

How to Raise Funding



Business Plan
Funding Sources
Company & Deal Structure
The Pitch

Disclaimer



- This presentation gives no guarantee that you will gain funding. The speakers do not provide legal, financial or other counseling. You are encouraged to see legal and financial professionals for your deal as your situation is unique.

Meeting Agenda

- Writing the Business Plan
 - What Angels Look For in a Deal
 - Funding Process
 - Business Plan
 - What to Expect in Due Diligence
- Finding Funding
 - Types of Funding
 - Valuations
 - Exits

Meeting Agenda Continued

- Structuring the Corporation & Deal
 - Company Structure
 - Deal Structure
 - Key Terms
 - Exits
- Pitching
 - Guy Kawasaki's Rule
 - The Four Questions
 - The Elevator Pitch

What Angels Look For in a Deal

- Management is seasoned and capable
- Proof of Market
- Compelling Competitive Advantage
- Realistic Financial Projections
- Intellectual Property
- Scalability
- Passion
- Coachability
- Broad Platform
- Existing, mature distribution system
- Return on Investment

Funding Process

- Initial contact with investor – provide one-page summary
- Grow relationship with investor – show pitch slides
- Investor desires more information on your deal – provide business plan
- Investor performs due diligence --- provide Due Diligence docs (*NDA's not relevant till this stage*)
- Investor wants to invest – provide Terms Sheet
- After Investment – provide quarterly financial statements and status report. Additional docs for Board members.

Executive Summary/Business Plan



- Customer Problem
- Management Team
- Product/Services
- Target Market
- Sales/Marketing Strategy
- Competition & Competitive Advantage
- Customers
- Business Model
- Financials
- Funds Sought and Use of Funds

Customer Problem

- Be specific
- Use numbers
- Must be large problem
- Describe a customer use case—tell a story

Management Team

- CEO must have experience
- Need two other people based on business needs
 - Operations
 - Sales/Marketing
 - Technical
- Show years of experience within industry
- Use Advisory Board to fill in gaps

Product/Services

- State what you do
 - Example—”We make radiation-hardened memories”
- Focus on core product/service
- Describe benefits without giving away “secret sauce”

Target Market

- Show Available Market (Billions of \$)
- Show Serviceable Market (Millions of \$)
- Show Beachhead Market (first industry segment)
- Explain why you chose those segments

Sales/Marketing Strategy

- Describe Sales Strategy
 - Direct, Indirect, OEM, Franchise, License, other?
 - Why?
- Show how you will generate leads
- Show how many leads generate how many sales
- Explain why you chose that path

Competition & Competitive Advantage



- List competitors with strengths/weaknesses
- Show specific competitive advantages of your solution
- Use numbers to show market share, your economic benefit, etc.

Customers

- List customers you have closed
- List customers in the pipeline
- Show their results from using your product/service



Business Model

- Show revenue from customer
- Show cost of acquiring the customer
- Show profit from above
- Discuss scalability issues

Financials

- Show Income Statement
 - Include both actual and forecast (show 5 years)
- Show Cash Flow Statement
 - Discuss critical points
- Show Sales Forecast
 - Describe assumptions – ASP, Unit Growth
 - Split out major product lines and revenue streams

Funds Sought and Use of Funds



- Show Funds Sought
- Break down the Use of Funds
- Discuss Exit Strategy

Avoid these Statements

- Our financial projections are conservative
- We need only 1% of market share to . . .
- We have no competition
- No one else does what we do
- We are serving a billion dollar market

Resources

- Business Plan Software
 - Palo Alto Business Plan (<http://www.paloalto.com/>)
 - Good, basic package
 - PlanHQ (<http://www.planhq.com/home/>)
 - Collaborative tool for business plan development
- BusinessPlan Coaches
 - ActionCoach (www.ActionCoach.com)

What to Expect in Due Diligence



- Financials
- Market
- Sales and Marketing
- People
- Intellectual Property
- Contracts
- Other Legal

How to Manage Consultants

- Determine Objectives -- Be Specific
- Make Contract Specific & Time Bounded
- If giving equity, then vest the shares over time and make the contract cancellable by either party at any time.

