Funding & Finance

Planning to Fund Your Venture

OREGON ANGEL FUND

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Oregon Angel Fund

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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

Cash Forecast ≠ Financial Statement

You will need both

Build Your Cash Forecast Model

How much CASH comes in

- From what sources

How much CASH goes out

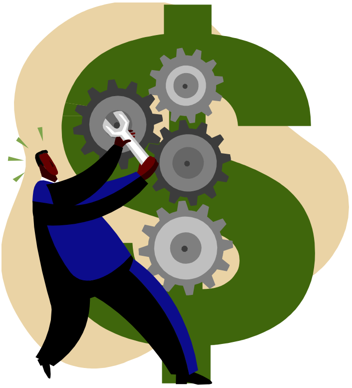
- To what uses

Think bottom-up

- Month by month

Cash Flow forecast

Item	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Total
product sales	1000	3500	5800	6500	7800	9000	9500	10800	11200	9400	10500	12000	97000
engraving		400	600	800	1100	900	1100	1300	900	1400	1600	1900	12000
Total income	1000	3900	6400	7300	8900	9900	10600	12100	12100	10800	12100	13900	109000
purchases	7400	8800	3400	4200	5000	10000	8000	4000	3200	3500	3000	3000	63500
accounting fees								600				900	1500
advertising	1100	600	400				300						2400
power			300			400			300			200	1200
rent	633	633	633	633	633	633	633	633	633	633	633	637	7600
motor vehicle exp													0
registration								500					500
insurance				600									600
petrol	200	200	200	200	200	200	200	200	200	200	300	300	2600
repairs						800							800
wages				800	700	2000	2000	2000	2000	2000	2500	2500	16500
insurance	1100							1000					2100
telephone		800			900			600			400		2700
maintenance					500							600	1100
profit goal	1125	1125	1125	1125	1125	1125	1125	1125	1125	1125	1125	1125	13500
	-10558	-8258	342	-258	-158	-5258	-1658	1442	4642	3342	4142	4638	-7600
cash balance	-10558	-18816	-18474	-18732	-18890	-24148	-25806	-24364	-19722	-16380	-12238	-7600	
establishment costs	13800	15900											
total capital required	-24358	-48516	-48174	-48432	-48590	-53848	-55506	-54064	-49422	-46080	-41938	-37300	

