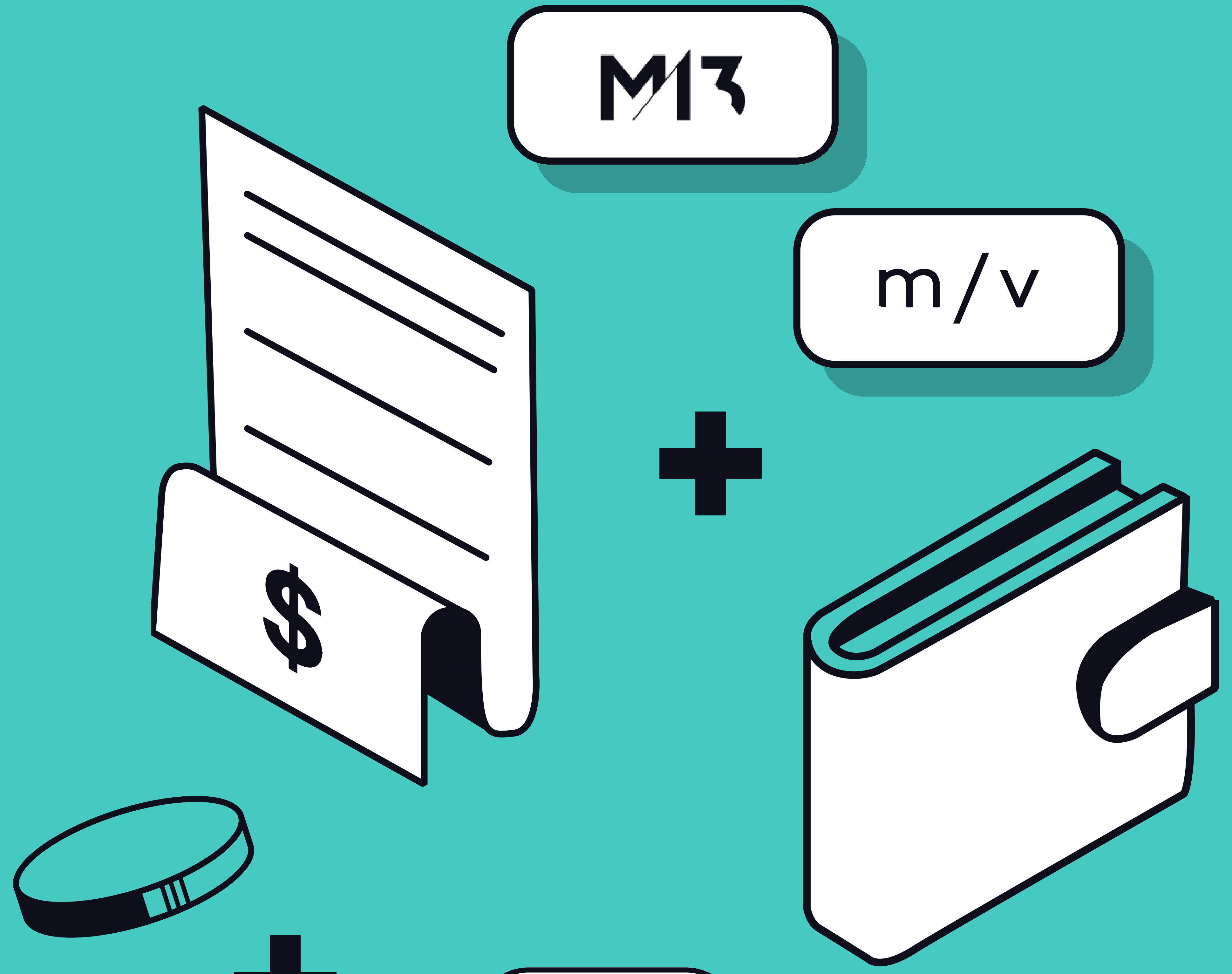


The State of Payments

Changes across the lending landscape strike as quickly as money moves. So, we sat down with Jackson Gates, managing GP at Manresa Ventures, and Brian Carroll, partner and head of finance at M13, to gain a bird's-eye view of the payments landscape.

