

DTU Master F-2013 e'ship class
7. lecture, Monday 21 October 2013

Financing Technology Ventures

1. Financing 1. Mapping the landscape. JH

2. The Investor 1:

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FINANCING Technology Ventures

Agenda

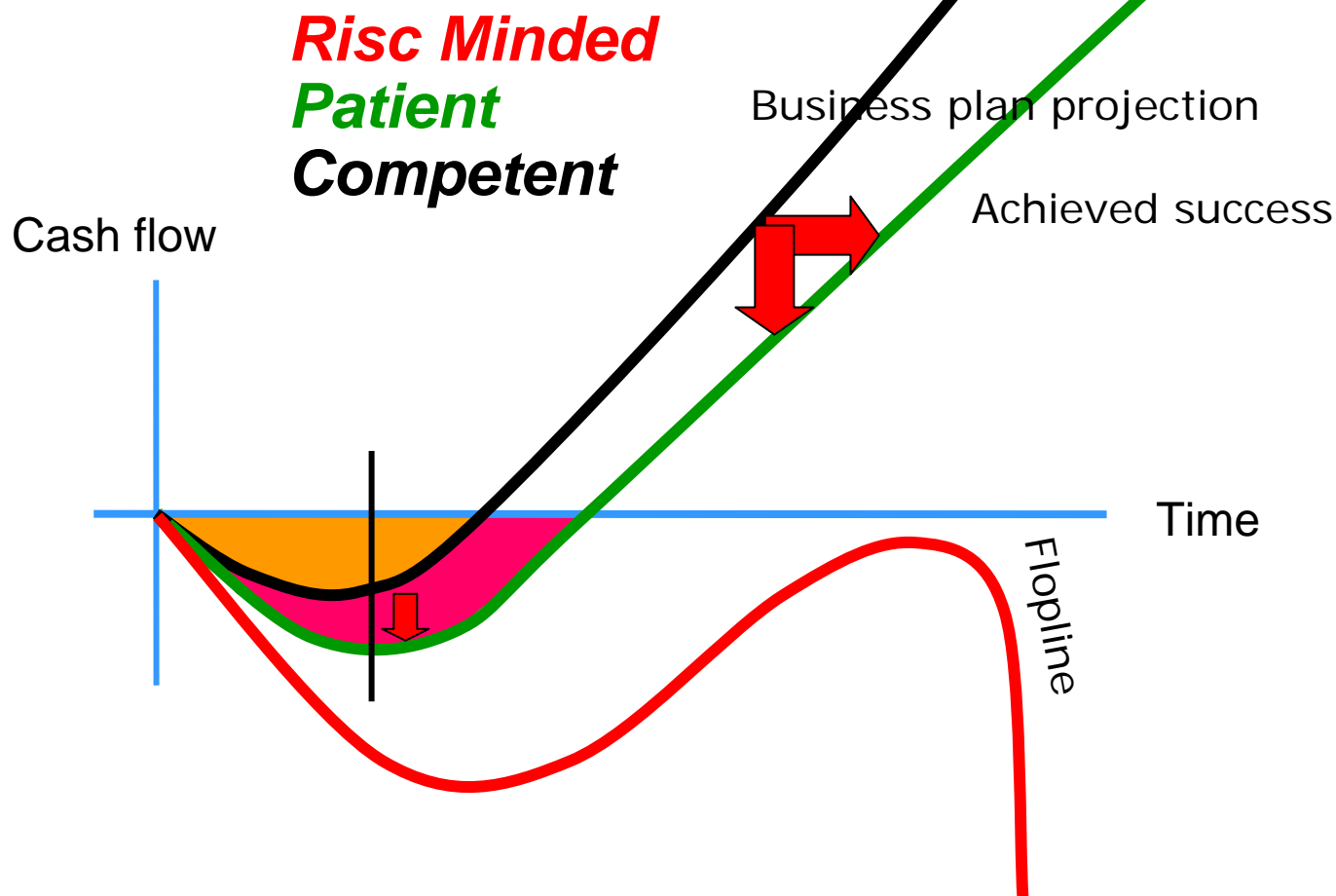
- ***Capital: for what ?***
- ***Capital: from where?***
- ***Capital types related to Business Development***
- ***Investor types***
- ***The Investor's Quality Criteria***
- ***Evaluation of Companies***
- ***Example***

Learning objectives:

- ***To enable you to identify your investment opportunities and to design your business model and your business plan accordingly.***
- ***To allow you to understand the investors***
- ***To communicate with experts***

Capital: for what?

Business Development!



