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The Debt-First Capital Stack: Founder's Toolkit

How growth-stage companies with contracted revenue are re-sequencing capital in a higher-for-longer rate environment

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Yanne Capital Research

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Executive Summary

For a decade, the default growth-stage capital sequence was equity first, debt later. Founders raised priced rounds every 18 to 24 months, and debt entered the stack only after Series C, if at all. That sequence made sense when equity was cheap. It no longer is.

At current rates, the true cost of a dilutive round for a growth-stage company with contracted revenue is often higher than the fully-loaded cost of a senior secured facility or a revenue-based structure. The math has not been this favorable to debt in fifteen years. Yet most founders still sequence equity first because that is what their board, their prior investors, and their pattern memory tell them to do.

This paper documents what has changed. Private credit AUM crossed 1.7 trillion USD in H1 2026, with roughly 40 percent of new deployment targeting the lower middle-market growth segment (PitchBook, H1 2026 Private Credit Report). Direct lending spreads to growth-stage borrowers compressed 175 basis points from Q1 2024 peaks (S&P LCD US Loan Comparable, June 2026). Term structure has liberalized: covenant-lite facilities now represent 62 percent of unitranche originations in the sub-100M ticket band, up from 34 percent two years ago (Bloomberg DCM, Q2 2026). The Federal Reserve H.4.1 release shows bank commercial and industrial lending to non-financial corporations stabilizing after eighteen months of contraction, opening a second channel for growth-stage founders who clear traditional credit boxes.

The founders who understand this are re-sequencing. They are drawing debt against contracted revenue to extend runway, delay the priced round by 12 to 18 months, and enter equity conversations at higher revenue and cleaner terms. In the best cases, the debt-first sequence saves 5 to 7 percentage points of dilution at exit.

This paper builds the framework. Section 1 defines the debt-first stack and identifies which companies qualify. Sections 2 and 3 walk the math: cost of capital comparison, coverage ratio construction, and the debt service reserve mechanics that gate every facility. Section 4 covers term sheet diligence, the fifteen provisions that decide whether a facility is founder-friendly or founder-hostile. Sections 5 and 6 sequence the stack across a 24-month operating window and address the coordination problem with existing equity investors. Section 7 documents where the strategy fails.

The toolkit is not universal. Companies without contracted revenue, without a defensible DSR of 1.3 times or better, or with equity holders unwilling to subordinate to senior secured lenders should not attempt the debt-first sequence. For the founders who do qualify, the arithmetic is unambiguous: dilution avoided at growth-stage compounds through every subsequent round and every exit scenario.

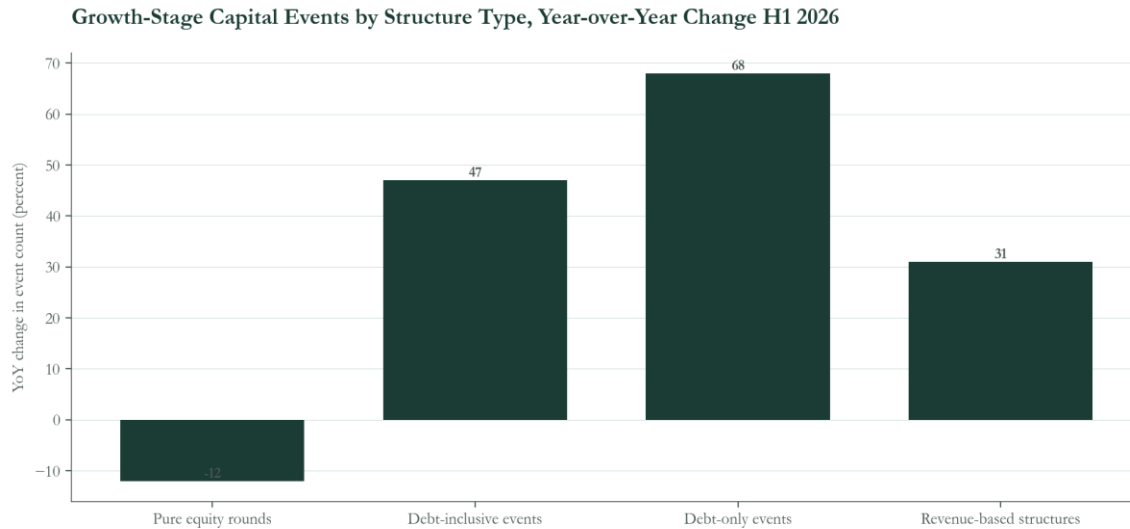
1. The Setup: Why Debt Moved to the Front of the Stack

