The Art and Science of Fundraising

@Rbelani

www.AlchemistAccelerator.com

Ravi.Belani@Gmail.com

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Introduction

Background

A Few Plugs (@rbelani)

Past

Draper Fisher Jurvetson

PubMatic

komli

McKinsey&Company

Extensity

zaplet™

Present(s)

Stanford University — ETL.STANFORD.EDU

The Alchemist Accelerator™ — ALCHEMISTACCELERATOR.COM

founders hookup — FOUNDERSHOOKUP.COM

The Alchemist Accelerator™

Agenda

The Art of Fundraising

- Motivations and incentives
- Psychology of Approaching VC's
- Tips during the Pitch

The Science of Fundraising

- Economics of Venture Capital
- How to Drive a Process
- Key Terms in a Term Sheet

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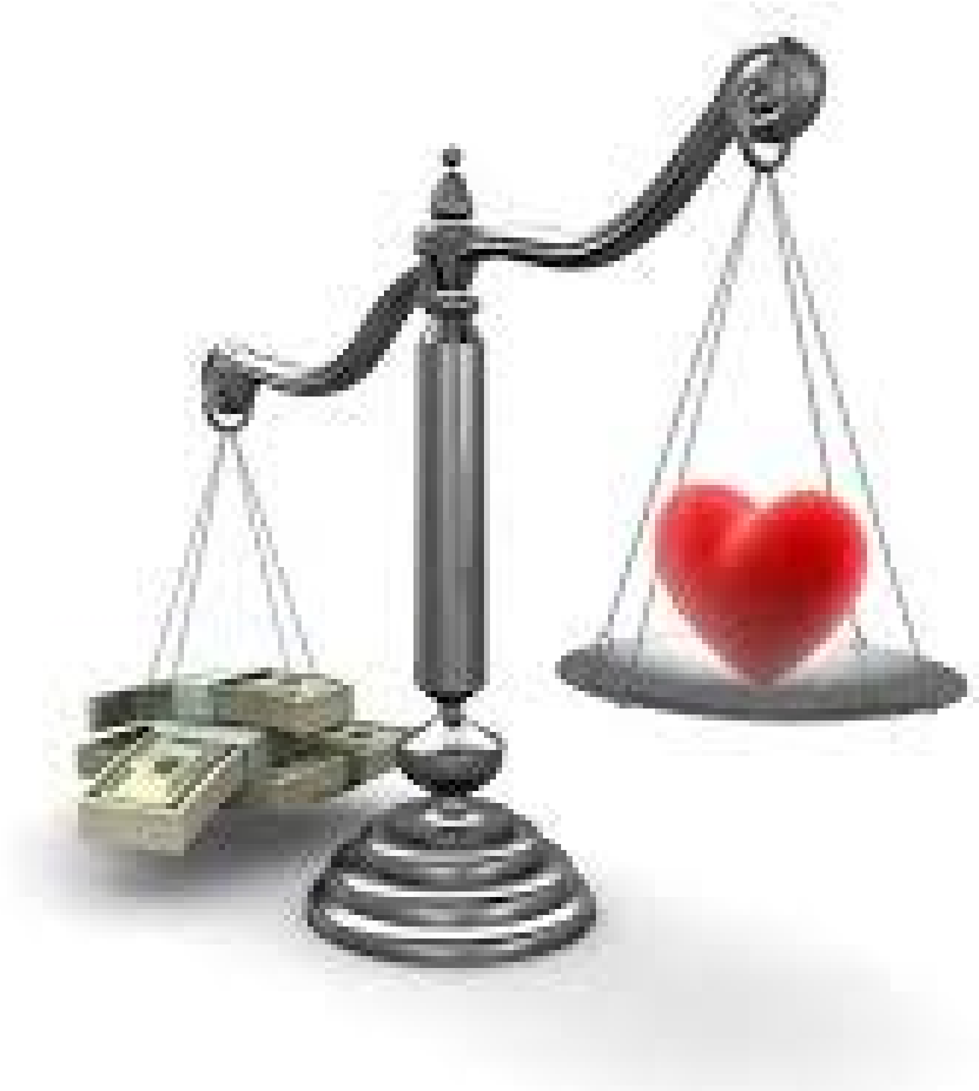
Get Clear on Your Personal Motivations