Combining their deep industry expertise, this piece dives deep into topics including:

1. Avoiding financial risk by hiring well and offloading ops
2. Optimizing your network for relevant, veteran advice
3. Popular funding options such as embedded lending



More and more folks are getting into the game to provide young businesses with whatever they need to grow from the credit side to the equity side.

Jackson Gates

Prepping Your Financials for Success

As a former CFO, Brian Carroll has built the foundational infrastructure for both finance and operations divisions at a host of young companies.

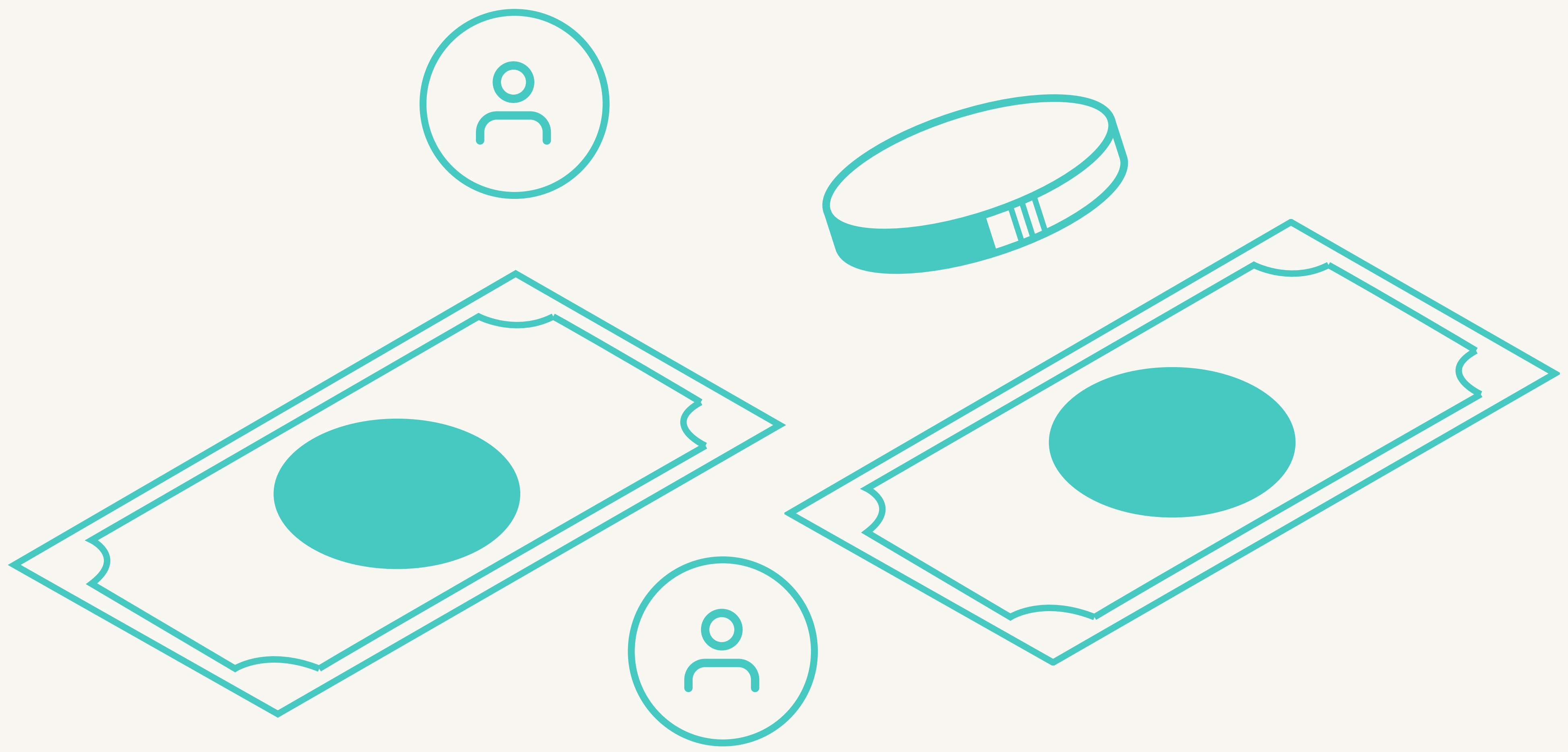
According to Carroll, a critical and determining factor for payments companies and cash advance providers is a clean bookkeeping system, specifically meticulously-kept internal financial documents.

