DTU Master 2010 e'ship class
7. lecture, Monday 11 October 2010

Financing Technology Ventures

13:00 – 13:45 Flemming Lind Andersen, Lindcom A/S
13:55 – 14:20 John Heebøll, DTU Management
14:25 – 14:50 Do.
15:00 – 15:35 Rasmus Bjerngaard, SEED Capital DenmarkA/S

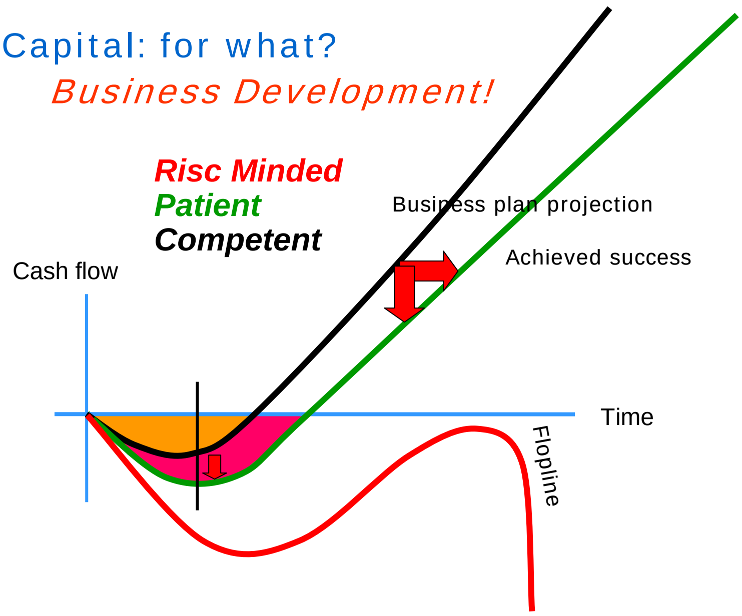
FINANCING Technology Ventures
Agenda

- *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.

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 ressources
- **Your first customer:** The more pain, the better
- **Investors' money** *If your business has a significant potential and realisation depends on speed and volume.* 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 deductable.

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**
  Paied 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 longterm 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

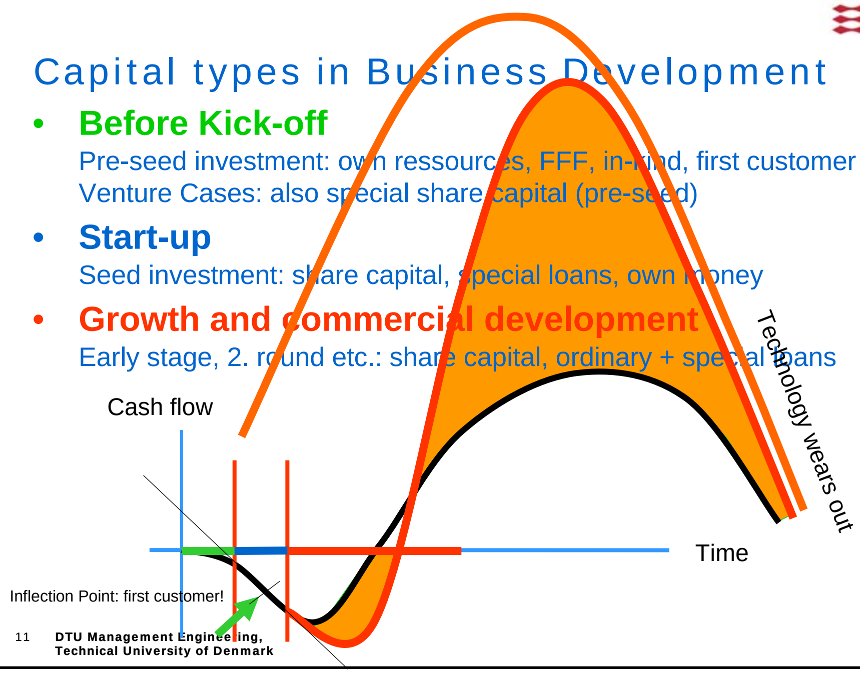
The inherent consequence of equity financing

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 ressources, 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

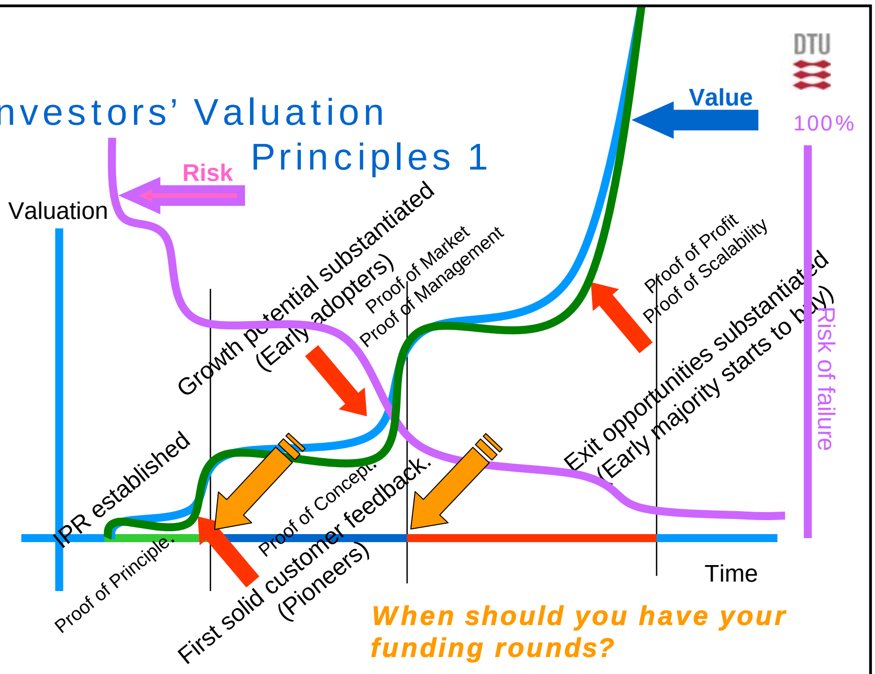
4P

- **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:

