First, Know Yourself

• Are you:
  • An high-growth venture?
  OR
  • A “small business”?

• What are your goals?
  • Long-term ownership, steady income, control
  OR
  • Rapid growth leading to cash “exit”
Know Your Cash Needs

No matter what kind of business you are

$ $$ $$ How much?

When?

Why?
Cash vs. Accounting

- Revenue ≠ cash coming in
  - Typically, revenue is recognized upon shipment
  - For subscriptions, revenue may be monthly
- Expense ≠ cash going out
  - Typically accrued when the product or service is delivered
  - Expenses include depreciation

You will need both
Build Your Cash Forecast Model

How much CASH comes in
• From what sources

How much CASH goes out
• To what uses

Think bottom-up
• Month by month

Your forecasts will be wrong. Measure, learn, and adjust.

If you don’t know spreadsheets, find someone to teach you!
Cash Requirements

Define clear milestones

Estimate cash needed for each step
Who Will Fund Your Company?

- Your Pocket$  
- Family/Friend$  
- Government$  
- Investor$  
- Customer$  
- “Crowd$”  
- Bank$  
- Supplier$  
- Infra$structure  
- Employee$  
- Facilitie$
Funding Plan
Align sources with stages

- **Concept**
  - Your Pocket$
  - Family/Friend$

- **Development**
  - Grant$

- **Pilot**
  - Investor$

- **Go-To-Market**
  - Loan$

- **Expansion**
Bootstrapping

“A self-sustaining process that proceeds without external help”

Do you really need to raise money?
• Consider pay-as-you-go growth instead

Can you get customers to fund you?
• Try to get product pre-orders

Pros
100% ownership
100% control

Cons
Slower growth
Competitive risk

Tradeoff: a balance between two desirable but incompatible features; a compromise.
Investors

Angels

Just people who want to make money by investing…

… their own money

VCs

Just people who want to make (lots of) money by investing…

… (lots of) other people’s money
Expectations & Alignment

You: Work Hard
Them: Take Risk
Low Pay: High Return

Align early; Check frequently
Convertible Notes vs. Priced Rounds
Two ways to raise the money to grow

Notes = Debt (aka Bridge Loan)
- You borrow the money
- Investors risk = you can’t pay them back
  - You pay interest
  - No valuation necessary
- Investors can convert to equity
- Investors get a discount
- Investors want capped valuation
  - Typical term = 18 months

Priced Rounds = Equity
- You sell shares to raise the money
- Investors risk = the shares might be worthless
  - Negotiate valuation (share price)
- You won’t own as much of your company

Notes only work well when priced round comes soon
Valuation

• Investors expect to own ~ 1/3 post-money
• How much do you need to achieve the next milestone?
• Q.E.D. pre-money valuation = 2 x Raise
• This is not a rule!
  • Stage/risk will determine actual valuation
  • Can you convince investors to own less of the company?
  • Can you show why the risks are low?
  • If the risks are low, is there a high potential ROI?
Types of Stock

**Preferred Stock – Investors**
- Series A
- Series B

**Common Stock – Everyone Else**
- Founders
- Employees
- Contractors
- Landlords

**Preferred Shareholders**
- Get their money back first - more than 1X
- Have additional rights, e.g. approval of major events
## Capitalization Table

Who owns what slice

<table>
<thead>
<tr>
<th>Round</th>
<th>Amount of Investment</th>
<th>Certificate Number</th>
<th>Date of issuance</th>
<th>Price per share</th>
<th>Price</th>
<th>Ownership</th>
<th>Shares</th>
<th>Diluted Voting Shares</th>
<th>Total Shares</th>
<th>Common Shares</th>
<th>Series A Preferred Shares</th>
<th>Series B Preferred Shares</th>
<th>Series C Preferred Shares</th>
<th>Warrants Shares</th>
<th>Options Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Round 1</td>
<td>$2,500</td>
<td>1</td>
<td>1/5/2007</td>
<td>$0.01</td>
<td>250,000</td>
<td>common</td>
<td>250,000</td>
<td>13%</td>
<td>12,500</td>
<td>250,000</td>
<td>39%</td>
<td>2,500</td>
<td>0%</td>
<td>53,333</td>
<td>11%</td>
</tr>
<tr>
<td>Round 2</td>
<td>$2,500</td>
<td>2</td>
<td>1/5/2007</td>
<td>$0.01</td>
<td>250,000</td>
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<td>4%</td>
<td>12,500</td>
<td>250,000</td>
<td>4%</td>
<td>2,500</td>
<td>0%</td>
<td>53,333</td>
<td>11%</td>
</tr>
<tr>
<td>Round 3</td>
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<td>3</td>
<td>1/5/2007</td>
<td>$0.01</td>
<td>250,000</td>
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<td>4%</td>
<td>12,500</td>
<td>250,000</td>
<td>4%</td>
<td>2,500</td>
<td>0%</td>
<td>53,333</td>
<td>11%</td>
</tr>
<tr>
<td>Round 4</td>
<td>$2,000</td>
<td>4</td>
<td>1/5/2007</td>
<td>$0.01</td>
<td>10,000</td>
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<td>6,667</td>
<td>10,000</td>
<td>4%</td>
<td>2,000</td>
<td>0%</td>
<td>53,333</td>
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</tr>
<tr>
<td>Round 5</td>
<td>$4,000,000</td>
<td>12</td>
<td>1/5/2008</td>
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<td>Series C Preferred</td>
<td>400,000</td>
<td>20.9%</td>
<td>400,000</td>
<td>400,000</td>
<td>20.9%</td>
<td>4,000,000</td>
<td>22.85%</td>
<td>53,333</td>
<td>2.8%</td>
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<tr>
<td>Round 6</td>
<td>$800,000</td>
<td>W1</td>
<td>1/5/2008</td>
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<td>Warrants</td>
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<td>3.5%</td>
<td>53,333</td>
<td>10,000</td>
<td>0.5%</td>
<td>800,000</td>
<td>22.85%</td>
<td>53,333</td>
<td>2.8%</td>
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</table>