It's generally essential for a company to provide evidence, including:

- Detailed knowledge of precisely where their cash goes
- Foundational systems for paying invoices as they're collected
- Key approval systems to control outbound payments
- Closing the books every month, ideally within 15 days before the end of the month

On this basis, startups need to designate one person to track finances early on. A CEO should rarely be preoccupied with unpaid bills or inquiries from creditors.

> Make sure you can provide regular updates on your month-to-month revenue and expenses. VCs will scrutinize this information.
>
> **– Brian Carroll**



Spend Wisely on Hiring

In Jackson Gates's experience, it's rare to find yourself in trouble with banks because, in reality, they never lend you the amount you'd like to borrow. Instead, the true risk lies in raising capital, especially given the industry-wide pressure to continuously fundraise and hire.

From his lens, a fundamental part of that pressure to grow at all costs is hiring. Gates points to this specific example, illustrating the endless hiring treadmill or snowball effect:

- A growing business begins hiring in-house teams
- In-house teams call for more funding for hiring and scaling
- That hiring process demands even more substantial resources
- High-performing team members call for promotions
- Those growing teams require more management and reinforced workflows

In Gates's words: "Once you're on the treadmill, it's tough to get off."

Even more so, if you don't properly calculate hiring spend from the get-go, you'll most likely wind up laying off folks to right-size the business.

How Many People Should I Hire?

When hiring strategically, Carroll recommends finding hands-on, in-house individuals to manage core operations as soon as possible.

Hiring team members who can seamlessly execute processes will naturally reduce everyone's workload.

He summarizes his "magic ratio" as 1:8: one ops person for every eight sales and product team members. That ratio will keep your CEO, COO, and CFO from becoming distracted or overburdened.

Finding the Right Hires

As for finding the best person for the job, Carroll advises hiring folks from startups a few steps ahead of you, especially if they've recently exited and are seeking work with another startup.

He emphasizes pairing experienced industry players with eager, intelligent, and adaptable talent that's newer to the space.

> **A pairing for long-term success: the smart go-getter and the outsourced consultant who's seen it before and can share templates and best practices.**
>
> **– Brian Carroll**

Optimize Your Network for Direction

Carroll and Gates both recommend seeking out advice from trusted individuals within your network. These could be:

- **Your investors** to help you understand the cost of capital
- **Other experienced VCs** who show interest in guiding startups
- **Operating & fractional CFOs** with deep experience in startup financing
- **Founder networks:** Think Slack channels, forums, and discussion groups where community members share vendor experiences and contacts as well as trade tips

The common thread: avoid wasting time with people who haven't been in your shoes or on the other side of the table.

Both experts suggest targeting individuals with market intelligence and domain expertise, and who are accustomed to skilled execution within the ambiguity of startups.

> There are strings attached to all capital you bring in for your business. Turning to trusted colleagues is a sure way to know what opportunities to pursue or avoid.
>
> – **Jackson Gates**

A New Age in Funding for DTC Businesses

DTC businesses have historically felt limited to raising money via equity.

