

Dreams to Dollars

An Introduction to Venture Capital

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March 24, 2005

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Venture Capitalists:

- **Finance new, rapidly growing companies**
 - Purchase equity securities
 - Have a long-term perspective
 - Seek higher returns

- **Actively participate in the company**
 - Frequently are members on the board of directors
 - Assist in the firm's development strategies
 - Recruit executive management

Famous companies funded with venture capital: Apple, Cisco, Compaq, eBay, Federal Express, Genentech, Google, Intel, Microsoft, Sun, Yahoo

• Domestic

- Foundations
- Endowments
- Pension Funds
- Fund of Funds
- Corporate
- Individuals, Families

• International

- Funds of Funds
- Corporate
- Individuals, Families

Venture is considered an Alternative Investment

Raising Venture Capital

- **Develop complete business plan including capital needs and future cash flows to return the investment**
- **Identify the VC firms that focus on your area**
 - Industry
 - Geography
 - Investment stage (Seed, Early-Stage, Expansion)
 - Size of Investment
- **Leverage available resources & network to reach your targets**
 - Professional organizations (www.NVCA.org, www.tie.org)
 - Investment conferences (www.tiecon.org, www.vcsummit.com)
 - Other entrepreneurs
 - Customers
 - Industry contacts
 - Advisors

- **Pitch presentation to venture capital firm**
- **Assist venture firm with initial exploratory work**
 - Team References
 - Technical/Market Diligence
 - Customer Validation
- **Negotiate term sheet**
- **Complete detailed due diligence**
- **Build investor syndicate**
- **Close financing and fund company**

Key Elements of a Fundable Plan

- **Capital efficiency**
- **Company/Business not just product focus**
 - Point products and technologies are not credible investment opportunities today
- **Management/Technical expertise**
 - Specific domain expertise a must
 - Complete teams are desirable
- **Growing market or large markets undergoing transition**
 - Strong customer pull

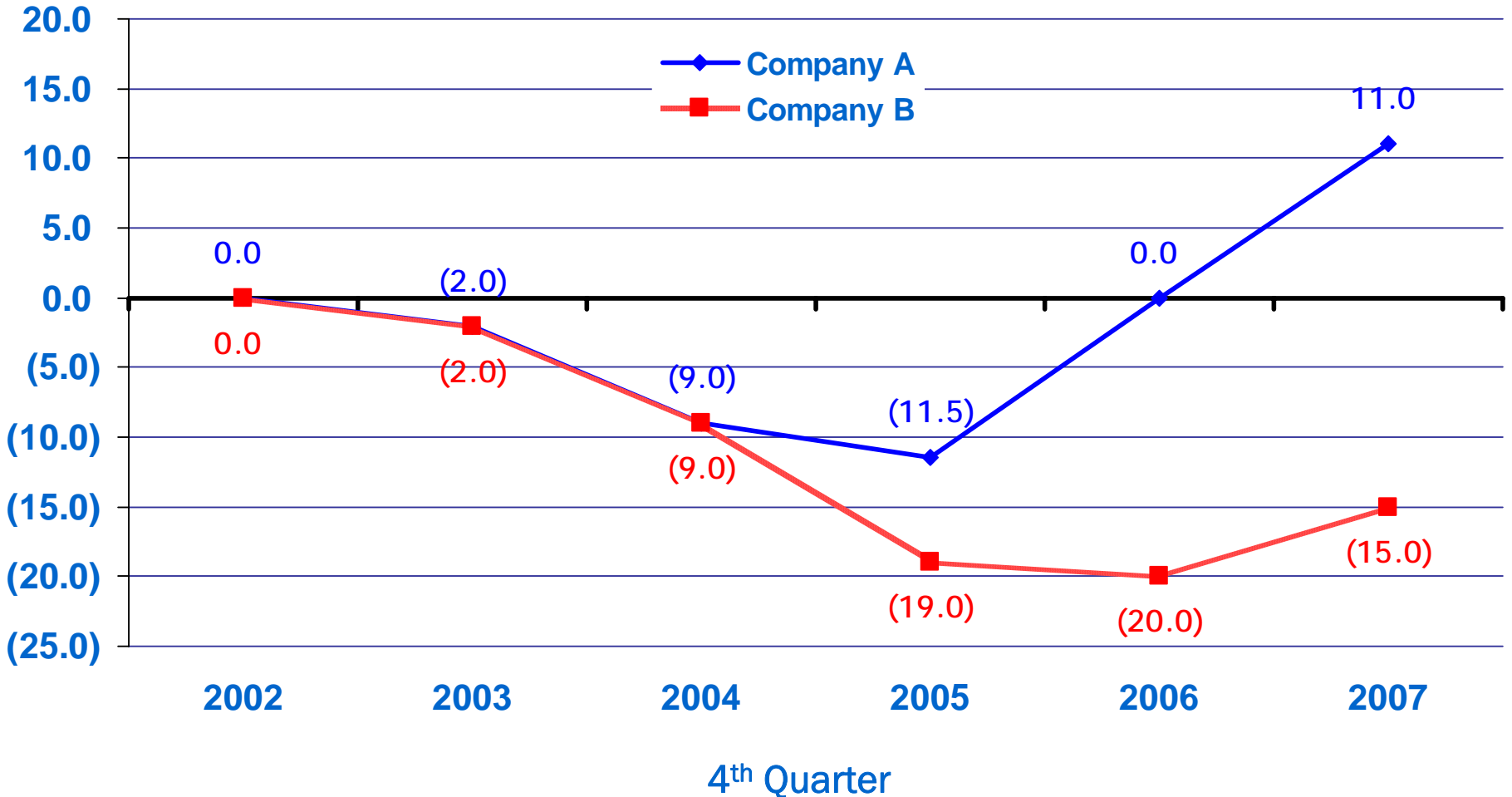
Patience / Passion / Experience are the new entrepreneurs' currency instead of Speed / Recruiting Ability / Marketing