The traditional growth-stage capital sequence is a product of the 2010-to-2022 rate regime. When ten-year Treasuries traded below 2 percent and equity risk premiums compressed to historic lows, the effective cost of equity for a well-positioned growth-stage company sat in the 15 to 20 percent range. Debt at 8 to 12 percent looked more expensive on a nominal basis than it actually was, because founders and boards priced equity as free.

That regime is gone. The ten-year has held above 4 percent for eight consecutive quarters. Equity risk premiums for private growth-stage assets have expanded materially. When Yanne Capital Research runs a fully-loaded cost of equity calculation for a typical growth-stage company today, incorporating dilution at the round, dilution through anti-dilution provisions, and the option value of preference stacks, the effective cost sits north of 25 percent per year of capital held. At the same time, senior secured debt for a company with 1.4 times DSR coverage and contracted revenue clears the market at SOFR plus 550 to 700 basis points, or roughly 10 to 12 percent all-in.

The arbitrage is direct. A growth-stage founder with contracted ARR of 15 million and a 1.5 times debt service reserve can raise a 12 million senior secured facility at approximately 11 percent all-in, deploy that capital across an 18-month operating window, and avoid a priced round that would have cost 20 to 25 percent dilution. If the company grows into a Series C-equivalent round eighteen months later at 2 to 3 times higher revenue, the founder has traded roughly 2 million of interest expense for the retention of 15 to 20 percent of equity at exit. The math holds under most reasonable exit scenarios.

Across our advisory work in 2025 and 2026, we observe that the founders most successful with this sequence share three characteristics: contracted revenue with weighted-average contract length above 24 months, gross margins above 65 percent, and existing equity investors who understand the dilution arithmetic and are willing to subordinate. The 2024 through 2026 vintage of growth-stage capital events reflects this pattern in the aggregate data. PitchBook reports that debt-inclusive capital events in the growth-stage band increased 47 percent year-over-year in H1 2026, while pure equity rounds in the same band declined 12 percent (PitchBook, H1 2026).



Source: Source: PitchBook H1 2026 Private Credit Report, growth-stage segment defined as companies with 5M-100M ARR.

Source: PitchBook H1 2026 Private Credit Report, growth-stage segment defined as companies with 5M-100M ARR.

2. The Data: What Growth-Stage Debt Actually Costs

The market for growth-stage debt bifurcates by borrower profile. Companies with contracted recurring revenue, positive contribution margins, and clear payment histories access one set of terms. Companies with lumpy revenue, high concentration, or unproven monetization access a materially different set. Founders who conflate the two markets mis-price their own capital.

For the first cohort, direct lending funds and specialty finance companies compete aggressively. S&P LCD US Loan Comparable data through June 2026 shows median spreads for unitranche facilities sized 5 to 50 million at SOFR plus 625 basis points, with the 25th percentile clearing at SOFR plus 525 and the 75th percentile at SOFR plus 750. All-in coupons for the tightest quartile of borrowers now clear at 10.2 percent, a 175 basis point improvement from the Q1 2024 peak of 11.9 percent.