However, many of today's brands are prioritizing non-diluted financing in the form of a loan. According to Gates, some of these loan options include:

- **Basic credit lines** for the business
- **Short-term loans** that need to be paid back quickly
- **BNPL providers** that pay you the next day for all sales
- **Bank loans** from established financial institutions
- **AR- or inventory-based loans** where founders borrow against suppliers

The common thread: avoid wasting time with people who haven't been in your shoes or on the other side of the table.

Both experts suggest targeting individuals with market intelligence and domain expertise, and who are accustomed to skilled execution within the ambiguity of startups.

> In the same way accepting debit and credit makes your product more accessible to users, platforms are applying that approach through embedded lending.
>
> – **Jackson Gates**

A Shifting Landscape for Early-Stage Fintech

In recent years, Gates notes several businesses that have started issuing small lines of credit to commercial ventures, such as:

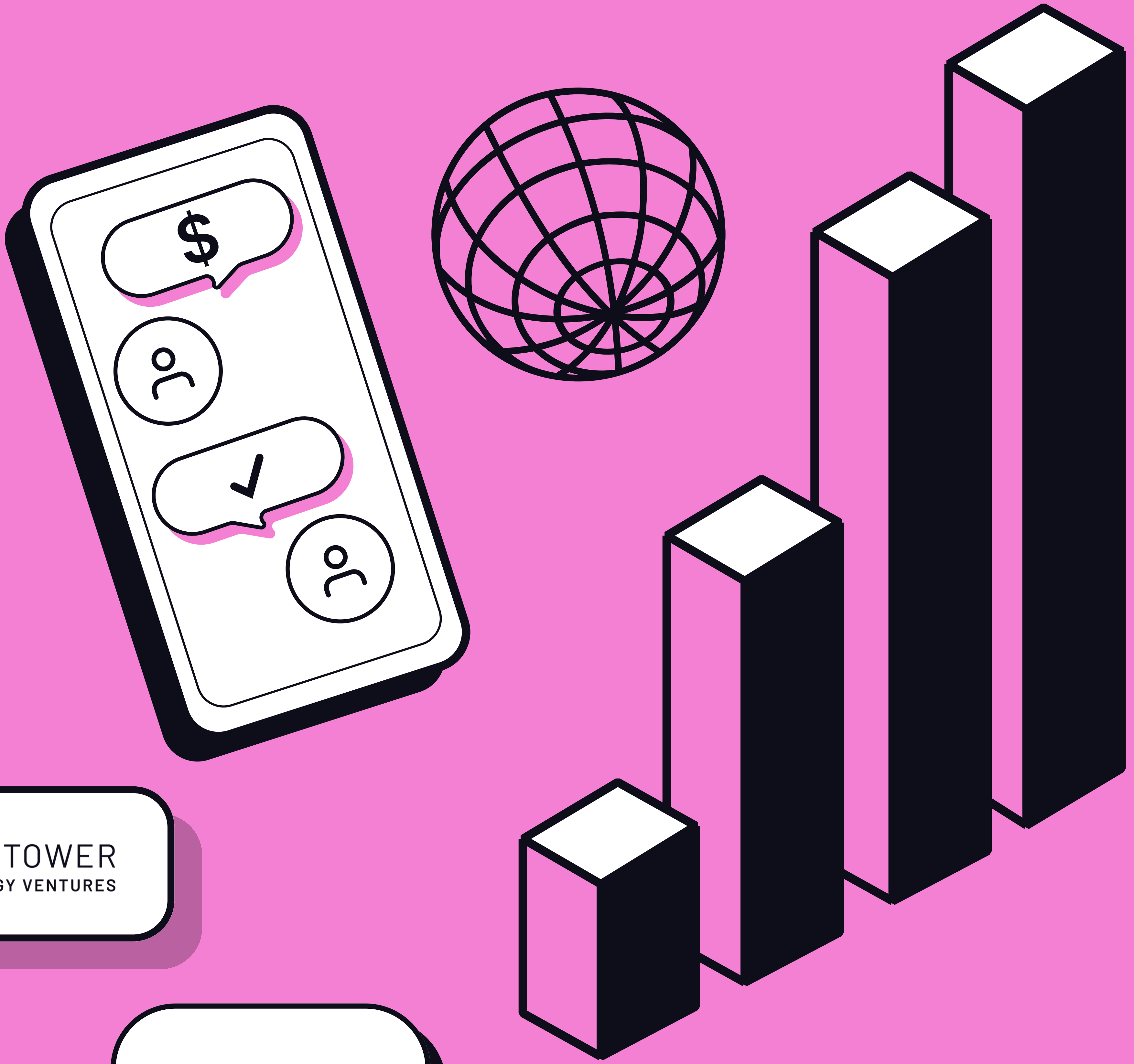
- Shopify Capital: Shopify's platform for business loans, which has lent over $2 billion to date
- Kabbage, Funding Circle, Bluevine: They provide SMB credit loans to companies
- Settle: They leverage loans based on accounts payable and accounts receivable to facilitate embedded lending across the entire stack