The entrepreneur's most important Capital Sources

- **Your own bloody money**
- **FFF** Family, Friends & Fools
- **In Kind** Other people's resources
- **Your first customer:** The more pain, the better

• **Investors' money** *If your business is scalable, has a significant potential, realization depends on speed and money – and there is a Return on Investment - ROI (an exit opportunity).*



VERY IMPORTANT PRECONDITION

Origins of Capital

- **You make it unnecessary**
 - Live on a Rock
 - Start selling!
 - In kind
- **You have it:**
 - Savings, personal fortune
- **You get it:**
 - Grants
- **You borrow it:**
 - Loan capital
- **You sell shares:**
 - Share capital
 - private equity
 - equity capital

GRANTS

- **Public Industrial Development Programs**
- **Ministerial focus area**
- **Private Foundations**

Comments:

- Dream-capital for start-ups
- Hard to find but it happens

Note 1: EU limit: 200.000 EUR in public grants

Note 2: Grants are taxable income, but expenditures are tax deductible.

LOAN CAPITAL

- **Banks**
- **Credit Institutions like FIH**
- **Private debt providers – the loaners**
- **Special products like Vækstkaution, Mezzanine capital etc.** See www.vf.dk

Comments:

- **Cheap for the entrepreneur – Expensive for the Company**
Paid back by the company. The entrepreneur preserves ownership
- **Personal collateral mandatory in the start-up phase.**
If business flops: repayment after personal tax. No tax-deduction!
- **Investor runs a business**
Never let this fact be forgotten during the moments of joy and enthusiasm

LOAN CAPITAL - 2

The Convertible Loan

- **Normal interest and repayment profile**
- **Can be converted into share capital on specific conditions and at specific milestones**

Comments:

- **Some advantages in the start-up phase**
Less initial dilution of the founders.
Investor may convert to preserve ownership at new funding rounds.
- **Check the conditions**
Investor gets a strong influence on business development
Conversion right linked to milestone specifications. Eg.: conversion rate linked to quantified performance.

SHARE CAPITAL – private equity

Investor buys shares in the company

- **At kick-off with the founders**
- **Later: at capital increase (Funding rounds)**

Comments:

- **Expensive for the entrepreneur – Cheap for the Company**
Nothing to pay back - but founders get diluted. Think about that, when company valuation passes a gazillion and you have sold 99%.
- **Possible mismatch in long-term objectives**
The investor wants a rapidly expanding business – to be sold at the right time, whereas the founders may have completely different personal goals and they are probably also more risk adverse

EXIT

The inherent consequence of equity financing

Investor converts assets to cash and pull out

- | | |
|---------------------------------------|------------------------|
| • IPO: Initial Public Offering | Rare but rewarding |
| • Trade Sale | Acquisition |
| • Management buy-out/buy-in | Not best but ROI > 0 |
| • Earn-outs | Even worse but ROI > 0 |
| • Repayment of loans | Not sustainable for VC |
| • Enforcing preferences | Cutting the loss |

Capital types in Business Development

- **Before Kick-off**

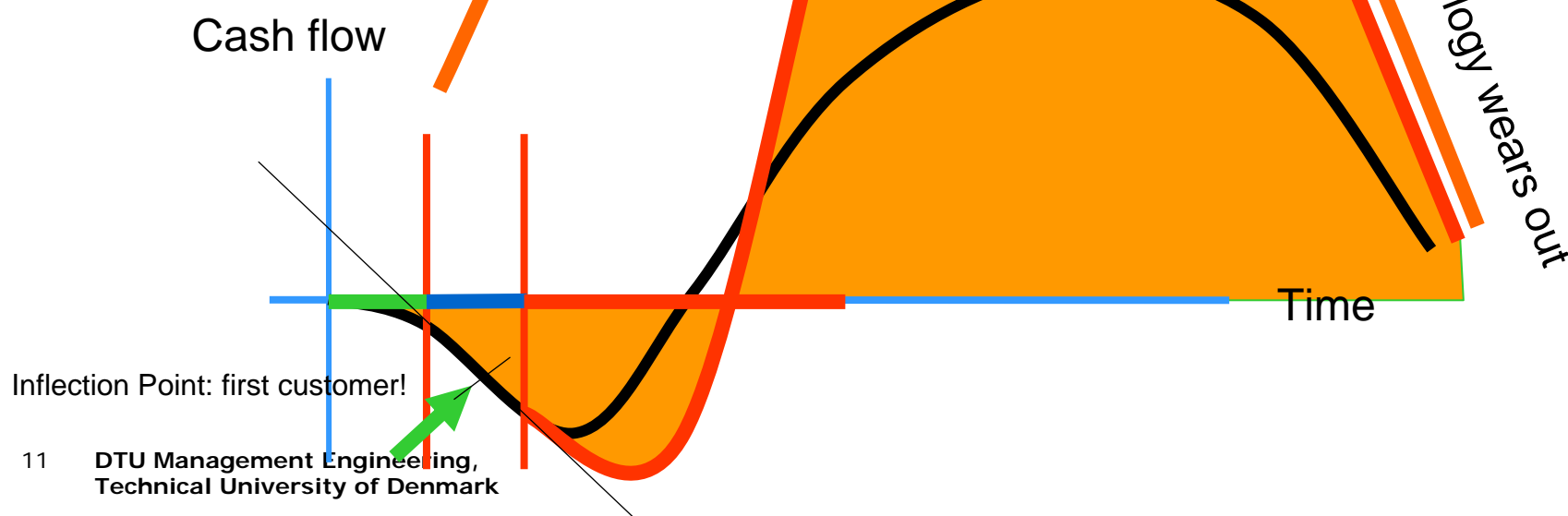
Pre-seed investment: own resources, FFF, in-kind, first customer
 Venture Cases: also special share capital (pre-seed)