The Fund Size You Pitch should mirror the Exit Outcome you Expect

* Most funds need to return 1/3 of their fund with each investment

* Your payouts and the GP's payouts are most aligned is exit expectation and fund payout are aligned

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Most Funds are looking to return 1/3 of their fund when considering an investment

Venture	Year	Cost ($)	1986 value
Advanced Recreation Equipment	1973	229 200	—
Amtekna Inc.	1973	275 000	150 000
Antex Industries	1973	200 000	2 529
Applied Material Inc.	1973	317 658	561 000
Dynastor Inc.	1973	497 405	500 000
Movacor Medical Corp.	1973	674 000	1 912 000
Office Communications Inc.	1973	429 748	94 453
Qume Corp.	1974	246 760	7 964 000
Speech Technology Corp.	1974	41 353	—
American Athletic Shoe	1975	418 782	—
Cetus Corp.	1975	500 100	641 795
Tandem Computers Inc.	1975	1 450 001	165 968 000
Amadahl Corp.	1976	92 500	607 148
Genetech Inc.	1976	200 000	160 372 000
Collagen Corp.	1977	655 211	4 010 000
Enviro Development Co.	1977	953 495	—
Andros Analysers Inc.	1980	279 059	2 780 000
Total		7 460 272	345 562 925

Of Kleiner Perkins' 17 Investments, 2 were responsible for 90% of returns

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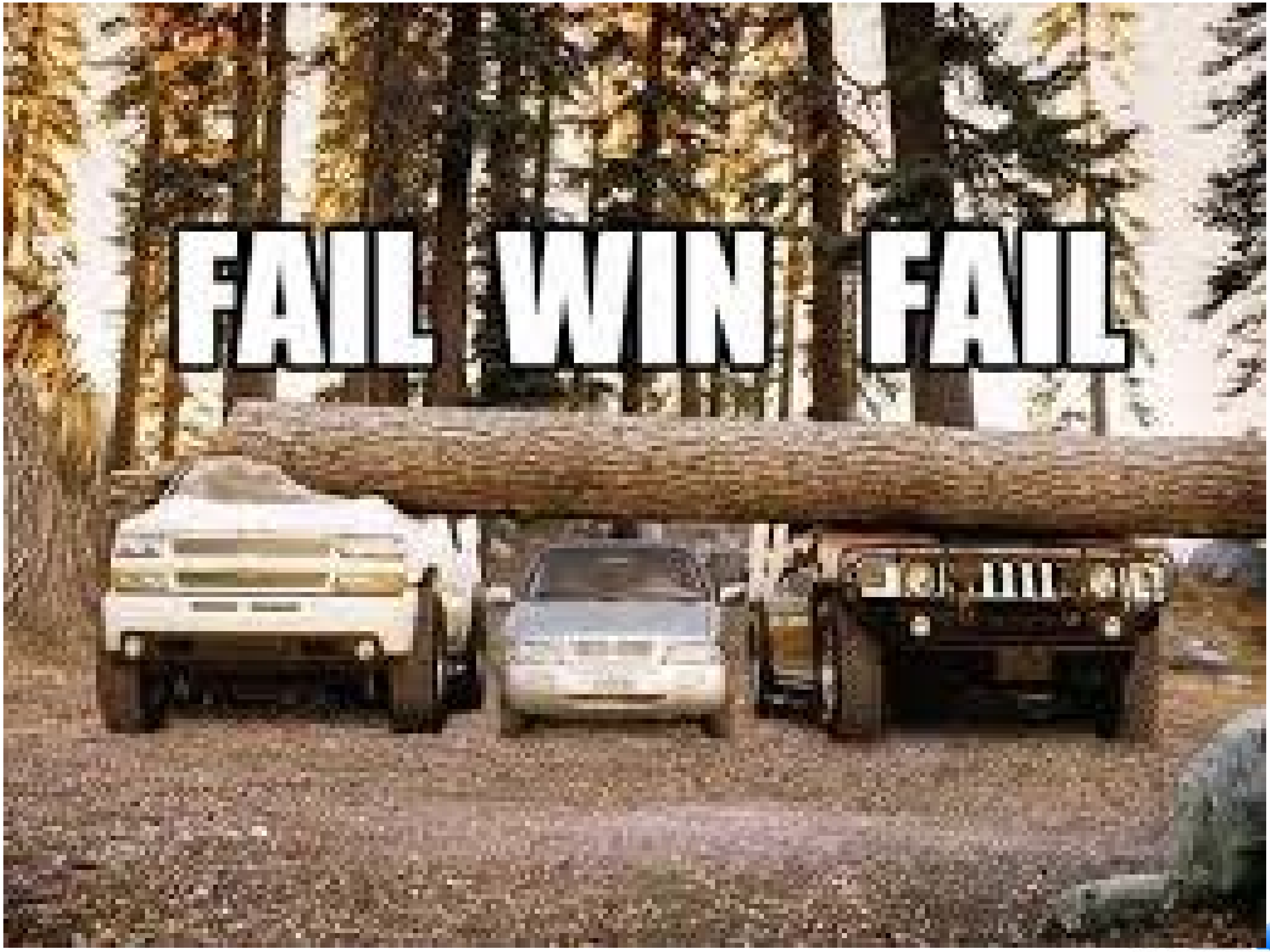
Bigger is not necessarily better



