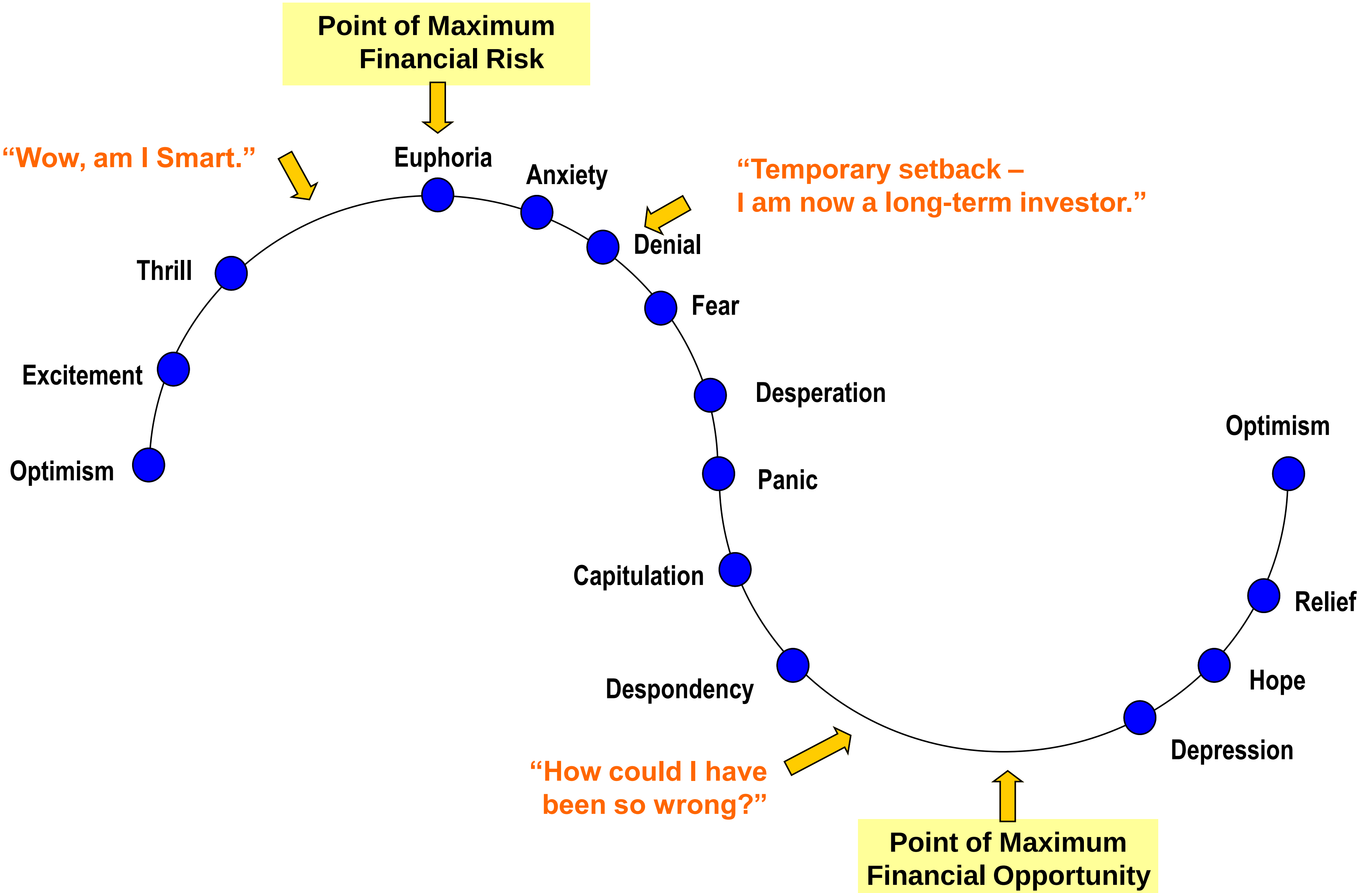
How To Raise Equity And Protect Your Interests

How to maintain substantially more ownership and control when raising money.

When NOT To Raise Money

- Out of cash
- Unprepared
- Panicked
- Desperate and have to take any offer
- Can’t project confidence in your business model
- Unable to differentiate your business
- Cannot validate market claims
- Don’t understand where your company is on its evolution track and which investors might be interested

The Funding Cycle of Emotions



Start Up Company Categories

Early Stage

- ✓ Seed round
- ✓ First round

Expansion Stage

- ✓ Second round
- ✓ Third round
- ✓ Bridge loan

Liquidation Stage

- ✓ Merger & Acquisition round
- ✓ Sale to strategic buyer
- ✓ Initial Public Offering (IPO)
- ✓ Leveraged buyouts

Venture Capital Financing Stages

- Bootstrap: Your money; your own blood, sweat and tears
- Blood Money: Hit up family and friends, but this has risks; it can be managed if you borrow money and prepare for the worst
- Seed Money: Low level financing needed to prove a new idea, often provided by “angel investors”
- Start-Up: Early stage firms that need funding for expenses associated with marketing and product development…angels and VCs
- First-Round: Early sales and manufacturing funds…angels and VCs
- Second-Round: Working capital for early-stage companies that are selling product, but not yet turning a profit…VCs
- Third-Round: Also called “Mezzanine Financing”; this is expansion money for a newly profitable company…VCs, private equity funds and banks
- Fourth-Round: Also called bridge financing, 4th round is intended to finance the "going public" or strategic sale process…VCs, banks

NOTE: Between the first round and the fourth round, venture backed companies may also seek to take "venture debt“.