For the second cohort, revenue-based financing structures, MRR lines, and warrant-inclusive facilities dominate. All-in cost of capital for these structures, when the equity kicker is fair-valued, typically runs 16 to 22 percent. This is materially more expensive than senior secured debt but remains cheaper than equity at current risk premiums for most growth-stage companies. The mistake founders make is comparing revenue-based financing against senior secured pricing and concluding that debt is expensive. The correct comparison is against the equity round the founder would otherwise raise.

Term structure has liberalized across both cohorts. Bloomberg DCM data for Q2 2026 shows covenant-lite structures representing 62 percent of new unitranche originations in the sub-100 million ticket band, up from 34 percent in Q2 2024. Maintenance financial covenants, when present, have loosened: median minimum liquidity requirements dropped from 6 months of forward burn to 4

months, and fixed charge coverage ratio floors moved from 1.25 times to 1.15 times over the same window.

The Federal Reserve H.4.1 release provides the second data channel. Bank commercial and industrial lending to non-financial corporations grew at a 3.2 percent annualized rate in Q2 2026, reversing an eighteen-month contraction. Regional banks in particular have re-entered the growth-stage senior secured market for borrowers clearing traditional credit boxes: 1.5 times DSR, 12 to 18 months of runway to operating cash flow positive, and existing equity sponsors with dry powder. Bank pricing typically undercuts direct lending by 100 to 200 basis points but requires tighter covenants and slower diligence.

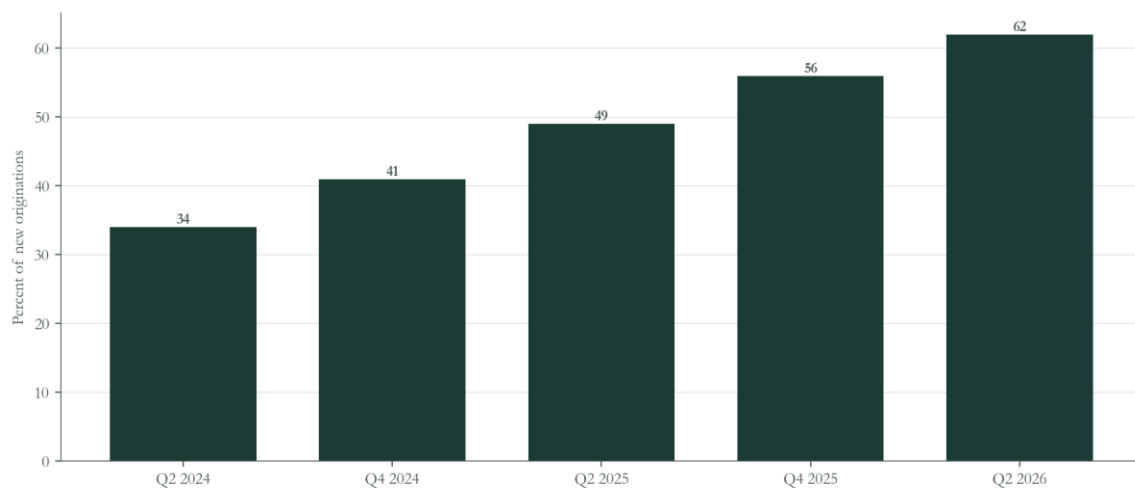
Median All-In Coupon on Unitranche Facilities, 5-50M Ticket Band



Source: Source: S&P LCD US Loan Comparable, quarterly medians through June 2026.

Source: S&P LCD US Loan Comparable, quarterly medians through June 2026.

Covenant-Lite Share of New Unitranche Originations, Sub-100M Ticket Band



Source: Source: Bloomberg DCM, quarterly origination data through Q2 2026.

Source: Bloomberg DCM, quarterly origination data through Q2 2026.

3. The Analysis: Cost of Capital, Reframed

Most founders calculate cost of capital wrong. They compare the nominal coupon on a debt facility (say, 11 percent) against the nominal dilution of an equity round (say, 22 percent) and conclude that equity is roughly twice as expensive. This calculation is missing four adjustments that materially change the answer.