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Venture Economics 101

Follow the money trail…

Economics are misaligned if Entrepreneur not gunning for big exit

How a VC Makes Money

- Assume a $500M fund with 10 partners ($50 M / partner)
- Two Revenue Sources
  - Management Fee: 2% / year for 10 years ($1 M / partner)
  - Carry: 20% of profits
- Fund is typically committed after 3 years
- But Fund has a 10 year life
- At any one point, a General Partner may be drawing down economics on 3 Funds

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Economics for a $20m Exit for a Traditional VC vs. Founder

Assumptions: $500m VC, Founder owns 25% of biz, VC firms owns 25%

	VC General Partner	Founder
Salary	$3 million	$150 thousand
	$500m fund x 2% mgmt fee x 20% (share of GP) = $1 million / fund x 3 funds	
Payout from Exit	$160 thousand	$5 million
	$20m acquisition x 25% equity (no part) = $4 million x 20% carry = $800 thousand for fund x 20% (share of GP)	$20m acquisition x 25% equity

- 30x change for founder
- 0.05x change for VC

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Economics for a $20m Exit for an Angel VC vs. Founder

Assumptions: $20m 1st time VC, Founder owns 25% of biz, VC firms owns 25%

	VC General Partner	Founder
Salary	$300 thousand	$150 thousand
	$20m fund x 2% mgmt fee x 100% (share of GP) = $300k / fund x 1 fund	
Payout from Exit	$1 million	$5 million
	$20m acquisition x 25% equity (no part) = $5 million x 20% carry = $1m for fund x 100% (share of GP)	$20m acquisition x 25% equity

- 30x change for founder
- 2.5x change for VC (50 times better than a VC)

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Vinod Khosla's Scorecard: The Beauty of Small Numbers (And Board Seats)

Initial investment: $100k to $1M, board

Date	Company Name
Jul-95	Excite (@home)
Jun-96	Juniper
Apr-97	Cerent (Cisco)
Sep-98	Corio
Oct-98	Siara (Redback)
Apr-99	Asera
Jun-00	Centrata
Jan-01	Infinera