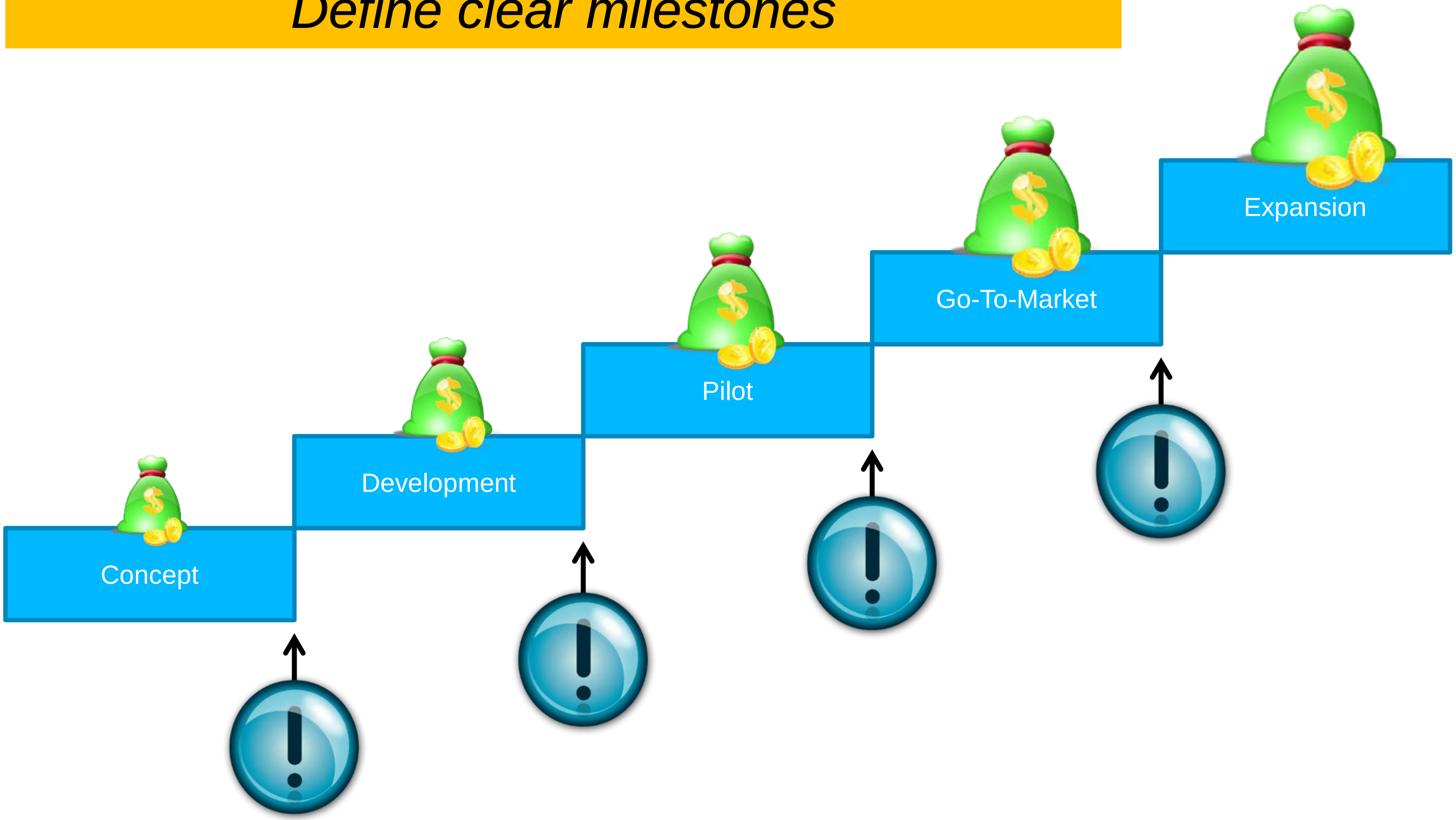


Your forecasts will be wrong. Measure, learn, and adjust

If you don't know spreadsheets, find someone to teach you!