Adjustment one: interest expense is tax-deductible above the corporate rate applied to the borrower. For a US-domiciled growth-stage company that expects to be a taxpayer within 24 months (either directly or through consolidated group structures), the after-tax cost of 11 percent debt is closer to 8.5 percent. Equity dilution has no equivalent tax shield.

Adjustment two: dilution compounds. A 22 percent dilutive round today does not cost the founder 22 percent of their existing stake. It costs 22 percent of their existing stake plus the anti-dilution adjustments on prior rounds, plus the reset of the option pool, plus the compounding effect on all future rounds. The fully-loaded dilution cost of a single growth-stage priced round, measured at exit, typically runs 30 to 35 percent of the pre-money founder position, not 22 percent.

Adjustment three: preference stacks. Every priced round adds preference above common. A growth-stage company that raises 20 million at Series B on a 1x non-participating preference has just moved 20 million of exit proceeds above common holders. In many exit scenarios below 3x the round, the founder's realized economics from that round are meaningfully lower than the headline dilution suggests. Debt has a repayment schedule but no preference stack.

Adjustment four: the option value of the future round. Debt is a fixed-term obligation. Equity is a permanent claim. Raising debt today preserves the option to raise equity later at a higher valuation, on cleaner terms, from a more competitive investor set. Raising equity today extinguishes that option.

When all four adjustments are applied, the correct comparison for most growth-stage borrowers is roughly 8 to 10 percent after-tax cost of senior secured debt against 30 to 40 percent effective cost of a dilutive round measured through exit. The gap is not a few points. It is a factor of three or four.

4. The Framework: The Debt-First Capital Stack

The framework has five sequential decisions. Each decision has a gating question that determines whether the founder proceeds or falls back to equity.

Decision one: DSR construction. Debt service reserve is the ratio of unrestricted cash plus 12-month forward contracted revenue to the sum of interest expense and mandatory principal amortization for the same period. A DSR of 1.5 times is the working minimum for senior secured facilities. Below 1.3

times, the borrower is either non-financeable or forced into revenue-based structures at materially higher cost. Gating question: does the company clear 1.3 times DSR at proposed facility size?

Decision two: contracted revenue quality. Lenders underwrite the contracted book, not the pipeline. Weighted-average contract length, customer concentration, gross retention rates, and payment history all feed the underwriting model. A company with 15 million ARR but 40 percent customer concentration and 18-month average contracts will finance at materially worse terms than a company with 12 million ARR, 15 percent concentration, and 36-month average contracts. Gating question: does the contracted book support the intended draw at the intended terms?

Decision three: existing equity holder coordination. Senior secured lenders require intercreditor agreements with existing equity holders. Most preferred stock has protective provisions that require investor consent for the incurrence of senior debt above a threshold. The founder cannot execute the debt-first strategy without existing equity investor cooperation. Gating question: do the existing preferred holders support the debt strategy, and are the protective provisions structured to allow it?

Decision four: operating runway sequencing. The debt facility should be sized to fund the operating window that produces the next round at higher valuation. Too small, and the founder returns to market prematurely. Too large, and interest expense drags coverage ratios into technical default zones during the operating window. The right size is typically 12 to 18 months of net burn, drawn incrementally rather than up-front. Gating question: does the facility size, drawn on the proposed schedule, produce a defensible operating window?

Decision five: exit sequence. The debt facility must have a defined path to repayment, refinancing, or conversion at the next equity event. Facilities without clear exit paths become permanent liabilities that suppress future equity valuations. Gating question: is the repayment or refinancing path clearly documented and aligned with the next round's expected close date?

5. Term Sheet Diligence: Fifteen Provisions That Matter

Debt term sheets are longer and more technically dense than equity term sheets. Founders who negotiated a Series B in a week will spend three weeks on a senior secured facility. The provisions that materially affect economics and control cluster into five groups.