- **Start-up**

Seed investment: share capital, special loans, own money

- **Growth and commercial development**

Early stage, 2. round etc.: share capital, ordinary + special loans



Investors

Pre-seed

FFF: the Business Angels

DK: Innovation environments (financial incubators)

US: Small Business Agency (SBA)

Seed – Early Stage

SEEDCapital Denmark

Business Angels

Venture Capital companies (VC)

Vækstfonden

Second round, follow-on

VC and Corporate Venture Capital

Credit Institutions

Banks

Vækstfonden

Some stock exchanges

Impact of the economical crisis:

Increased risk and scarce capital force the investors to avoid loss and protect their portfolio – so –

Investors move up in the market =>

No money in the seed – early stage segment =>


Business start-up strategies adopt to

- *FFF*
- *First Customer opportunities and*
- *Slow self-financed sustainable growth*

Venture cases become even more rare

Investor's Criteria for Interest

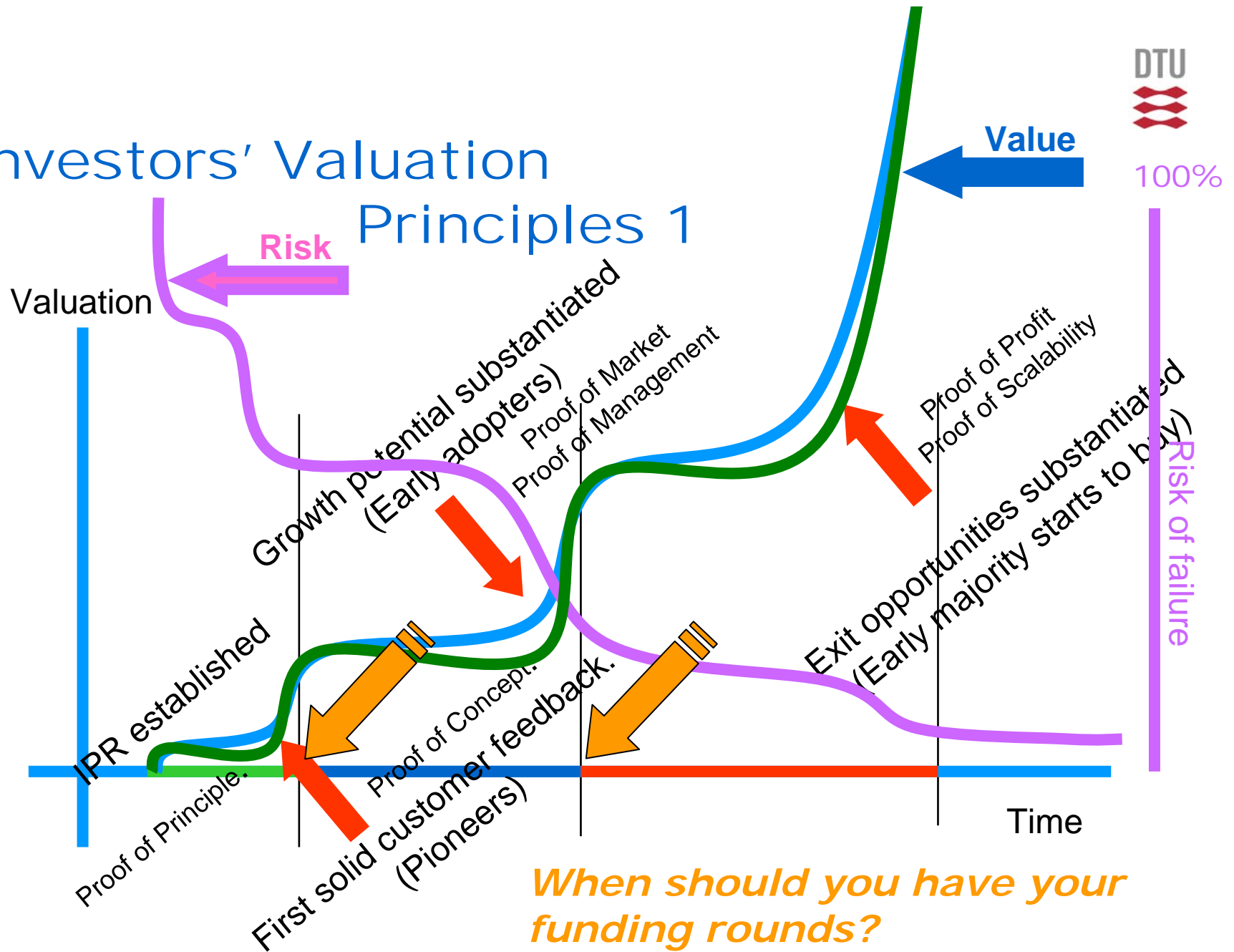
4P

- **Perspectives** *Pain, market size/share exit-op.* 
- **Persons** *Track records, competencies, ambition*
- **Platform** *Proof of principle, concept, value, pull, profit*
- **Process** *The project acc. to the Business Plan*

Comments:

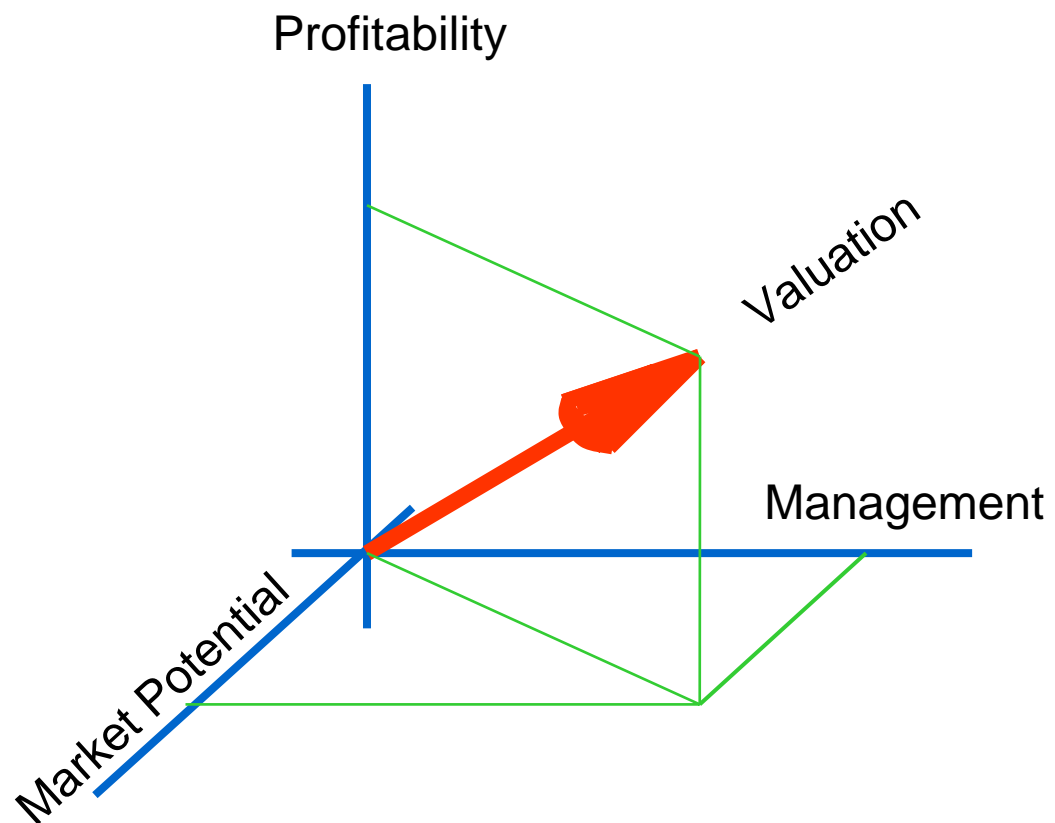
- Must be a Venture Case: ROI > 10 in less than 5 years.
(126 rule applies too: 100 mio in T/O, 20% profit in less than 6 yrs)
- The team is the single most important precondition
- Platform: the more commercial proofs, the better.
Commercial proofs reflect risk and competence

Investors' Valuation Principles 1



When should you have your funding rounds?