Overall, Gates anticipates many more fintech businesses emphasizing embedded lending as a best practice on top of their traditional product offerings.

> More and more folks are getting into the game to provide young businesses with whatever they need to grow from the credit side to the equity side.
>
> – **Jackson Gates**

"By using non-dilutive financing, we've been able to build faster and reach more sustainable levels of growth. It's been a gamechanger for us.

Jeremy Cai
CEO, Italic



The State of Merchant Cash Advances

Cash is king, so we sat down with Shane Feldberg, GP at Feld Ventures, and Adriana Saman, principal at Clocktower Technology Ventures, to get the lowdown on how today's startups can leverage merchant cash advances for aggressive scale.

Their unique lenses into ecommerce and fintech make them qualified to break down the following topics:

1. Evolving sub-sectors of financial support for brands
2. How to seek financial advice from peers and funds
3. The ABCs of merchant cash advances for young merchants

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CLOCKTOWER
TECHNOLOGY VENTURES

For early-and growth-stage merchants: Merchant cash advances are a great form of credit that require no credit checks. They're quick, easy to use, repeatable, and scalable.

Shane Feldberg

The Basics of Merchant Cash Advances

The cash advance industry has dramatically shifted over the years.

A few years ago, cash flow was mostly limited to capital-intensive businesses.

Today, early-stage commerce ventures are afforded far greater access to merchant cash advances.

The Impact of Widespread Merchant Cash Advances

Cash flow is one of the most common obstacles to early-stage business success for two reasons:

1. Companies commonly require upfront investments in marketing and inventory planning
2. Founders often experience a long delay in ROI for both of these expenses, which poses a significant threat to the venture's financial stability

As a result, merchant cash advances can be a helpful alternative financing tool.

> If your data shows consistent, month-after-month revenue scale, you'll have a better chance of receiving a beneficial merchant cash advance.
>
> – **Shane Feldberg**

Assessing The Need & Potential for Advances

When assessing a business's need for merchant cash advances and the appropriate investment amount to fill the gap in cash flow, Feldberg will:

- Look at monthly revenue using AdSense, Google Ads, and Shopify
- Run algorithms on data sets to determine potential action plans
- Determine the risk alongside the potential of ROI

These core metrics can help Feldberg foresee whether an advance will generate profitability.

If Feldberg's team chooses to proceed and offer a merchant cash advance, the company can then use that money to continue scaling without any major financial tie-ups.

The Evolving Ecommerce Financing Landscape

Historically, ecommerce and fintech have existed in separate spheres. However, as commerce brands continue to collect data, more and more opportunities for collaboration between the two sectors will arise.

Fintech players, tech-first lenders, and alternative lenders now look at more than a business's bank statement. They harness real-time data, which leads to more accurate forecasts.

This poses the perfect opportunity for brands to receive non-linear financing and to think more creatively about how to grow their business.