A Simple Valuation Formula

- **VCs look for 10X return on investment (I)**
 - Where I is the investment required to get to positive cash flow
- **Exit valuation: n times revenue (R) at exit**
 - Where “n” is determined by industry segment and expected exit strategy – IPO or acquisition
 - n typically ranges from 3 to 10 times forward revenue
- **Investors must own a certain percentage of the company for a deal to be attractive:**

$$\text{Investor Ownership} = \frac{10 \cdot I}{n \cdot R}$$

Company A vs. Company B Cumulative Cash Flow



Forecast from Business Plan

	2005	2006	2007	2008	2009
Revenue (\$M)		1.5	6.0	15.0	30.0
Cum Cash Flow (\$M)	(2.0)	(9.0)	(12.0)	0.0	11.0

Values for Formula

Multiple of Revenue for Company Valuation	6
Return Requirement Multiple	10
Venture Investment (\$M)	12.0

$$\text{Investor Ownership} = \frac{10 \cdot 12}{6 \cdot 30.0} = 66\%$$

Forecast from Business Plan

	2005	2006	2007	2008	2009
Revenue (\$M)		1.5	6.0	12.0	30.0
Cum Cash Flow (\$M)	(2.0)	(9.0)	(19.0)	(20.0)	(15.0)

Values for Formula

Multiple of Revenue for Company Valuation	6
Return Requirement Multiple	10
Venture Investment (\$M)	20.0

$$\text{Investor Ownership} = \frac{10 \cdot 20.0}{6 \cdot 30.0} = 111\%$$

PROS

- Professional Investors
- Dedicated
- Domain Expertise
- Broad Network
- Fat Playbook
- Deep Pockets
- Driven by Financial Return

CONS

- Not Personal
- Micromanagers
- Biased thinking
- No room for brother-in-law
- Conventional Thinking
- Short hands
- Driven by Returns only

- **To complete a deal, entrepreneurs need to be very focused on:**
 - Delivering a very compelling value proposition
 - Constructing a business plan that minimizes equity capital
 - Meeting funding milestones within cash and revenue projections
- **Historically, this point in the cycle has been a great time to launch companies**

Thank You
Comments, Criticisms, Feedback ??