Initial investment: $2.5m to $16M

Date	Company Name
Apr-95	Concentric (XO)
May-96	Viant
Jul-96	Cybermedia
May-97	Extreme Networks
Apr-98	Silicon Spice
May-98	(Broadcom)
Jul-98	Corvis
Mar-99	Lightera (Ciena)
Sep-99	CoSine
Nov-99	BBO
Dec-99	Zaplet
Dec-99	Valiant
Dec-99	Zambeel
Jan-00	OnFiber
Mar-00	Coreon
Aug-00	Kymata (Alcatel)
Nov-00	Cenix
Jul-01	SS8
	Kovio

Red = Board Seat

	Aggregate Return*	Success Rate*
< $1M (n=8)	192.7 x	100%
> $1M (n=18)	4.5 x	67%
On board (n=16)	70.8 x	88%
Not on board (n=10)	8.0 x	60%

Takeaways

- Attention matters
- Board responsibility = better due diligence
- Quick money makers don't work
- Too many passive deals last few years
- One seed per year works for Khosla

* Numbers include current private companies at cost of fm

Venture Capital Is Bottlenecked in Scaling by Partner's Time, Top 10 Performing Funds of All Time < $250m

Fig. 4: Top 10 Performing Venture Funds

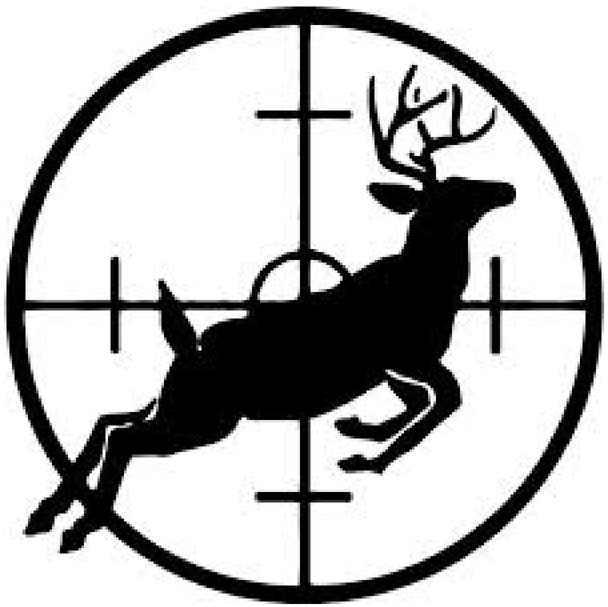
Rank	Fund	Fund Manager	Vintage	Fund Size (Mn)	Type	Net IRR (%)
1	Matrix Partners V	Matrix Partners	1998	200 USD	Venture (General)	514.3
2	Benchmark Capital Partners II	Benchmark Capital	1997	125 USD	Venture (General)	267.8
3	Matrix Partners IV	Matrix Partners	1995	125 USD	Venture (General)	218.3
4	Focus Ventures I	Focus Ventures	1997	106 USD	Venture (General)	213
5	Columbia Capital Equity Partners I-A	Columbia Capital	1989	73 USD	Early Stage	198.5
6	Mayfield IX	Mayfield Fund	1997	252 USD	Venture (General)	195.7
7	Columbia Capital Equity Partners I-B	Columbia Capital	1995	90 USD	Early Stage	192.3
8	Accel V	Accel Partners	1996	150 USD	Venture (General)	188.4
9	Celtic House International Corporation	Celtic House Venture Partners	1998	241 USD	Early Stage	180.1

Understand the Psychology of a VC

The VC-Entrepreneur Dance

- VC’s are hunters, psychologically.
  - They will look at 1000’s of pitches, and only fund a small handful
  - They know there are countless other VC’s so they are constantly thinking:
    - Are you any good?
    - If you are good, why do I have an advantage here over other VC’s
    - What’s my strategy in investing in you
      - contrarian bet – large ownership -- Hotmaill;
      - pay up for a winner – Google

Be a Frolicking Deer: Signal Strength AND Access



VC-Entrepreneur Dance

The entrepreneur's greatest asset is your Scarcity of Equity Supply

You only can take 1 or 2 VC's

Your valuation is driven by the marginal value of the investors you raise from, not the average

Everything you do should be around restricting supply:

* Do Coffee's Not Pitches
* Interview VC's
* Pitch A LOT OF VC's, of all types (at least 35!)