While most companies are eager to build through VC funding, Saman says that lifestyle businesses are better served by non-dilutive financing before reaching significant scale.

> **Given the different risk profiles, an Amazon reseller or Shopify brand is likely better off going with undiluted capital than a VC-backed company.**
>
> **– Shane Feldberg**

Why Merchant Cash Advances Matter

As valuations continue to decline and teams struggle to raise equity rounds, alternative funding methods are becoming more and more popular—with debt leading the pack as a solid option.

Feldberg and Saman both note that merchant cash advances are the simplest and most scalable way to acquire cash flow that doesn't impact the founder's credit.

However, one of the few notable drawbacks is that advances are costlier from an APR perspective.

Overall, for companies with collateral and histories of solid repayment, merchant cash advances are the cheaper, simpler option, especially for repeatable, scalable expenses.

Don't Repay Debts Too Soon

Both Feldberg and Saman agree that businesses do not need to repay their debts too quickly.

Lenders offering merchant cash advance products use a metric called capped IRR (the internal rate of return), which is essentially the time it takes a business to repay the capital.

This number helps lenders set the maximum time a company has to repay its debts, meaning the key to commercial cash advances is not to repay debts immediately.

> **Timing is everything for a young company —as in every single day matters. You don't want to be paying back the money you haven't even spent yet.**
>
> **– Adriana Saman**

> Modeling is fundamental. It demonstrates an understanding of what you'll be doing with the debt as well as the will and skill to execute according to plan.
>
> – **Adriana Saman**

Pitching Your Business Case to Lenders & Investors

Based on her experience advising founders, Saman recommends presenting your most robust historical data and prepping all the necessary documents and metrics ahead of time.

She advises aggregating these three data points:

- Percentage of spend for user acquisition
- What spread will be lent to consumers
- How you plan to earn that spread back

Pitching Specific Strategies

If you're pitching alternative lenders to finance a specific growth strategy, go as granular as you can in discussing where every dollar will go, the desired results, and the financial payoff.

This level of detailed foresight will (understandably) provide funders more peace of mind.

Pitching to Lenders

For merchants looking to partner with lenders, Saman recommends demonstrating learnings from your business journey thus far while showcasing a crystal-clear financial plan.

After all, lenders focus more on short-term plans than equity investors.

Common Blockers & Solutions in Lending

Merchants face varying degrees of difficulty in the lending space, depending on the type of SMB or early-stage commercial venture.