Venture Statistics

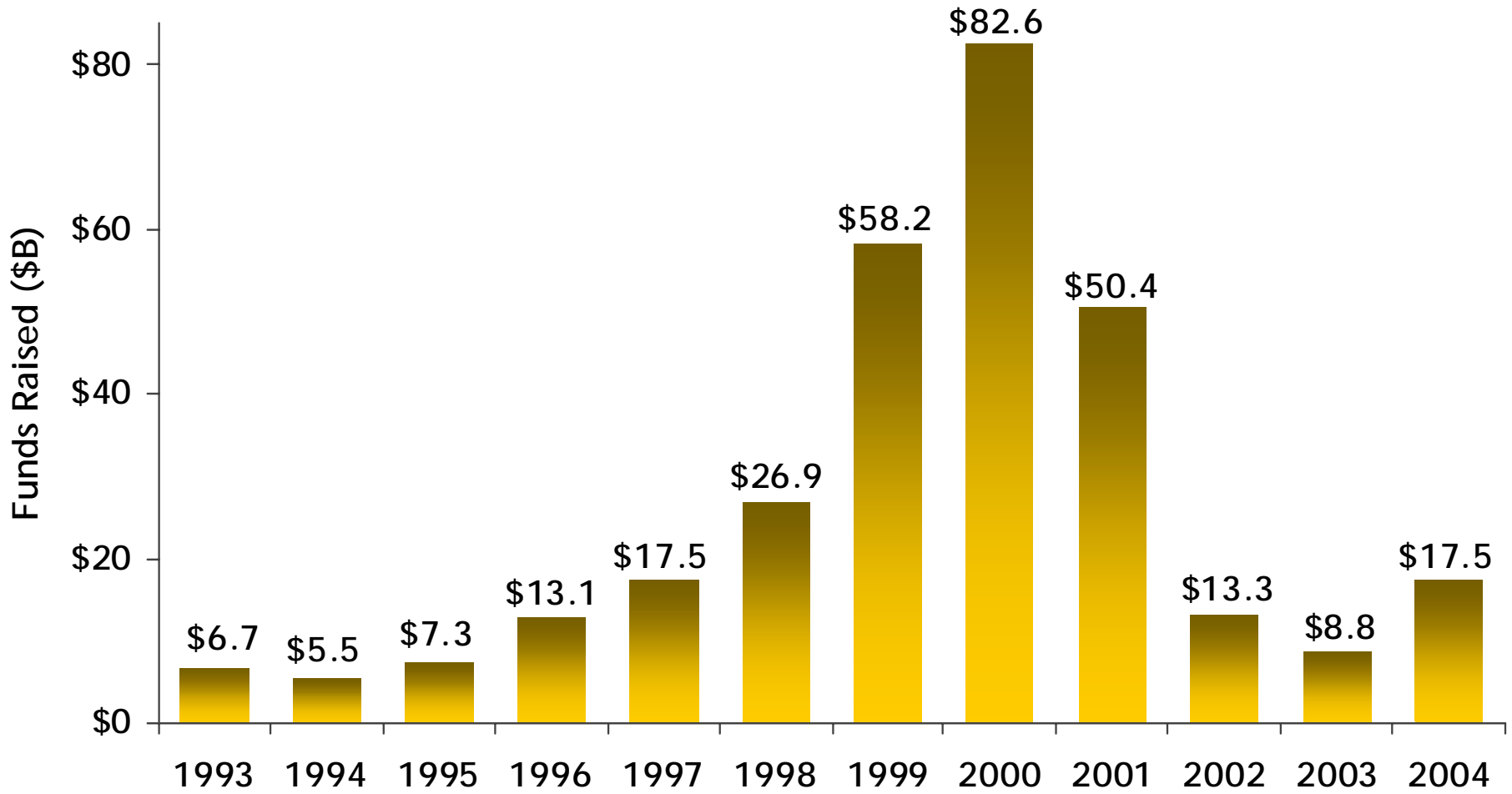
Source: Venture One

US Venture Industry Has Grown

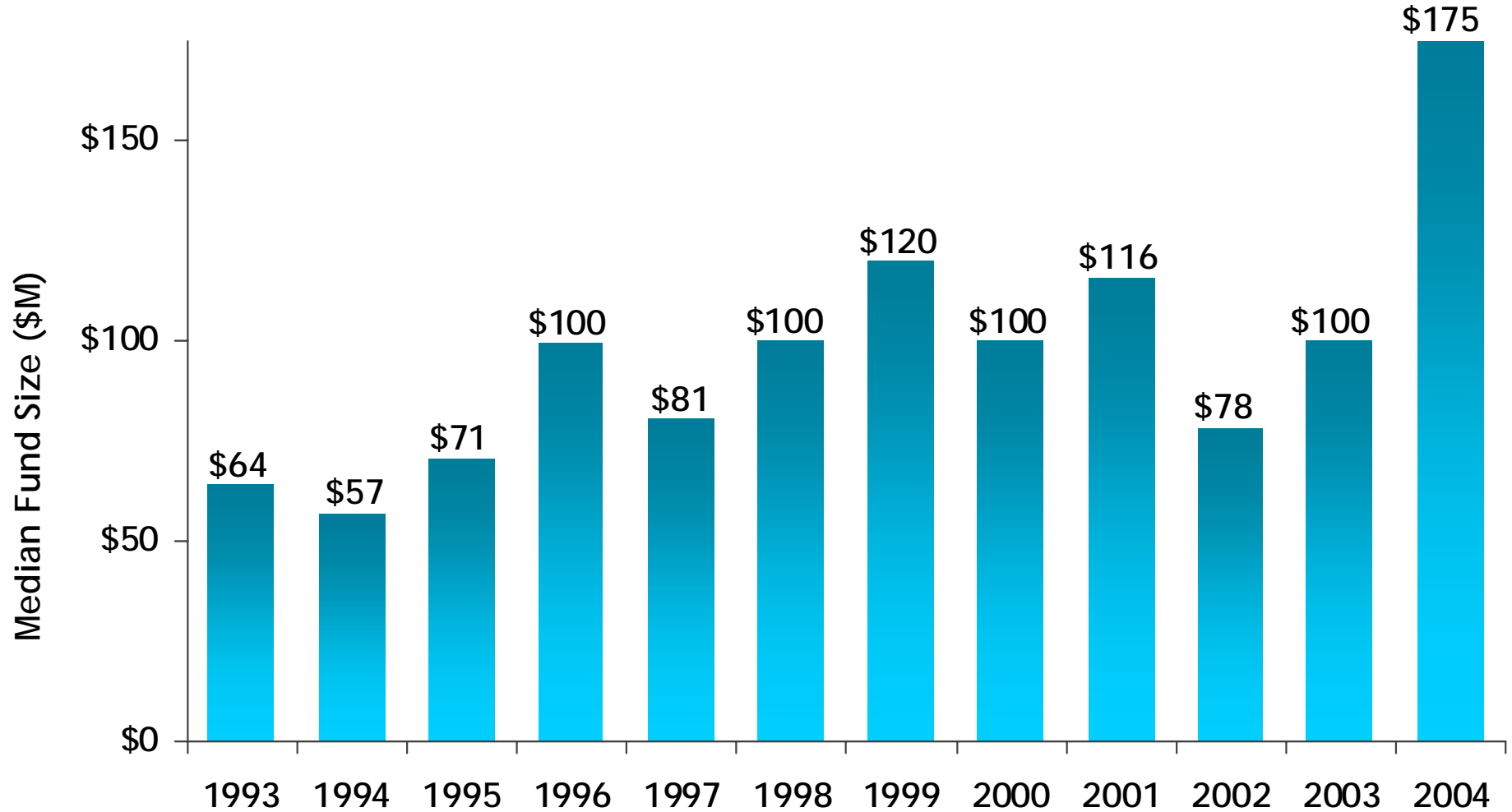
<i>At Year End</i>	<i># Venture Firms</i>	<i>Capital Under Mgt</i>
1970	28	\$1B
1980	89	\$4B
1990	399	\$31B
2001	943	\$257B
2003	919	\$257B