Separate out in your mind sources of CASH, ADVICE, and GOVERNANCE/CONTROL

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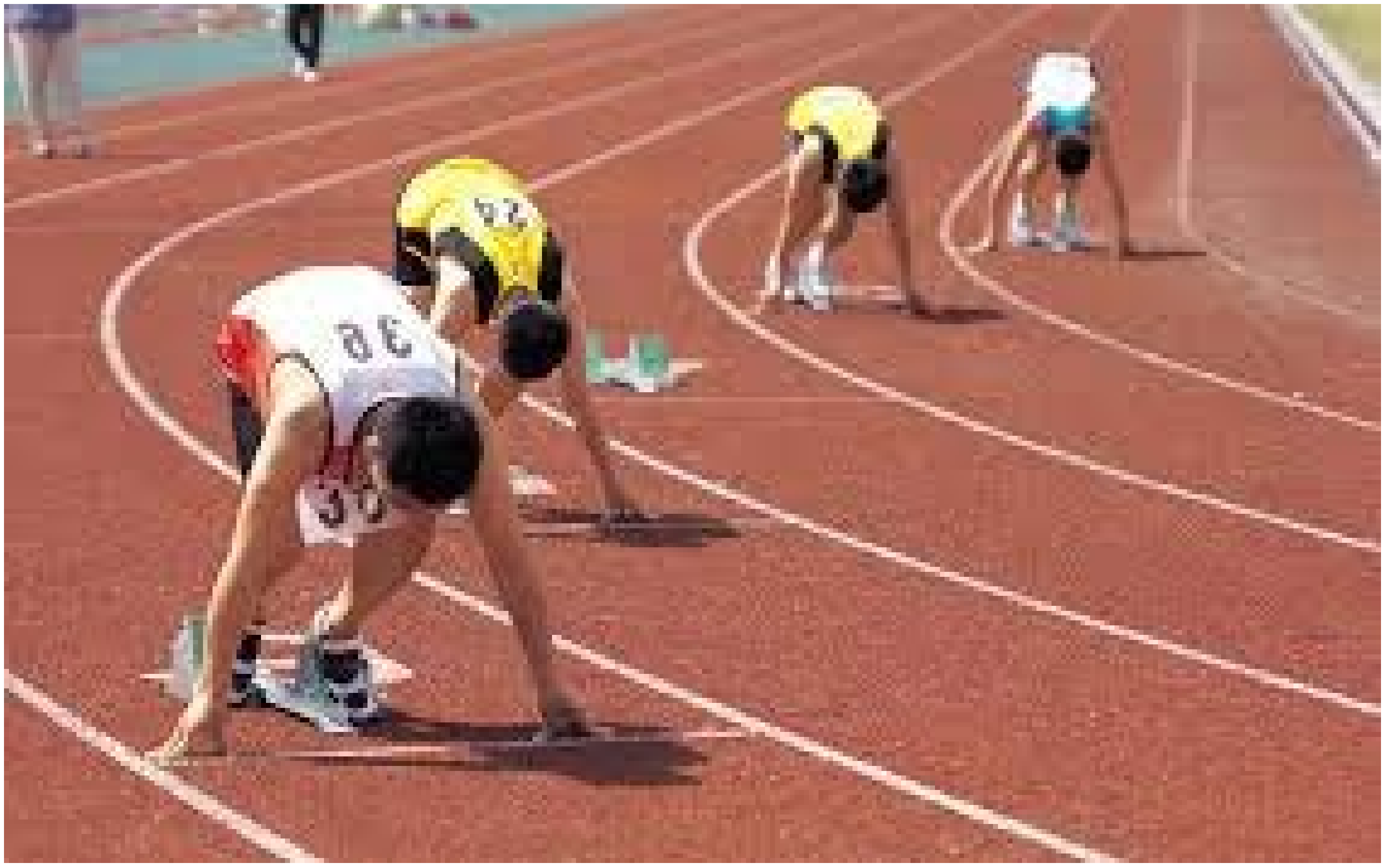
Get Ready for the Race