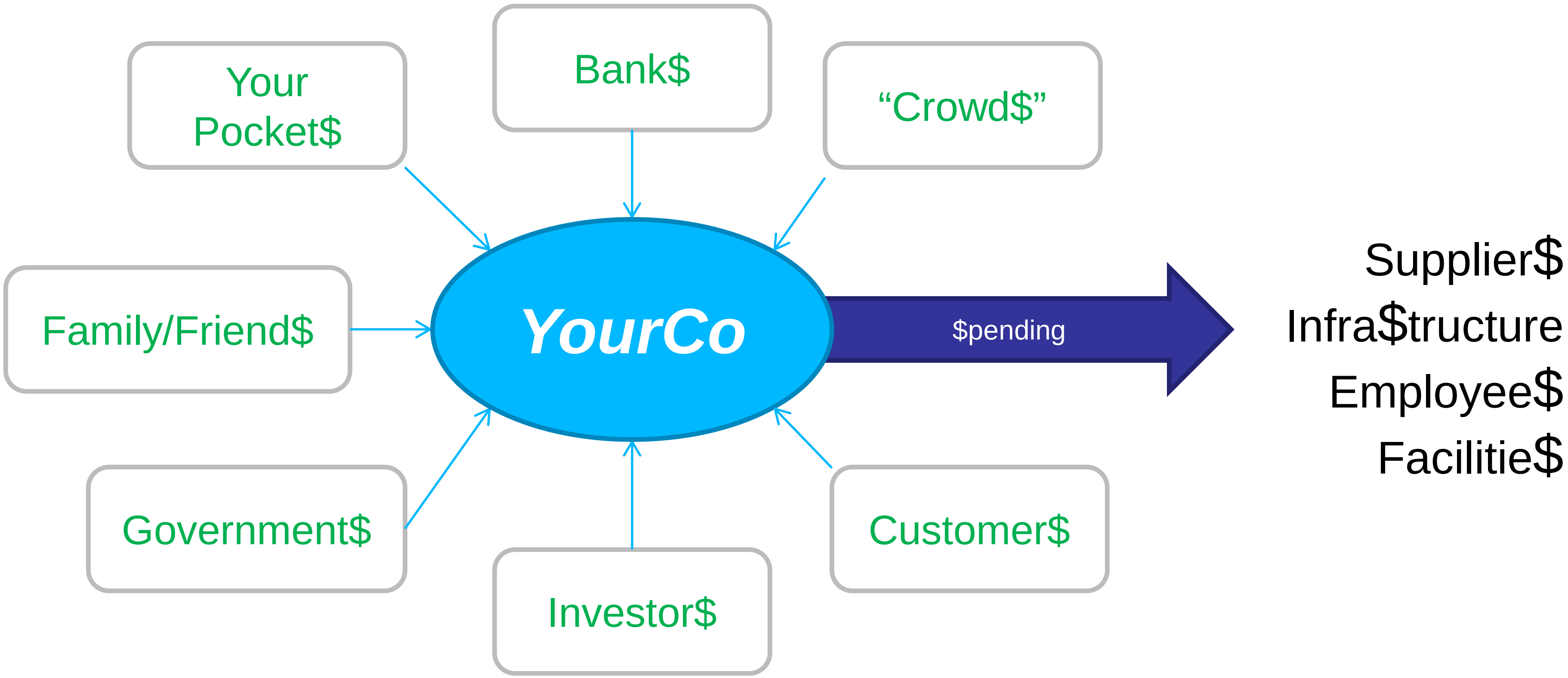
Cash Requirements

Define clear milestones



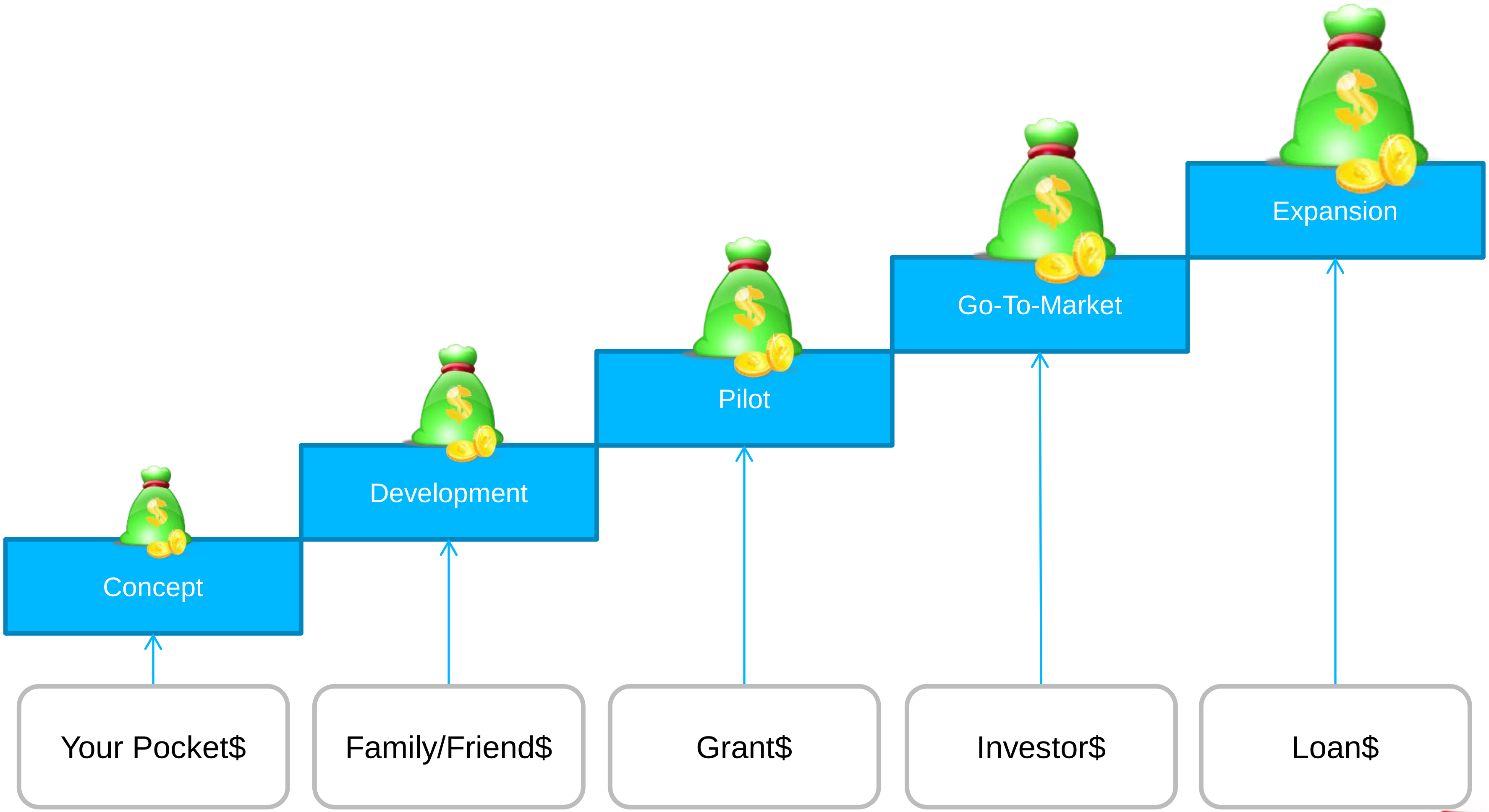
Estimate cash needed for each step

Who Will Fund Your Company?



Funding Plan

Align sources with stages



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	Cons
100% ownership 100% control	Slower growth Competitive risk

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

Investors

Angels

Just <u>people</u> who want to make money by investing…