Source: 2004 NVCA Yearbook, prepared by Venture Economics, page 18

Fundraising in 2004 at '97 Levels *Commitments to Venture Capital Funds*

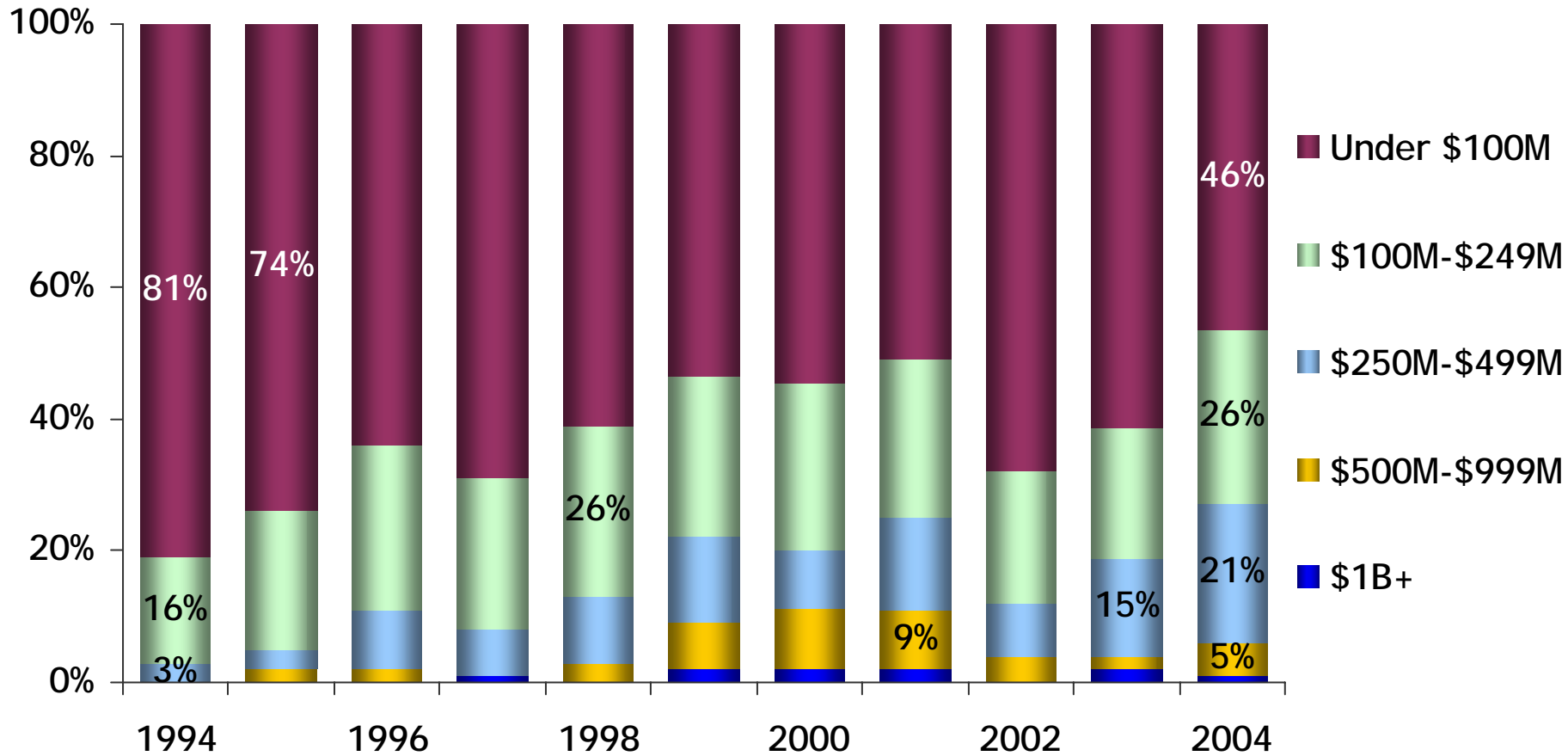


Established Players Raise in '04, Raise Median *Median VC Fund Size (for funds greater than \$20M)*