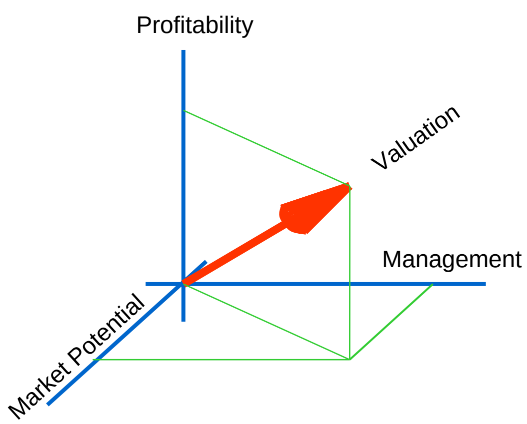
- Must be a Venture Case: ROI > 10 in less than 5 years. (126 rule applies too: 100 mio in T/O, 20% profit in less than 6 yrs)
- The team is the singlemost important precondition
- Platform: the more commercial proofs, the better. Commercial proofs reflect risk and competence

Investors' Valuation Principles 1



When should you have your funding rounds?

Investor's Valuation Principles 2



Dancing with Woolves

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 Maneovering**
  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 maneovering
- **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 1.5 mio -> Proof of Business
app. DKK 10 mio -> Proof of Profitability

Kick-off: DKK 550.000 to reach Proof of Concept

Founders + pre-seed investor
Private equity

First Milestone: DKK 1.000.000 to reach Proof of Pull

Pre-seed investor: private equity

Second Milestone: DKK 10.000.000 ro reach Proof of Profit

Venture Capital Company: private equity

Exit: Profits (EBITDA) > 20 mio. DKK/yr.

(Earnings Before Interest, Tax, Depreciation and Amortization)
Valuation based on Price/Earnings (P/E) ~ 10

Kick-off

DKK 125.000 shares

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

Founding				
Funding goal: DKK	**600.000**			
	Contribution	**Share Price:**	**1,00**	**DKK per share class A**
			20,00	**DKK per share class B**
	Nominal	Contribution	Ownership Ratio	
Founding Team, cash	**50.000**	**50.000**	40,00%	Class A
Founding Team, non-cash	**50.000**	**50.000**	40,00%	Class A
Investor A	**25.000**	**500.000**	20,00%	Class B = liquidation preference
Total	**125.000**	**600.000**	100,00%	
Total cash contribution at kick-off:		550.000		

1. Milestone

Contribution through capital expansion

Increased valuation accepted by investor due to commercial results

Capital Expansion 1.	**Valuation pre-money**		**7.000.000**	**DKK**				
Funding goal: DKK	**1.000.000**							
		Share Price:	**56,00**	**DKK per share**				
	Nom. ante	OR ante	Value ante	Contribution	New shares	Value post	OR Post	Nom post
Founding Team	100.000	80,00%	5.600.000	**0,00**	0,00	5.600.000	70,00%	100.000,00
Investor A	25.000	20,00%	1.400.000	**1.000.000,00**	17.857,14	2.400.000	30,00%	42.857,14
Total	**125.000**	100,00%	7.000.000	1.000.000,00	17.857,14	8.000.000	100,00%	**142.857,14**
		Capital expansion: from		**125.000,00**	**DKK - to**	**142.857,14**	**DKK**	

2. Round

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

Capital Expansion 2.	**Valuation pre-money**		**10.000.000**	**DKK**				
Funding goal: DKK	**15.000.000**							
		Share Price:	**70,00**	**DKK per share**				
	Nom. ante	OR ante	Value ante	Contribution	New shares	Value post	OR Post	Nom post
Founding Team	100.000	70,00%	7.000.000	**0,00**	0,00	7.000.000	28,00%	100.000,00
Investor A	42.857	30,00%	3.000.000	**0,00**	0,00	3.000.000	12,00%	42.857,14
Investor B	0	0,00%	0	**15.000.000,00**	214.285,71	15.000.000	60,00%	214.285,71
Total	142.857	100,00%	10.000.000	15.000.000,00	214.285,71	25.000.000	100,00%	**357.142,86**
		Capital expansion: from		**142.857,14**	**DKK - to**	**357.142,86**	**DKK**	

EXIT

Venture-case criterion: Rule 126:

100 mio T/O, 20% revenues (EBITDA = DKK 20 mio.) in 6 years

Valuation principle: Price/earnings

With profits (EBITDA) = 20 mio. DKK and P/E ~ 10 (Solid and perspective company): **Price: 10 X 20 mio. DKK = 200 mio. DKK**

Exit		**Valuation :**	**200.000.000**	**DKK**	
		Share Price:	**560,00**	**DKK per share**	
	Nominal	Ownership	Share value	Cash invested	Return on cash investment
Founding Team	100.000	28,00%	**56.000.000**	**50.000**	**1.120**
Investor A	42.857	12,00%	**24.000.000**	**1.500.000**	**16**
Investor B	214.286	60,00%	**120.000.000**	**15.000.000**	**8**
Total	357.143	100,00%	**200.000.000**	**16.550.000**	