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Types of Funding

- Angel Funding
- Bootstrapping
- Emerging Technology Fund
- SBIR/STTR—Small Business Innovation Research Grant
- SBA-Small Business Administration Loan
- CAPCO
- VC or Venture Capital

Angel Investment

- Central Texas Angel Network
 - 50+ Investors meeting quarterly
- Criteria
 - \$2M Raise or less
 - Texas-based deal
 - Complete/Near-complete product
- Syndication
 - Refer deals to Houston Angel Network and other groups

Types of Angels

- Marriage partner—in for the long haul
- Networker—industry knowledgeable
- Executive recruiter—management specialist
- Therapist—CEO coach
- Strategic partner--specialist
- General utility player—jack of all trades
- Fund raiser—knows where the money is

Source: “Every Business Needs an Angel” John May

Bootstrapping

- Internally fund through revenues, consulting services, funded development contracts
- Minimizes dilution
- Slower growth for the company
- Generates higher valuation in the long term

Emerging Technology Fund

- Grants
 - Commercialization
 - Research Grant Matching
- Requirements
 - Tie to a Texas University
 - In target research area
- Workshops Available
 - http://www.texasone.us/site/PageServer?pagename=tetf_homepage
- More information
 - RCIC—Regional Center for Innovation & Commercialization
 - <http://www.austinchamber.com/DoBusiness/TheAustinAdvantage/CenTexRCIC.html>

SBIR—Small Business Innovation Research Grant



- SBIR Qualifications:
 - Technology-based companies
 - American-owned and independently operated
 - For-profit
 - Principal researcher employed by business
 - Company size limited to 500 employees
- SBIR Setup
 - Each Dept. runs own SBIR
 - DOD (easiest) to NIH (hardest)

SBIR—Small Business Innovation Research Grant



- Phases
 - Phase I: \$100K (6-9 months)
 - Phase II: \$750K (2 yrs)
 - Phase III: No limits on funding or duration (not funded by allocated set-asides)
- Reality Check
 - Takes 40 hours to complete a Phase 1 proposal
 - Only 15% of submitted plans for Phase 1 are accepted
 - 33% of Phase 2 plans are accepted
- Links
 - <http://www.zyn.com/sbir/>
 - <http://www.sbirworld.com/>
 - <http://www.sbircoach.com/program.aspx>

SBA-Small Business Admin Loan



- Most banks can provide
- Loan with 80% guaranteed by SBA
- Prime Rate + 3%
- Sometimes personal guarantee required if no collateral available

CAPCO Qualified Business



Texas-based Businesses

- Headquartered in Texas.**
- 80% of payroll or employees in Texas.**
- Less than 100 employees.**
- Engaged in manufacturing, processing and assembly, research and development, or services.**
- NOT retail sales, real estate development, financial services, or professional services (accountants, attorneys or physicians)**

Early-Stage Firms

- Involved in development of initial product or service offering,**
- Less than 2 years in business, OR**
- Less than \$2 million in consolidated revenue**

CAPCO



- Funded by “Insurance Premium Tax Credits,”
- Definition of a CAPCO
 - <http://www.window.state.tx.us/taxinfo/taxforms/25-308.pdf>
- List of Preferred Counties—”Strategic Investment Areas”
 - <http://www.window.state.tx.us/news/50928taxcredits.html>
- Purpose of a CAPCO
 - <http://www.window.state.tx.us/comptrol/cra05/agency.html>
- Example – Lone Star CAPCO
 - <http://www.lscapcopartners.com/>

VC—Venture Capital

- Seek companies with 10x to 30x growth in 5 to 10 years
- Invest \$3M+
- Terms
 - Control board and company
- Examples
 - G51
 - Aegis Ventures
 - Silverton

Other Sources of Funding

- Family/Friends/Founders
- Debt financing—(e.g. Amplify)
 - Lend \$100K to \$1.5M
 - Need collateral or personal guarantee
 - <http://www.goamplify.com/>
- Purchase Order financing
- Equipment Financing – (e.g. Ven-Core)
 - Equipment serves as collateral for loan
- Factoring-- Selling the Accounts Receivables
- BIG -- \$15K loads for “Lifestyle” businesses