Pricing group: base rate plus spread, PIK toggle mechanics, original issue discount, commitment fees on undrawn portions, and prepayment penalties. Founders focus on the coupon and miss the OID, which can add 100 to 200 basis points to effective cost. Prepayment penalties in the first 24 months are standard but should not exceed 2 percent declining to zero by month 36.

Covenant group: minimum liquidity, fixed charge coverage, maximum leverage, and information rights. Covenants should be measured against a projection model the borrower produced, not the lender's

downside case. Cure rights on covenant breaches are the single most negotiated provision in most facilities. Founders should insist on at least two equity cures per year at the sponsor's option.

Security group: collateral package (typically all assets), guarantors (parent and material subsidiaries), and springing lien provisions. The collateral package rarely varies. The guarantor structure requires careful review, particularly for companies with international subsidiaries or IP holding entities.

Warrant group: percentage coverage, exercise price, and expiration. Warrants are the mechanism by which lenders capture equity upside on riskier facilities. Coverage above 3 percent is generally excessive for senior secured debt with strong DSR coverage; coverage above 5 percent effectively converts the facility into a mezzanine instrument and should be repriced accordingly.

Change of control group: mandatory prepayment triggers, consent rights, and step-up provisions. Every senior secured facility contains change of control provisions. The question is whether they are triggers (facility must be repaid), consents (lender must approve the transaction), or step-ups (facility repricing without repayment). Consent rights above modest thresholds meaningfully constrain the borrower's strategic optionality and should be avoided where possible.

6. Sequencing the Stack Across a 24-Month Window

The debt-first sequence works when the facility is calibrated to a specific operating outcome, not deployed as generic runway extension. The 24-month window has three phases.

Months 1 through 6 are the draw and stabilization phase. The company draws 40 to 50 percent of the committed facility, deploys against the highest-conviction growth initiatives, and stabilizes operating rhythm with the new interest expense on the P&L. Board reporting expands to include DSR, covenant compliance metrics, and lender relationship management. Founders who treat this phase as business-as-usual with more cash typically breach covenants by month 9.

Months 7 through 15 are the compounding phase. The company draws the remaining commitment in tranches tied to milestone achievement, revenue expands against a fixed cost base plus interest, and unit economics improve. This is the phase where the debt-first strategy pays off: every additional dollar of contracted revenue added during this window is added without dilution. Yanne Capital Research observes that companies executing well in this phase typically grow ARR 60 to 100 percent while consuming 50 to 70 percent of the committed facility.

Months 16 through 24 are the harvest phase. The company enters the next equity round preparation with materially higher revenue, cleaner unit economics, and demonstrated capital efficiency. The equity round that emerges is typically 30 to 60 percent larger than what would have been raised 18 months earlier, at valuations 2 to 3 times higher, from a more competitive investor set. A portion of the round

proceeds refinances or repays the debt facility. The founder's diluted position at close of the equity round is materially higher than it would have been under the equity-first sequence.

The failure mode is misalignment between phases. Founders who draw the full facility in month 3 (front-loaded deployment) lose the discipline benefits of tranche-based drawing. Founders who wait until month 18 to begin equity round preparation typically enter market with insufficient runway coverage, weakening negotiating position. Sequencing discipline is the difference between debt-first as a compounding strategy and debt-first as expensive equity extension.

7. Where the Strategy Fails: Debt-First Is Not Universal

The debt-first sequence is a specific tool for a specific borrower profile. It fails, sometimes catastrophically, when applied to companies that do not qualify. Four failure modes recur.

Failure mode one: revenue quality below the underwriting threshold. Companies with lumpy revenue, high customer concentration, or short-duration contracts cannot support senior secured debt at reasonable pricing. Founders in this situation who force a debt-first sequence end up in revenue-based financing structures at 18 to 22 percent all-in cost, which is not materially better than equity and imposes cash-flow constraints equity does not.

Failure mode two: gross margin structure. Companies with gross margins below 55 percent generate insufficient contribution to service debt at growth-stage burn levels. The debt-first strategy assumes that interest expense can be absorbed within existing gross profit without forcing operational contraction. Below 55 percent gross margin, this assumption typically fails, and the debt facility accelerates rather than delays the need for the next equity round.