### Series A Preferred

<table>
<thead>
<tr>
<th>Stockholder</th>
<th>Date of Investment</th>
<th>Amount of Investment</th>
<th>Certificate Number</th>
<th>Date of issuance</th>
<th>Price per share</th>
<th>Shares</th>
<th>Voting Shares</th>
<th>Total Shares</th>
<th>Common Shares</th>
<th>Series A Preferred Shares</th>
<th>Warrants Shares</th>
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</thead>
<tbody>
<tr>
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<td>1/1/2007</td>
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<td>1/5/2007</td>
<td>$0.01</td>
<td>250,000</td>
<td>13%</td>
<td>12,500</td>
<td>250,000</td>
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<td>0%</td>
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<tr>
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<td>2</td>
<td>1/5/2007</td>
<td>$0.01</td>
<td>250,000</td>
<td>4%</td>
<td>12,500</td>
<td>250,000</td>
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<td>0%</td>
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<tr>
<td>Founder 3</td>
<td>1/1/2007</td>
<td>$2,500</td>
<td>3</td>
<td>1/5/2007</td>
<td>$0.01</td>
<td>250,000</td>
<td>4%</td>
<td>12,500</td>
<td>250,000</td>
<td>4%</td>
<td>2,500</td>
<td>0%</td>
</tr>
<tr>
<td>Stockholder 1</td>
<td>6/1/2007</td>
<td>$10,000</td>
<td>4</td>
<td>6/5/2007</td>
<td>$1.50</td>
<td>6,667</td>
<td>0.3%</td>
<td>6,667</td>
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<td>6,667</td>
<td>0.3%</td>
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<tr>
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<td>$10,000</td>
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<td>6,667</td>
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### Series B Preferred

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<th>Amount of Investment</th>
<th>Certificate Number</th>
<th>Date of issuance</th>
<th>Price per share</th>
<th>Shares</th>
<th>Voting Shares</th>
<th>Total Shares</th>
<th>Common Shares</th>
<th>Series B Preferred Shares</th>
<th>Warrants Shares</th>
<th>Options Shares</th>
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</thead>
<tbody>
<tr>
<td>Stockholder 6</td>
<td>1/1/2008</td>
<td>$250,000</td>
<td>9</td>
<td>1/5/2008</td>
<td>$5.00</td>
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<td>50,000</td>
<td>50,000</td>
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<td>Stockholder 7</td>
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<td>$250,000</td>
<td>10</td>
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<td>50,000</td>
<td>2.6%</td>
<td>50,000</td>
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<td>2.6%</td>
<td>50,000</td>
<td>2.6%</td>
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<tr>
<td>Stockholder 8</td>
<td>1/1/2008</td>
<td>$250,000</td>
<td>11</td>
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<td>2.6%</td>
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<td>2.6%</td>
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<td>2.6%</td>
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</table>