Majority of Funds Closed > \$100M in Size

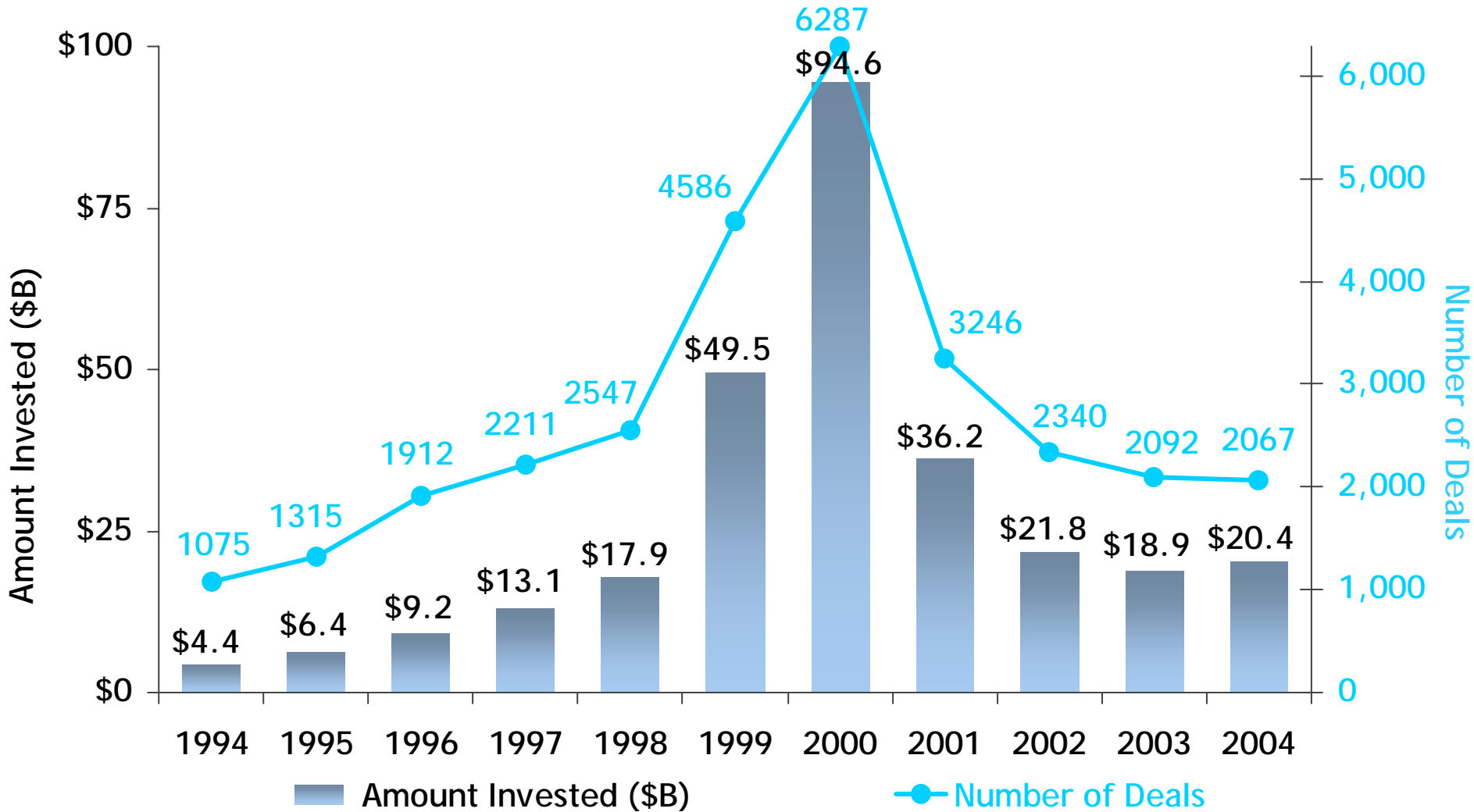
Allocation of Fund Size by Number of Funds Raised per Vintage Year