… <u>their own </u>money

VCs

Just <u>people</u> who want to make (lots of) money by investing…

… (lots of) <u>other people's </u>money

Expectations & Alignment

OAF
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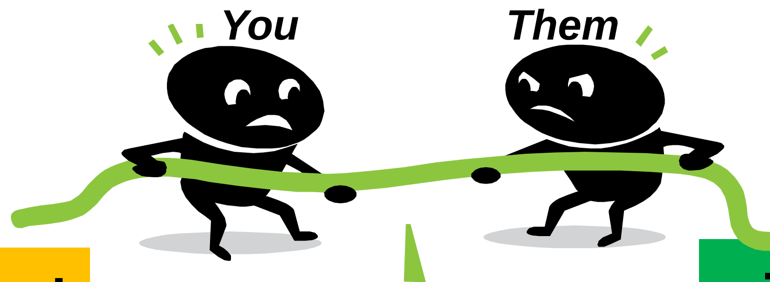
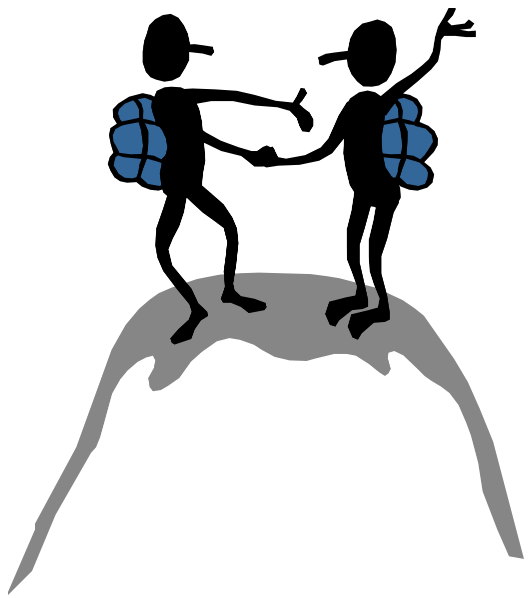


Work Hard
Low Pay

Take Risk
High Return



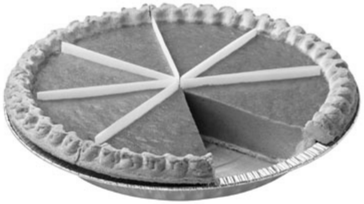
Align early; Check frequently

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?