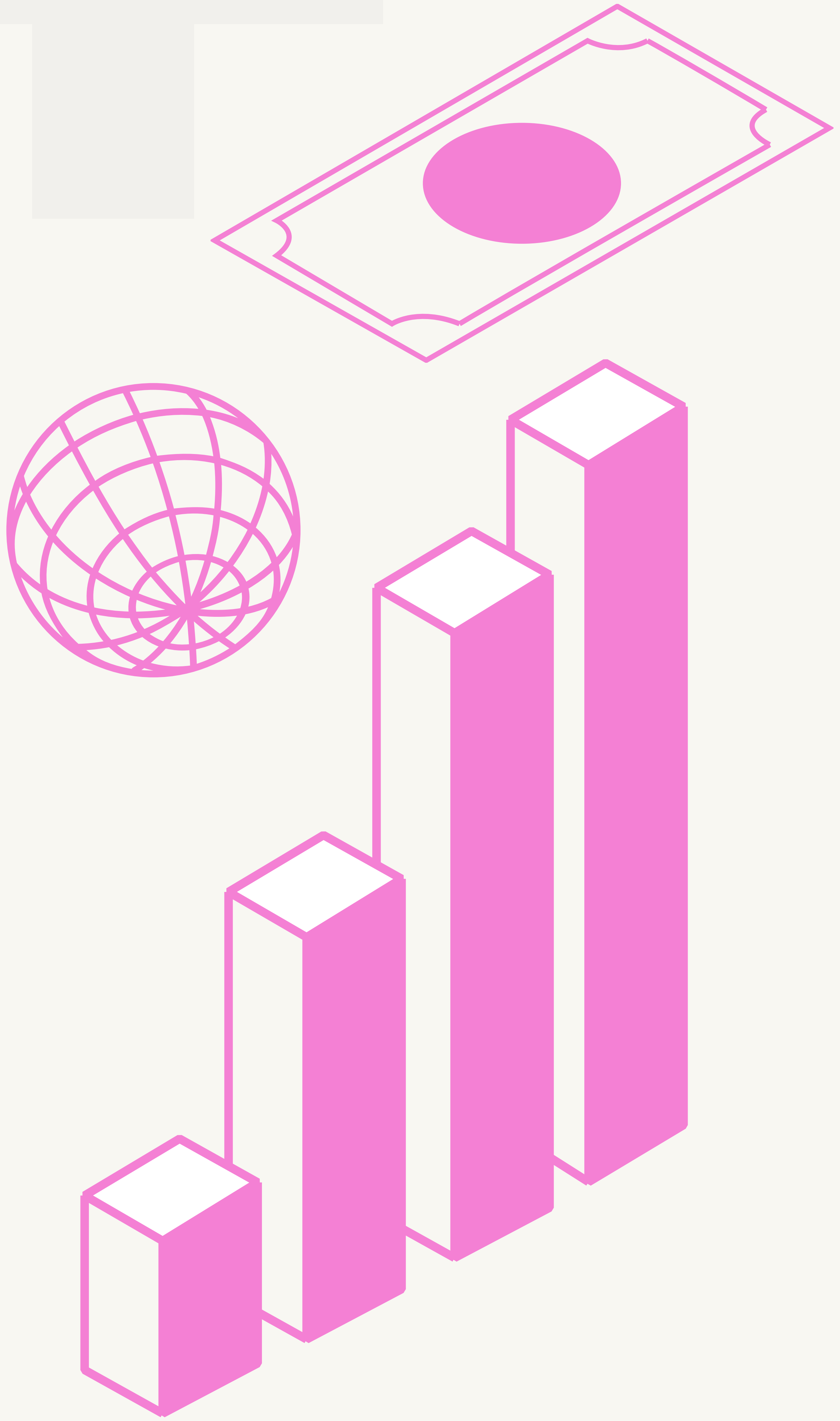
Yet, for all companies, Saman cautions founders to be wary of interest rates.

Shopify SMBs might fetch higher rates since their ability to drive revenue accordingly is less of a guarantee than if they were to, for instance, use cash from their balance sheet.

So, for SMB merchants considering credit alternatives or non-dilutive options, it's essential to seek out the most relevant advice for your business and its maturity. You can:

- Lean on institutional advice and feedback from investors
- Speak to founders working with investors at both ends of the financing spectrum

> The best way to learn is from those who've gone through the same financial process. Seek out firsthand knowledge on these interactions and negotiations.
>
> – **Adriana Saman**



Looking Forward:
The Future of Merchant Cash Advances

Historically, acquiring debt has been difficult for brands, especially those that sell limited products.

As such, both Feldberg and Saman believe that as the cost of capital goes down in the long run, cash advance usage will increase. They envision:

- Merchant cash advance product lines growing to meet the needs of today's ecommerce brands
- More SMBs looking to grow without turning to traditional credit or equity

Ultimately, lenders and debt providers inhabit a competitive landscape, forced to innovate and undercut one another to win business—meaning an all-around, indirect victory for merchants.

> Both businesses and lenders can win in this next era of lending innovations. Merchant cash advances uniquely unlock business synergies and opportunities.
>
> – **Shane Feldberg**

"Merchant advances are a fantastic tool and a good, quick way to get money. I recommend asking a lot of questions ahead of time, especially around the fee structure. Know your costs of capital. In the meantime, make sure to build relationships with your bank."

Michael Hillel
Founder & CEO, SunHaven