Failure mode three: existing equity investor opposition. Preferred stock protective provisions typically require investor consent for senior debt incurrence above defined thresholds. Existing equity investors who do not understand the dilution arithmetic (or who prefer to see additional equity issued to maintain their own participation options) can block the strategy. Founders who assume investor cooperation without a direct conversation frequently find the facility blocked at the intercreditor stage.

Failure mode four: covenant breach during the operating window. Growth-stage companies have volatile month-to-month performance. A single quarter of missed contracted revenue targets can trigger a covenant breach even in covenant-lite structures. Facilities that lack sufficient equity cure rights, adequate cure baskets, or reasonable material adverse change definitions can convert routine operating volatility into technical default. The strategy is only viable when the term sheet contains meaningful founder-friendly cure mechanics.

The correct posture is diagnostic before prescriptive. Every growth-stage founder considering the debt-first sequence should run all five decisions in Section 4 against their specific facts before

proceeding. Companies that fail two or more of the gating questions should default to the traditional equity-first sequence, even in the current rate environment.

Case Studies

Vertical SaaS, contracted revenue, deferred priced round by 18 months

A vertical SaaS company operating in regulated compliance workflows entered 2025 with approximately 14 million ARR, 72 percent gross margins, and weighted-average contract length of 32 months. The company's board had approved a Series B raise at approximately 90 million pre-money. In conversations with the founder that quarter, the debt-first alternative was structured against the contracted book: a 10 million senior secured facility at SOFR plus 625 basis points, 5 percent warrant coverage at the last round strike, and a 24-month term. The facility was drawn in three tranches over 14 months. During the operating window, ARR grew to approximately 24 million. The subsequent equity round closed at materially higher valuation than the deferred Series B would have supported, and the debt facility was repaid from proceeds. The founder's diluted position at close of the equity round was measurably higher than the counterfactual equity-first sequence, and the effective all-in cost of capital across the 18-month window ran below what a comparable equity dilution would have produced measured through the next exit scenario.

Vertical AI, insufficient contract length, strategy blocked at diligence

A vertical AI company serving marketing operations workflows approached debt financing with 8 million ARR growing 140 percent year-over-year. Superficially the profile qualified for the debt-first strategy. Diligence revealed that weighted-average contract length was 11 months, customer concentration in the top three accounts exceeded 45 percent, and gross retention on the smaller-account cohort ran below 80 percent. Direct lending funds declined to underwrite at senior secured pricing. The available structures priced above 18 percent all-in with warrant coverage exceeding 8 percent, at which point the effective cost of capital converged with equity. The founder proceeded with a traditional priced round. This is the correct outcome: the debt-first strategy is diagnostic, not prescriptive, and companies that fail the contracted revenue quality test should default to equity.

Forward Look: 12-Month Outlook

Yanne Capital Research expects three trends to define growth-stage debt markets through mid-2027. First, direct lending pricing will continue to compress modestly as private credit AUM growth outpaces qualified deal flow. Base rates will drive most of the pricing signal, but spreads on high-quality unitranche paper will likely tighten another 50 to 75 basis points from current levels. Second, the covenant-lite share of new originations will stabilize between 60 and 70 percent, with maintenance covenants selectively returning for borrowers with weaker credit profiles or lower DSR coverage. Third, regional bank participation in growth-stage senior secured lending will expand meaningfully as

bank C and I lending recovers, providing a second competitive channel that undercuts direct lending pricing by 100 to 200 basis points for borrowers clearing traditional credit boxes. Founders with strong contracted revenue and 1.5 times or better DSR should expect materially improved terms on new facilities and refinancings entered into during this window. Companies without those attributes will find debt markets no more accessible than in prior cycles.