Investor's Valuation Principles 2



Negotiating with VC Investors

Or how to dance with wolves

- **Capital always Wins**
- **Your opponent has done this many times**
- **Your opponent is not depending on you**
- **Your opponent has lots of time**

Negotiating tactics:

- **Freedom of Maneuvering**
Never enter negotiations without having fall-back positions.
- **No major payments that jeopardize your project**
Your investor will find out at "due diligence"
- **Don't go for money unless you can do without**
Make it clear from the beginning that you actually don't need it
- **If you are asked for exclusivity: it costs** (all claims cost)
Exclusivity reduces your freedom of maneuvering
- **Consider to get more investors into the game – transparently**
- **The more proofs before investment – the better**
- **Strategic partners also an asset**
- **Get yourself a management team and battle-proven advisors before opening the game**

The End

Coming up now:

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Coming up next:

1. High-risk high-gain financing 2.

The numericals of a funding round. JH

2. Cases and 5-Liners in 42435. JH

3. CONNECT Denmark.

Nicholas Hawtin. 14:25 – 14:50

Special Event: 15:00 – 16:30

Israel – the Start-up Nation

Guest lecture from Deputy Ambassador Roi Dvir from the Embassy of Israel

EXAMPLE: GBQ Ltd.

Capital need: DKK 2.5 mio -> Proof of Business
DKK 15 mio -> Proof of Profitability

Kick-off: DKK 1.000.000 to reach Proof of Concept

Founders + pre-seed investor
Private equity

First Milestone: DKK 1.500.000 to reach Proof of Pull

Pre-seed investor: private equity

Second Milestone: DKK 15.000.000 to reach Proof of Profit

Venture Capital Company: private equity

Exit: Profits (EBITDA) > 25 mio. DKK/yr.

(Earnings Before Interest, Tax, Depreciation and Amortization)

Valuation based on Price/Earnings (P/E) ~ 10

Kick-off

DKK 80.000 shares

Shares: founders: cash contribution
 founders: non cash contribution (patent)
 pre-seed investor: class b shares with
 liquidation preferences

Founding						
Investment goal: DKK	1.055.000					
		Share Price:	1,00 DKK per share class A			
			40,00 DKK per share class B			
	Shares	Contribution	Ownership Ratio			
Founding Team, cash	30.000	30.000	37,50% Class A		Class A total:	55.000
Founding Team, non-cash	25.000	25.000	31,25% Class A		Class B total:	25.000
Investor A	25.000	1.000.000	31,25% Class B = liquidation preference			
Total	80.000	1.055.000	100,00%			
	Total cash contribution at kick-off:	1.030.000				

1. Milestone

Contribution through capital expansion

New shares are sold by cash contribution

Increased valuation accepted by investor due to commercial results

Funding round 1.	Valuation pre-money	5.000.000	DKK						
Investment goal: DKK	1.500.000								
	Share Price:	62,50	DKK per share						
	Shares ante	OR ante	Value ante	Contribution	New shares	Value post	Shares post	OR Post	
Founding Team	55.000	68,75%	3.437.500	0,00	0,00	3.437.500	55.000,00	52,88%	
Investor A	25.000	31,25%	1.562.500	1.500.000,00	24.000,00	3.062.500	49.000,00	47,12%	
Total	80.000	100,00%	5.000.000	1.500.000,00	24.000,00	6.500.000	104.000,00	100,00%	
		Capital expansion: from		80.000,00	DKK	- to -	104.000,00	DKK	

EXIT

Venture-case criterion: Valuation principle: Price/earnings

With profits (EBITDA) = 25 mio. DKK and P/E ~ 10 (Solid and perspective company):
Price: 10 X 25 mio. DKK = 250 mio. DKK

Exit						
			Valuation :	250.000.000	DKK	
			Share Price:	961,54	DKK per share	
	Shares ante	Ownership	Share value	Cash invested	Return on cash investment	
Founding Team	55.000	21,15%	52.884.615	30.000	Obscene	
Investor A	49.000	18,85%	47.115.385	2.500.000	19	
Investor B	156.000	60,00%	150.000.000	15.000.000	10	
Total	260.000	100,00%	250.000.000	17.530.000		