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Can be a Hard Fight: Companies that received 0 or 1 term sheet from VC's

Basics of a Pitch

- Team
- Market (Size, growth)
- Product (Succinct description) & Demo
- Traction
- Competition and Advantage
- Unit economics (acquisition, retention, monetization)
- Revenue model and financial projections
- Capital needed and use of proceeds
- Exit Strategy
- Risks & Responses

Raise off of Potential

OR

Raise off of Results

VC's are not all the same: the best entrepreneurs cater the pitch to the VC

* B-button : Set context, find out your VC's questions before you start talking, read what they are like

* Minimal Deck with Thick Appendix

•Ask them about their successes, not failures (they may associate you with success)

Biggest Issues are typically TEAM and MARKET

- Pay attention to these issues the VC's may be thinking:
  - YOU: Do I like you? Do I want to spend 5 years with you as a person? Are you passionate? AND Are you coachable?

- Bi-Focal challenge. Best Pitches address both:
  - MARKET: Big enough
  - MARKET ENTRY: Clear, specific, sellable

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Valuations: Just ONE term…

Pre-Money vs. Post Money

Valuations in Early Raises are NOT based on intrinsic value.

They are driven by the ownership needs of the funds you raise from and the cash needs of the company

Post – Money Valuation = Cash Needs of the Company / Ownership Needs of the Fund

Larger Funds are Much More Sensitive about Ownership Needs than Cash Needs!

Series A : Raising off of the IDEA
Series B: Raising off of RESULTS

Trick is balancing the Series A valuation to set you up so you can raise off of Results in the Series B at a markup (ideally 3x!)

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Employee Pool

- Employee Pools typically come out of the PRE-MONEY – that is YOUR Total Dilution is the NEW INVESTOR's money PLUS the Employee Pool

- Can always expand the employee pool later – and when you do, all will be diluted equally. Try to minimize the employee pool to what's absolutely needed.

- Exercise: You own 40% of a company. A VC wants to put in $2m for 25% of your company, and requires a 20% employee pool post-money.
    - What's the Post-Money Valuation?
    - What percent of the company do you own afterwards?

Advice for Entrepreneurs

Be Bifocal

Raising the first $150K is Do-able; Need a Strategy to Source the Next Million (or $25 million)

- **Build a Great Team**
- **Focus passionately on getting to Product-Market Fit**
- **For companies that don't get to Product-Market Fit, find quit exits (acquihires) which can be mutually meaningful**
- **For companies with Product-Market Fit, develop a path to going to financing centers (Silicon Valley, London, Berlin, New York) AND leverage your home base as a competitive advantage**

Get funding from a fund with an individual GP you trust, a fund size that matches your exit, and a fund with the resources to help you build

- **Can’t divorce a VC**

- **ALIGN incentives:**
  - **Valuation is JUST ONE TERM**

  - **VC’s need to return a 1/3 of their fund with each investment, and will operate against that**

- **Diligence your fund by asking for references from other CEO’s the fund has backed**

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The bigger the vision, the more resources are available to help you

- **Early valuation not based on traction. Valuation = Cash Divide BY VC’s ownership needs.**
- **VC’s are cash insensitive if the vision is big enough.**
- **Series B will be judged based on results. So plan things out – be bifocal.**

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Dziękuję!

Ravi.Belani@gmail.com

Twitter: @Rbelani

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