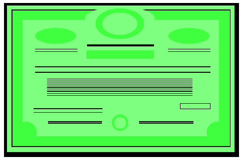
Types of Stock

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

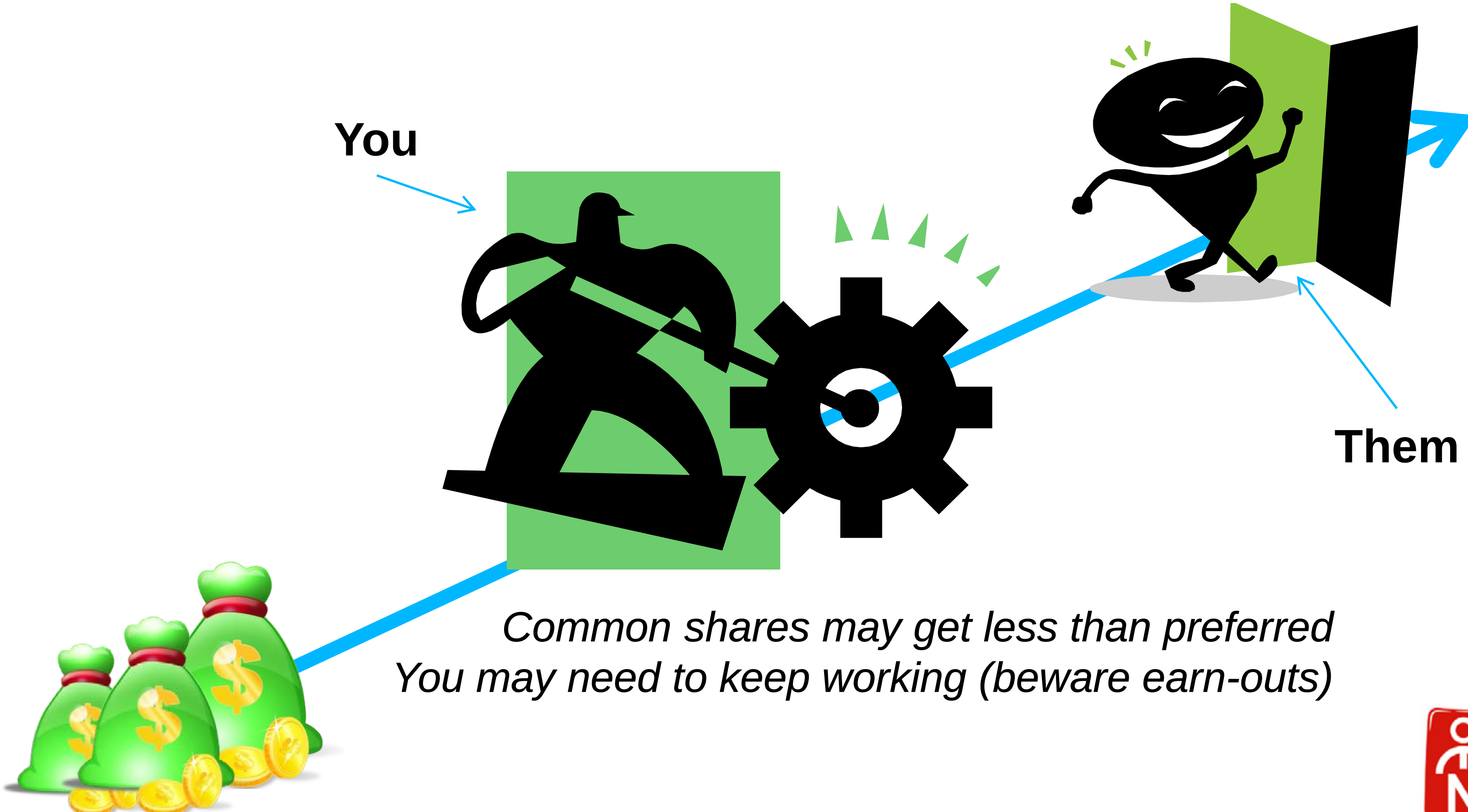
Who owns what slice

stockholder	round	date of investment	amount of investment	certificate number	date of issuance	price	shares	class	Round 1	Round 2	Round 3	Round 4	Round 5	total shares	fully diluted	voting	voting
								price per share	$0.01	$0.25	$1.00	$4.69	$9.38	$2.00			
								round value	$7,500	$20,000	$75,000	$750,000	$8,000,000	$3,836,668			
								ownership	39%	4%	4%	8%	44%	100%			
			$9,877,500	**13 shares**		**$5.15**	**1,918,334**		750,000	80,001	75,000	160,000	853,333	1,918,334	100%	1,750,834	100%
common																	
founder 1	1	1/1/2007	$2,500	1	1/5/2007	$0.01	250,000	common	250,000					250,000	13.0%	250,000	14.28%
founder 2	1	1/1/2007	$2,500	2	1/5/2007	$0.01	250,000	common	250,000					250,000	13.0%	250,000	14.28%
founder 3	1	1/1/2007	$2,500	3	1/5/2007	$0.01	250,000	common	250,000					250,000	13.0%	250,000	14.28%
stockholder 1	2	6/1/2007	$10,000	4	6/5/2007	$1.50	6,667	common		6,667				6,667	0.3%	6,667	0.38%
stockholder 2	2	7/1/2007	$10,000	5	7/5/2007	$1.50	6,667	common		6,667				6,667	0.3%	6,667	0.38%
Series A Preferred																	
stockholder 3	3	8/2/2007	$25,000	6	8/6/2007	$2.00	12,500	Series A Preferred			12,500			12,500	0.7%	12,500	0.71%
