

*DTU 42705 PhD Knowledge based Entrepreneurship 2011  
Tuesday 26 April 2011*

## Financing Technology Ventures

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### Agenda

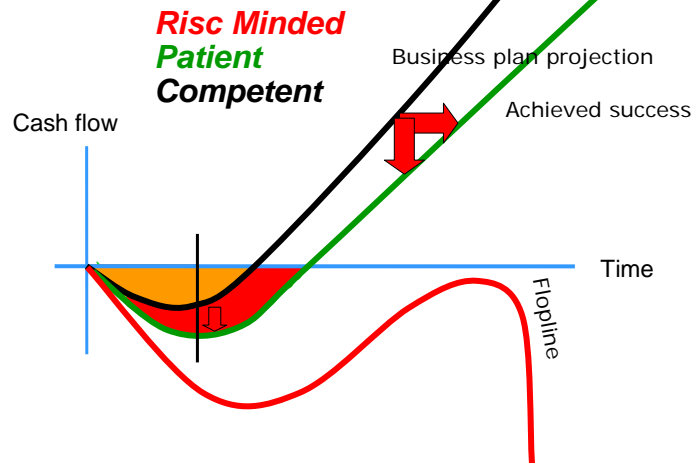
- ***Capital: for what ?***
- ***Capital: from where?***
- ***Capital types related to Business Development***
- ***Investor types***
- ***The Investor's Quality Criteria***
- ***Evaluation of Companies***
- ***Example***

### ***Learning objectives:***

- ***To enable you to identify your investment opportunities and to design your business model and your business plan accordingly.***
- ***To prepare you for meeting the investors***
- ***To communicate with experts at an educated level***

## Capital: for what?

*Business Development!*



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## 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, and realization depends  
on speed and volume.* **VERY IMPORTANT PRECONDITION**

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## 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](http://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 handle bar 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.
- **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

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

## Capital types in Business Development

- **Before Kick-off**

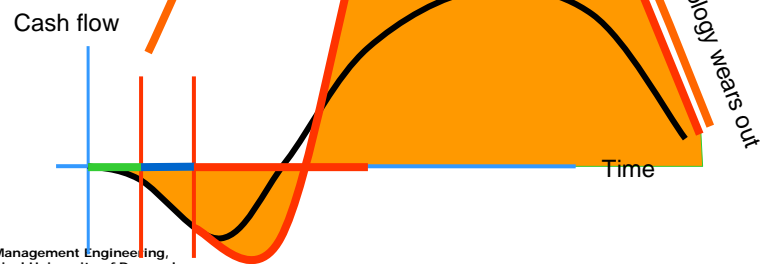
Pre-seed investment: own resources, FFF, in-kind, first customer  
 Venture Cases: also special share capital (pre-seed)

- **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  
 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 like First North

## Impact of the economical crisis:

Increased risk and scarce funding 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