Conclusion

If you have contracted revenue above 5 million ARR, gross margins above 65 percent, and are within 12 months of a capital event, we can walk you through the debt-first framework against your specific facts. Reach out at contact@yannecapital.com. Yanne Capital is an independent boutique investment bank advising growth-stage companies on equity, debt, and M&A transactions across 26 sectors, with 240+ closed deals and relationships with 3,500+ institutional investors globally. We are your trusted filter between noise and signal.

Frequently Asked Questions

What is a debt-first capital stack for a growth-stage company?

A debt-first capital stack is a financing sequence in which a growth-stage company with contracted recurring revenue draws senior secured or unitranche debt to fund operations before raising a priced equity round. The purpose is to extend runway 12 to 18 months without dilution, allowing the company to enter equity conversations at higher revenue, cleaner unit economics, and stronger negotiating position. The strategy requires DSR coverage of 1.3 times or better, gross margins above 65 percent, and cooperation from existing equity investors on intercreditor terms.

What is the true cost of a growth-stage priced round versus senior secured debt?

When properly adjusted, the effective cost of a growth-stage priced round measured through exit typically runs 30 to 40 percent of the pre-money founder position, accounting for headline dilution, anti-dilution provisions, option pool refresh, and preference stack economics. The after-tax cost of senior secured debt at current market pricing runs 8 to 10 percent for borrowers clearing the underwriting threshold. The gap between the two is roughly a factor of three to four, not the factor of two suggested by comparing nominal coupon against nominal dilution.

What DSR ratio do lenders require for growth-stage senior secured debt?

The working minimum for growth-stage senior secured facilities is a debt service reserve ratio of 1.5 times, calculated as unrestricted cash plus 12-month forward contracted revenue divided by scheduled interest and mandatory principal amortization over the same period. Facilities below 1.3 times DSR either do not clear underwriting or force borrowers into revenue-based financing structures at materially higher cost, typically 16 to 22 percent all-in when the equity kicker is fair-valued.

When does the debt-first strategy fail for a growth-stage company?

The debt-first strategy fails in four common scenarios: contracted revenue with weighted-average contract length below 24 months or high customer concentration, gross margins below 55 percent, existing preferred equity holders who block senior debt incurrence through protective provisions, and term sheets without adequate equity cure rights on covenant breaches. Companies that fail two or more of these tests should default to the traditional equity-first sequence, even in the current higher-for-longer rate environment.

How large should a growth-stage debt facility be relative to burn?

The optimal facility size is typically 12 to 18 months of net burn, drawn incrementally in tranches tied to milestone achievement rather than up-front. Facilities smaller than 12 months of burn force the founder back to market prematurely and defeat the sequencing benefit. Facilities larger than 18 months of burn typically produce interest expense that drags coverage ratios into technical default zones during the operating window. Tranche-based drawing preserves discipline and matches capital deployment to actual milestone execution.

What term sheet provisions matter most in a growth-stage senior secured facility?

The five provision groups that materially affect founder economics and control are pricing (base rate, spread, PIK toggle, OID, prepayment penalties), covenants (minimum liquidity, fixed charge coverage, maximum leverage, and cure rights), security (collateral package and guarantor structure), warrants (coverage percentage and exercise price), and change of control mechanics (mandatory prepayment triggers versus consent rights versus step-ups). Founders should focus particular attention on cure rights, warrant coverage above 3 percent, and change of control consent rights above modest thresholds.

Why are direct lending spreads compressing in 2026?

Direct lending spreads compressed roughly 175 basis points from Q1 2024 peaks through H1 2026, driven primarily by private credit AUM growth outpacing qualified deal flow. Private credit AUM crossed 1.7 trillion USD in H1 2026 with approximately 40 percent of new deployment targeting the lower middle-market growth segment. As capital availability expanded, competition for high-quality unitranche paper intensified and spreads compressed. Federal Reserve H.4.1 data also shows bank commercial and industrial lending recovering, providing a second competitive channel that undercuts direct lending pricing by 100 to 200 basis points for borrowers clearing traditional bank credit boxes.

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