Where To Look For Equity…initially

Private Money (Friends and Family)

1) May be available when other sources may not
2) May be cheaper than other sources
3) Loans offer flexibility
4) Validation from key supporters
5) Requires less work than other sources of equity capital

Note: Stay disciplined

- ✓ *Ask correctly*
- ✓ *Make it legal*
- ✓ *Make it work*

Where To Look For Equity…next

Angel Investors*

1) Historically, high net worth individuals
   - Evolved into angel networks
   - Further evolved into angel funds
2) Focus on seed, start up, early-stage, high-risk ventures
3) 275,000+ angels in the U.S. invest ~$35 billion annually
4) Often syndicated with other angels, angel networks or angel funds

*NOTE: Angels, Angel Networks and Angel Funds are different

Where To Look For Equity…then

Venture Capital Funds

1) ~500 VC funds in U.S.
2) Most funds $100 - $200 million
3) Look for investments that have $100+ million annual revenue potential
4) Investee companies are too small to raise capital in the public markets, cannot secure a bank loan or complete a debt offering
5) In 2009" ~ $15 billion, ~2500 deals
6) Often syndicated with other funds as the lead or follow on investor

10 Tips to Appeal to Angels

1. Understand that most early-stage entrepreneurs are better suited for investment from private investors (“angels”) than from professional venture capital funds
   - If you pursue both, you don’t know where your company is

2. Create a Business Plan that emphasizes your sustainable competitive advantage
   - Clearly define the competitive landscape
   - Validate how your solution has a clear advantage
   - Share barriers to entry and barriers to exit

3. Accept the fact that having “a good idea” is often not enough to raise capital from private investors; do your homework to provide “proof of concept” for your venture
   - Good ideas are abundant; well-done execution is rare
   - Existence of a prototype or working model can greatly improve chances
   - Line up potential customers who are willing to test or sample, and also commit to purchase it, should their problems be solved

10 Tips to Appeal to Angels

4. Accept the fact that raising capital requires an expenditure of capital
   - Consider hiring professional assistance

5. Identify and contact angels who are suitable for you
   - What is their average deal size? (Industry = $35K - $250K)
     - Do they have the resources?
     - Do they have the expertise?
   - Company stage
     - Are they investing in other companies in your stage?
   - Industry
     - What is the angel's industry expertise?
   - Confidentiality
     - Will the angel sign a NDA if IP is shared? If not, why not? Are you prepared to take that risk?
   - Due diligence
     - What is the angel's reputation as an investor?
       - Helpful?
       - Intrusive?
       - Reasonable?

10 Tips to Appeal to Angels

6. Recognize that industry experience is valuable and important to angels
   - You should have 1 or 2 parties experienced in the industry that you are pursuing, so that the skills of the angel become an adjunct to your team
   - Angels want to see that you understand your industry and your business, and have some relevant experience
   - Angels are more willing than VCs to invest in a person who has not been in a start up business before

7. Recognize that raising capital takes time
   - Q. "How long will it take me to raise money?"
   - A. "Longer than you think."
     - Raising money can take 50% - 70 % of your time and can last 6 months or longer
   - Your ability to be prepared and correctly answer questions will be crucial to your ability to raise capital and its timeline

10 Tips to Appeal to Angels

8. Recognize that angels are "value-added investors"
   - Many derive as much personal satisfaction from helping a new business owner as they do contributing capital
   - Angels bring "value added" benefits
     a. Prior industry experience
     b. Valuable knowledge about business itself
     c. Their ability to mentor
     d. Creative ideas
     e. Contacts for your business

9. Never stop looking for additional angels until all the checks have cleared the banks
   - Raising capital is a marketing and selling process
   - All sales professionals know that they must have a sales pipeline
   - All GOOD sales people know that a customer is not a customer until his/her check has cleared the bank

10 Tips to Appeal to Angels

10. **Invest your own money in your venture**
    - **Guideline: ≥ 20% of your own net worth**
    - **If you are not willing to assume that level of risk, angels will not likely consider you a serious entrepreneur**

Key factors equity investors look for in a company are:

1. A quality management team with a proven track record
2. An attractive company with maintainable growth prospects / competitive advantage
3. An attractive sector
4. A sound and well researched business plan
5. A strategy for delivering value growth in your company
6. A clean and tidy business

Summary

Key factors for equity investors:

1. A quality management team with a proven track record
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Things That You Can Do Now

- Be prepared
  1) Investors will be prepared; <u>you will always lose if you are unprepared</u>
- Develop a fair, reasonable, credible and defendable valuation
  1) Don't overreach, but certainly don't go empty-handed
  2) Use several common valuation techniques
- Write a focused presentation and Business Plan
  1) Presentation: 10 – 15 slides; ≤ 20 minutes
  2) Outline product/service, market, management team
  3) Practice, practice, practice
- Identify potential investors (rifle shot approach)
  1) Perform your own due diligence
  2) < 2 degrees of separation
  3) Get references
  4) Stay local…higher probability of success, less costly
- Create a Term Sheet and Specify a Valuation
  1) 1-page outline of investment opportunity, including the valuation
  2) Warn about risks
  3) Structure the investment as common stock or units

If I Can Help You…

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Thank you