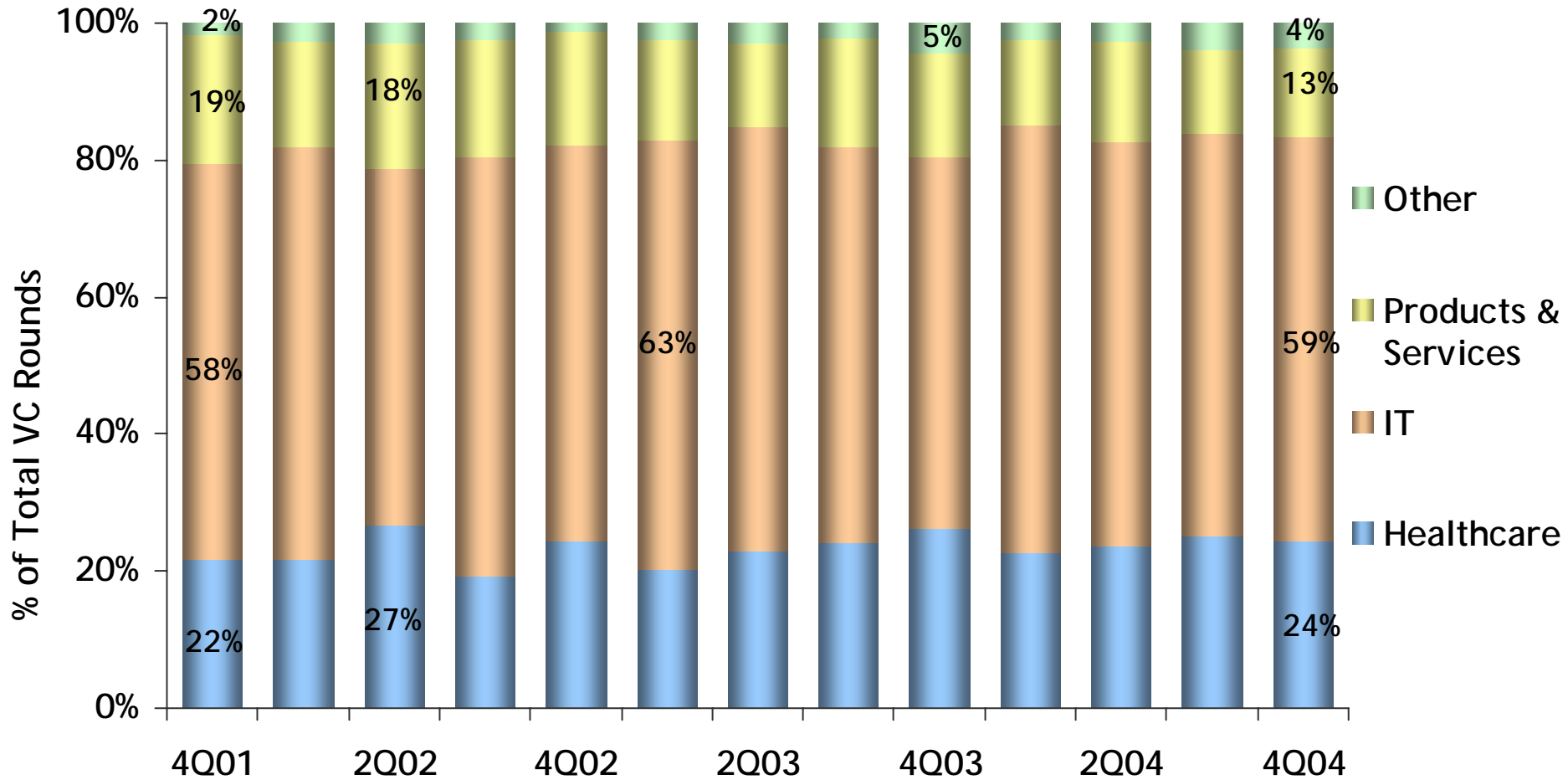
After 3 Down Years, Investment Rises in '04