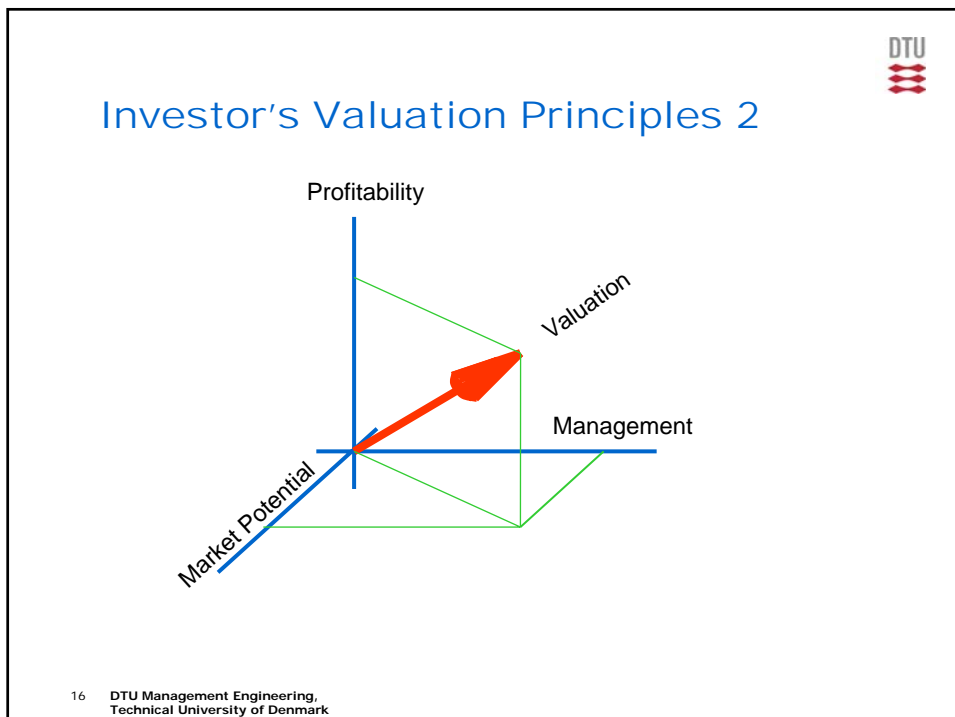
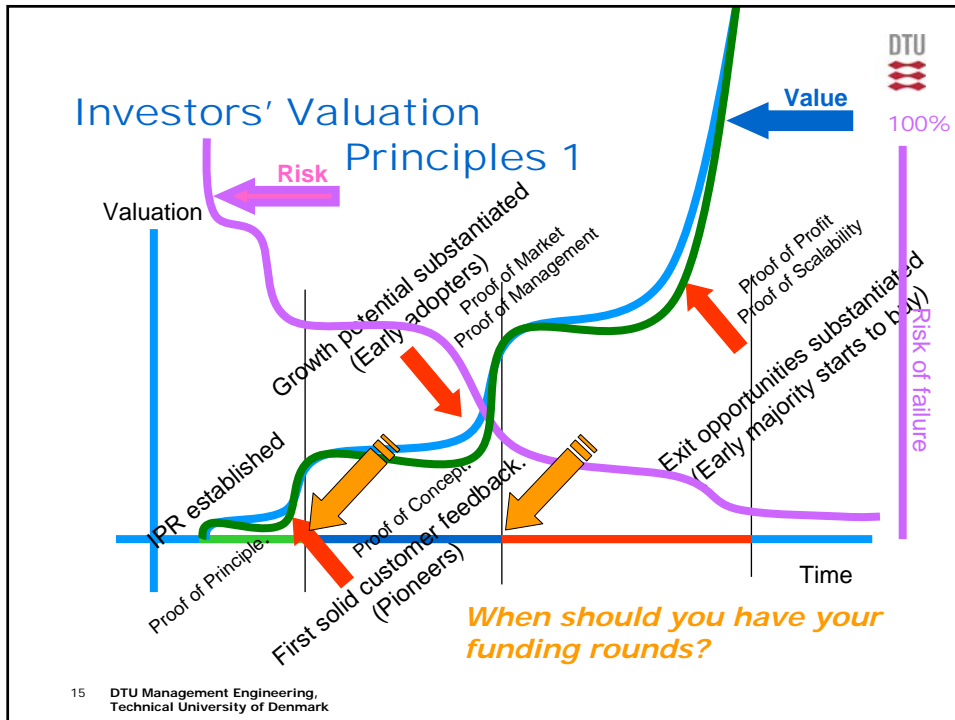
## Investor's Criteria for Interest

### 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





## Dancing with Wolves

### Or how to deal with investors

- **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**

## 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

<b>Founding</b>							
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

<b>Funding round 1.</b>								
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				

## 2. Round

Contribution through capital expansion  
 New VC investor enters  
 Funding goal: DKK 15 mio.  
 Achieved pre-money valuation: DKK 10 mio.

<b>Funding round 2.</b>		<b>Valuation pre-money</b>		<b>10.000.000 DKK</b>					
Funding goal: DKK		15.000.000		Share Price:		96,15 DKK per share			
	Shares ante	OR ante	Value ante	Contribution	New shares	Value post	Shares post	OR Post	
Founding Team	55.000	52,88%	5.288.462	0,00	0,00	5.288.462	55.000,00	21,15%	
Investor A	49.000	47,12%	4.711.538	0,00	0,00	4.711.538	49.000,00	18,85%	
Investor B	0	0,00%	0	15.000.000,00	156.000,00	15.000.000	156.000,00	60,00%	
<b>Total</b>	<b>104.000</b>	<b>100,00%</b>	<b>10.000.000</b>	<b>15.000.000,00</b>	<b>156.000,00</b>	<b>25.000.000</b>	<b>260.000,00</b>	<b>100,00%</b>	
<b>Capital expansion: from</b>				<b>104.000,00 DKK</b>	<b>- to -</b>	<b>260.000,00 DKK</b>			

## 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

<b>Exit</b>		<b>Valuation :</b>		<b>250.000.000 DKK</b>					
	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				
<b>Total</b>	<b>260.000</b>	<b>100,00%</b>	<b>250.000.000</b>	<b>17.530.000</b>					