stockholder 4	3	8/2/2007	$25,000	7	8/6/2007	$2.00	12,500	Series A Preferred			12,500			12,500	0.7%	12,500	0.71%
stockholder 5	3	8/2/2007	$25,000	8	8/6/2007	$2.00	12,500	Series A Preferred			12,500			12,500	0.7%	12,500	0.71%
Series B Preferred																	
stockholder 6	4	1/1/2008	$250,000	9	1/5/2008	$5.00	50,000	Series B Preferred				50,000		50,000	2.6%	50,000	2.86%
stockholder 7	4	1/1/2008	$250,000	10	1/5/2008	$5.00	50,000	Series B Preferred				50,000		50,000	2.6%	50,000	2.86%
stockholder 8	4	1/1/2008	$250,000	11	1/5/2008	$5.00	50,000	Series B Preferred				50,000		50,000	2.6%	50,000	2.86%
Series C Preferred																	
stockholder 9	5	5/1/2008	$4,000,000	12	1/5/2008	$10.00	400,000	Series C Preferred					400,000	400,000	20.9%	400,000	22.85%
stockholder 10	5	5/1/2008	$4,000,000	13	1/5/2008	$10.00	400,000	Series C Preferred					400,000	400,000	20.9%	400,000	22.85%
Warrants																	
stockholder 11	5	5/1/2008	$800,000	W1	1/5/2008	$15.00	53,333	Warrants					53,333	53,333	2.8%		
Options																	
employee 1	2	6/15/2007	$100,000	Option 1	6/18/2007	$1.50	66,667	Options		66,667				66,667	3.5%		
employee 2	3	9/15/2007	$75,000	Option 2	9/18/2007	$2.00	37,500	Options			37,500			37,500	2.0%		
employee 3	4	4/1/2008	$50,000	Option 3	4/4/2008	$5.00	10,000	Options				10,000		10,000	0.5%		

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!