Deal Flow and Equity into Venture-Backed Companies



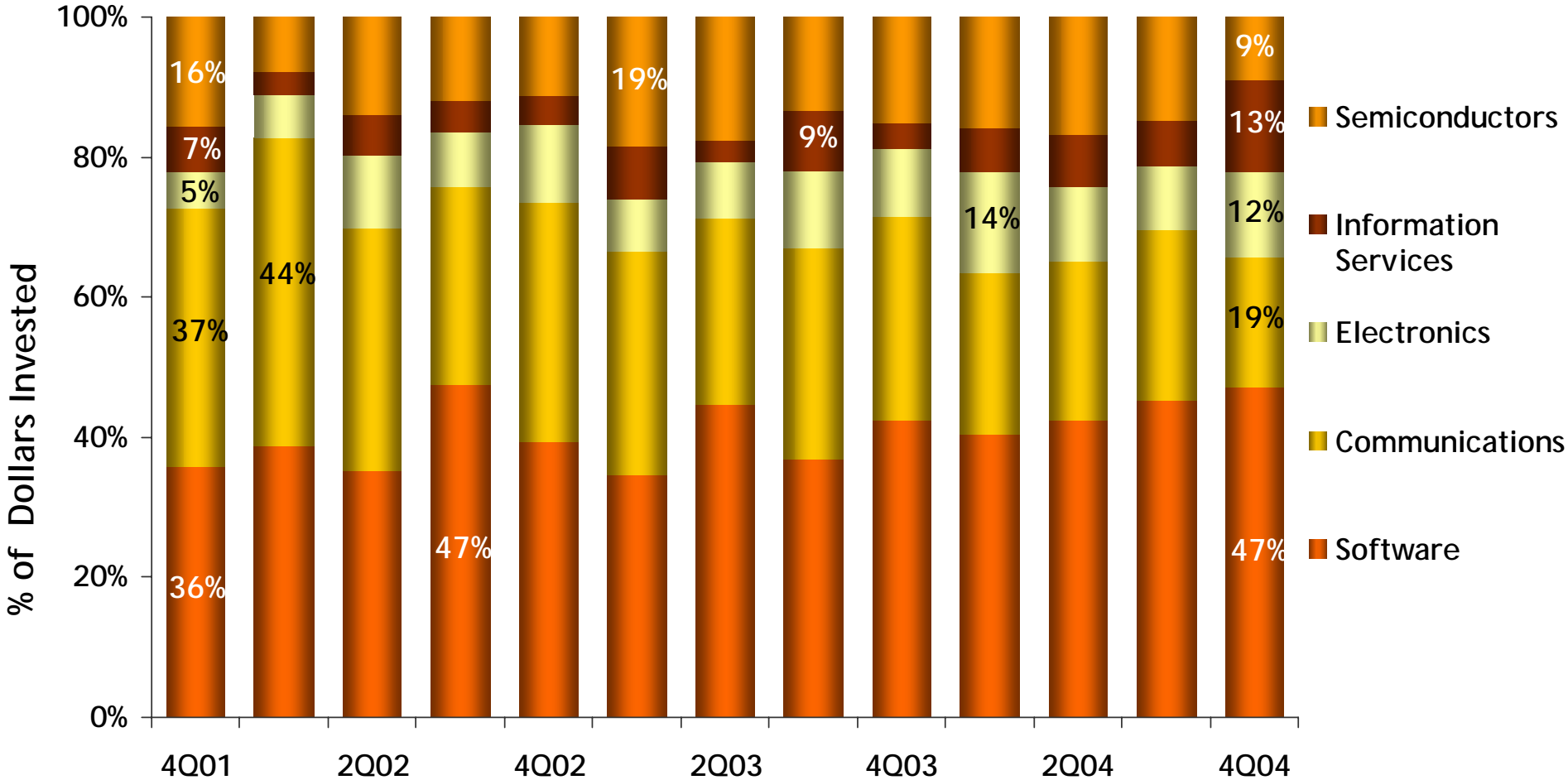
Deal Flow Maintains Typical Division

Deal Flow Allocation by Industry Sector



Software Increases its Share of IT Pie in 2004

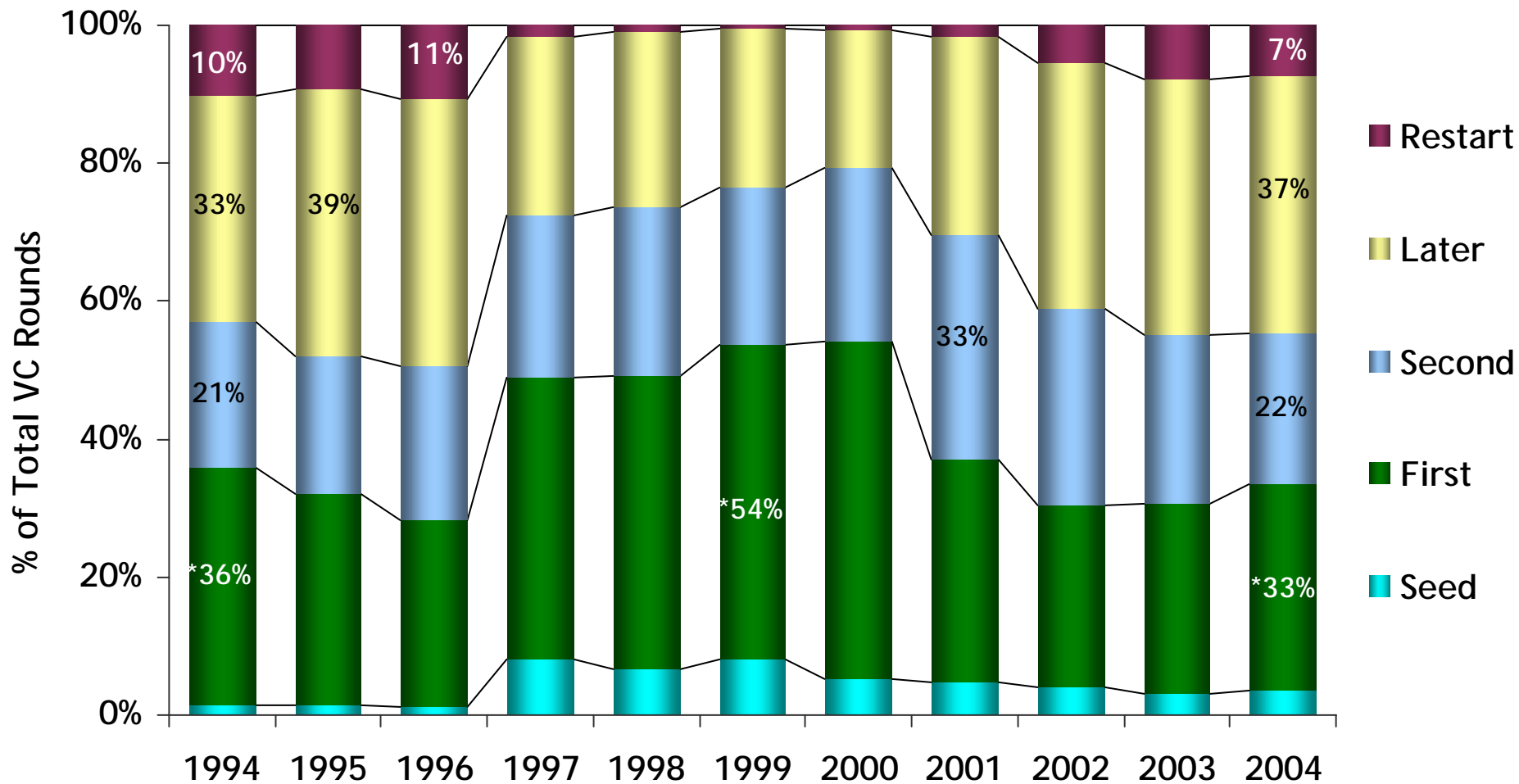
