

DTU Master 2011 e'ship class
7. lecture, Monday 10 October 2011

Financing Technology Ventures

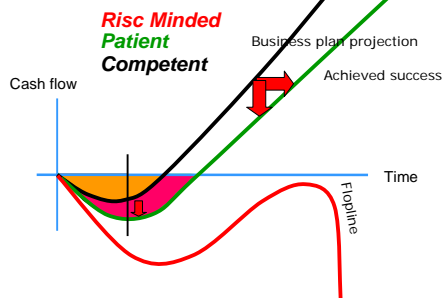
FINANCING Technology Ventures Agenda

- **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!*



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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 money.* **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

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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.

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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

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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.

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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

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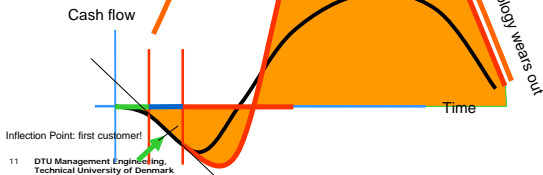
EXIT

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
- 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

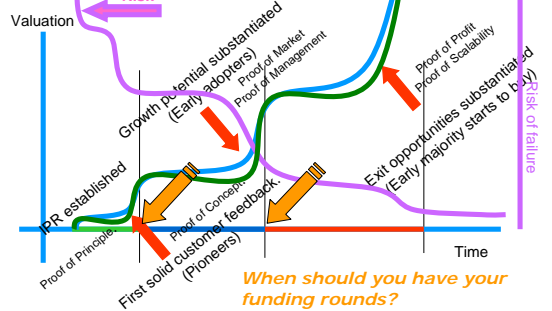
4P

- **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

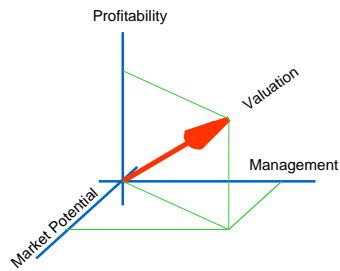
Comments:

- 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

Investors' Valuation Principles 1



Investor's Valuation Principles 2



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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**

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EXAMPLE: GBO 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

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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	19,85%	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	