Valuations

- Multiples & Ratios Method –P/E, Pre-tax Income
- Asset-valuation Method—value of assets
- Discounted Cash Flow Method
- Other issues
 - Share-price value
 - Class of stock
 - Investment and returns timing
 - Exit strategy

Exits

- M&A—Mergers & Acquisitions
- IPO—Initial Public Offering
- AIM/TSX—Alternative Investment Market
- Dividends
- Others

Angel / Entrepreneur Interaction

- Board of Directors Responsibilities
 - Board member carries liability & fiduciary responsibility
 - The CEO reports to the Board
 - The Board is for strategic advisory, not day-to-day operations.
 - Compensated with equity shares (1%/year)
- Advisory Board
 - Bring additional expertise
- General Investor
 - Keep informed on a quarterly basis

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 - **Guy Kawasaki's Rule**
 - **The Four Questions**
 - **The Elevator Pitch**

Corporate Structure

- C-Corp—most commonly used
- LLC—formerly tax advantaged but no longer so
- Limited Partnership
- S-Corp—avoids double taxation
- Other

Deal Structure

- Debt
- Common Stock
- Convertible Preferred Stock
- Warrants
- Convertible Debt (Bridge Loan)

Debt

- Advantages
 - Paid before shareholders
 - Current return
 - Exit when note matures
 - Defers valuation decision
- Key Terms
 - Principal
 - Interest rate
 - Term Note
 - Collateral or guarantee

Common Stock

- Simple, fast, easy, inexpensive
- Requires a valuation decision—price per share



Convertible Debt

- Debt converts into shares issued in the next round
- Advantages
 - Downside protection, like ordinary loan
 - More reasonable interest rate
 - Provides an equity “sweetener”
 - Defers investment decision and valuation

Warrants

- An option to purchase stock
- Fixed price
- Expires after some years
- Advantages
 - Lock in a low price
 - Valuable if valuation of company goes up

Convertible Preferred

- Better rights and preferences than common stock
- Has characteristics of debt
- Benefits from growth in value of stock

Terms Sheet

- Economic Terms
- Power and Control
- Planning the Exit



Valuation

- Pre-money = value before financing
- Post-money = pre-money plus the financing
- Example
 - \$1M pre-money, with \$100K invested
 - \$1.1M post-money, you own ($\$100\text{K}/\$1.1\text{M}=9\%$)

Liquidation Preference

- Preferred get at least all of their original money back before Common gets any
- But debt still comes first

Participating Preferred

- Preferred gets its investment back
- Preferred and Common share the rest



Anti-Dilution

- Protects early investors who paid too much
- Adjusts the “conversion ratio”
- Types
 - Full ratchet
 - Narrow weighted average
 - Broad-based weighted average

Pre-emptive Rights

- Purpose: Maintain your percentage
- When Company issues new stock, it must offer it to you on the same terms.

Power and Control

- Voting agreement – board seats
- Protective Provisions—supermajority for big decisions
- Information Rights – Reports, financials, access
- Drag Along Rights – Investors can't block a sale
- Co-Sale Rights – Majority cannot sell out the minority

Plan for an Exit

- IPO
- Merger
- Slow Progress
 - Redemption – investment + dividends
- Failure
 - Liquidation preferences
 - Debt
 - Recapitalization

Warning Signs to Entrepreneur



- Under financing
- Impossible milestones
- Limitations of syndication
- Corporate strategic investors

Warning Signs to Investor

- Lack of downside protection
- Non-willingness to report
- Weak board & poor approval requirements for board membership
- Corporate strategic investor

Model Documents & Glossary

- Model Documents

http://www.nvca.org/model_documents/model_docs.html

- Venture Capital Glossary

<http://vcexperts.com/vce/library/encyclopedia/glossary.asp>

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Guy Kawasaki's Rule

- Make the font big
- Follow the 10/20/30 rule
- Tell a story
- Examples:

http://blog.guykawasaki.com/2007/03/the_worlds_best.html

The Elevator Pitch

- 60 seconds to answer these questions
 - What problem you solve & how you solve it?
 - How are you unique?
 - How are you going to make money?
 - Why should we care?
 - How much are you seeking to raise?
 - How will you use the funds?

More Examples

- PlanHeaven
 - <http://www.planheaven.com/>
- Vator.tv
 - <http://www.vator.tv/>



Discussion