### Series C Preferred

<table>
<thead>
<tr>
<th>Stockholder</th>
<th>Date of Investment</th>
<th>Amount of Investment</th>
<th>Certificate Number</th>
<th>Date of issuance</th>
<th>Price per share</th>
<th>Shares</th>
<th>Voting Shares</th>
<th>Total Shares</th>
<th>Common Shares</th>
<th>Series C Preferred Shares</th>
<th>Warrants Shares</th>
<th>Options Shares</th>
</tr>
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<tbody>
<tr>
<td>Stockholder 9</td>
<td>5/1/2008</td>
<td>$4,000,000</td>
<td>12</td>
<td>1/5/2008</td>
<td>$10.00</td>
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<td>20.9%</td>
<td>400,000</td>
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<td>20.9%</td>
<td>400,000</td>
<td>22.85%</td>
</tr>
<tr>
<td>Stockholder 10</td>
<td>5/1/2008</td>
<td>$4,000,000</td>
<td>13</td>
<td>1/5/2008</td>
<td>$10.00</td>
<td>400,000</td>
<td>20.9%</td>
<td>400,000</td>
<td>400,000</td>
<td>20.9%</td>
<td>400,000</td>
<td>22.85%</td>
</tr>
</tbody>
</table>

### Warrants

<table>
<thead>
<tr>
<th>Stockholder</th>
<th>Date of Investment</th>
<th>Amount of Investment</th>
<th>Certificate Number</th>
<th>Date of issuance</th>
<th>Price per share</th>
<th>Shares</th>
<th>Voting Shares</th>
<th>Total Shares</th>
<th>Common Shares</th>
<th>Series C Preferred Shares</th>
<th>Warrants Shares</th>
<th>Options Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stockholder 11</td>
<td>5/1/2008</td>
<td>$800,000</td>
<td>W1</td>
<td>1/5/2008</td>
<td>$15.00</td>
<td>53,333</td>
<td>2.8%</td>
<td>53,333</td>
<td>53,333</td>
<td>2.8%</td>
<td>53,333</td>
<td>2.8%</td>
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</table>

### Options

<table>
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<th>Employee</th>
<th>Date of Option</th>
<th>Amount of Option</th>
<th>Stock Option</th>
<th>Date of Stock Option</th>
<th>Price per share</th>
<th>Shares</th>
<th>Voting Shares</th>
<th>Total Shares</th>
<th>Common Shares</th>
<th>Series C Preferred Shares</th>
<th>Warrants Shares</th>
<th>Options Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee 1</td>
<td>6/15/2007</td>
<td>$100,000</td>
<td>Option 1</td>
<td>6/18/2007</td>
<td>$1.50</td>
<td>66,667</td>
<td>3.5%</td>
<td>66,667</td>
<td>66,667</td>
<td>3.5%</td>
<td>66,667</td>
<td>3.5%</td>
</tr>
<tr>
<td>Employee 2</td>
<td>9/15/2007</td>
<td>$75,000</td>
<td>Option 2</td>
<td>9/18/2007</td>
<td>$2.00</td>
<td>37,500</td>
<td>2.0%</td>
<td>37,500</td>
<td>37,500</td>
<td>2.0%</td>
<td>37,500</td>
<td>2.0%</td>
</tr>
<tr>
<td>Employee 3</td>
<td>4/1/2008</td>
<td>$50,000</td>
<td>Option 3</td>
<td>4/4/2008</td>
<td>$3.00</td>
<td>16,667</td>
<td>0.5%</td>
<td>16,667</td>
<td>16,667</td>
<td>0.5%</td>
<td>16,667</td>
<td>0.5%</td>
</tr>
</tbody>
</table>
The So-Called “Exit”

Where shareholders get liquidity

Investors get their money back – several X
While you may be “locked up” for a while

Common shares may get less than preferred
You may need to keep working (beware earn-outs)
The Exit Paradox

Convincing investors to put money into your company requires that you understand your exit opportunities

&

Running your company pretty much requires that you ignore it

Investors require return on investment
  • Different types of investors have different expectations

Venture investors:
  • Is 30x in 5 years plausible?

Paradox: statement that apparently contradicts itself and yet might be true.
Exit Options

• “We’ll get bought” is a bit too vague
• Name 3 potential buyers
• Why would they buy your company?
• When?
• For how much?

Understand comparative examples
Exit Expectations

You are not guaranteeing that one of the companies you name will be the buyer – you are just saying it’s plausible.

The more data you have (comparable examples) the more credible your valuation will be.

And having comparable examples shows you did your homework.

Alignment is key:
- Among your team
- Between you and investors
10x to 30x: Why so High?

- Investors think in terms of portfolio
- Many startups in their portfolio return zero
- There will be dilution
- It may take 5-7 years to get any return

20-30% total portfolio return requires some home runs
Every investment should have the potential
Summary

Planning
• “Build it and they will come” is a terrible strategy
• Funding needs a plan - Just like every important element of your business

Alignment
• Within your organization
• Right source(s) at right time(s)
• Investor/management expectations

Can’t run a company for “the exit”
• But investors need to know you’re willing to sell

Bootstrapping is the cheapest way
• Pay as you go
• Sell real stuff to real customers!