IT Investment Allocation by Sector



Round Allocation Back to Mid-'90s Levels

Deal Flow Allocation by Round Class (Annual)

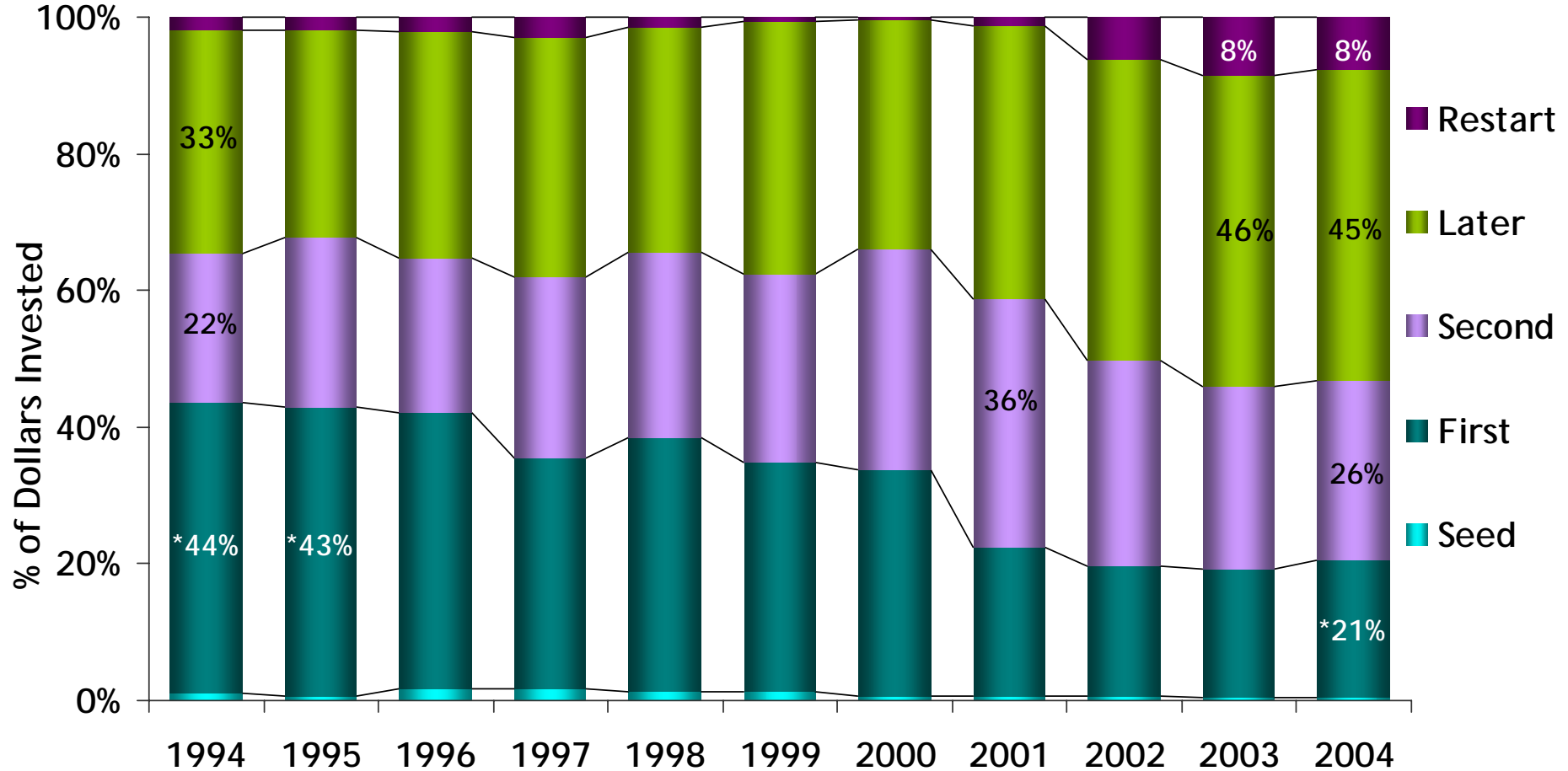
*Seed and First Rounds Combined



Most Dollars Directed at 2nd & Later Rounds

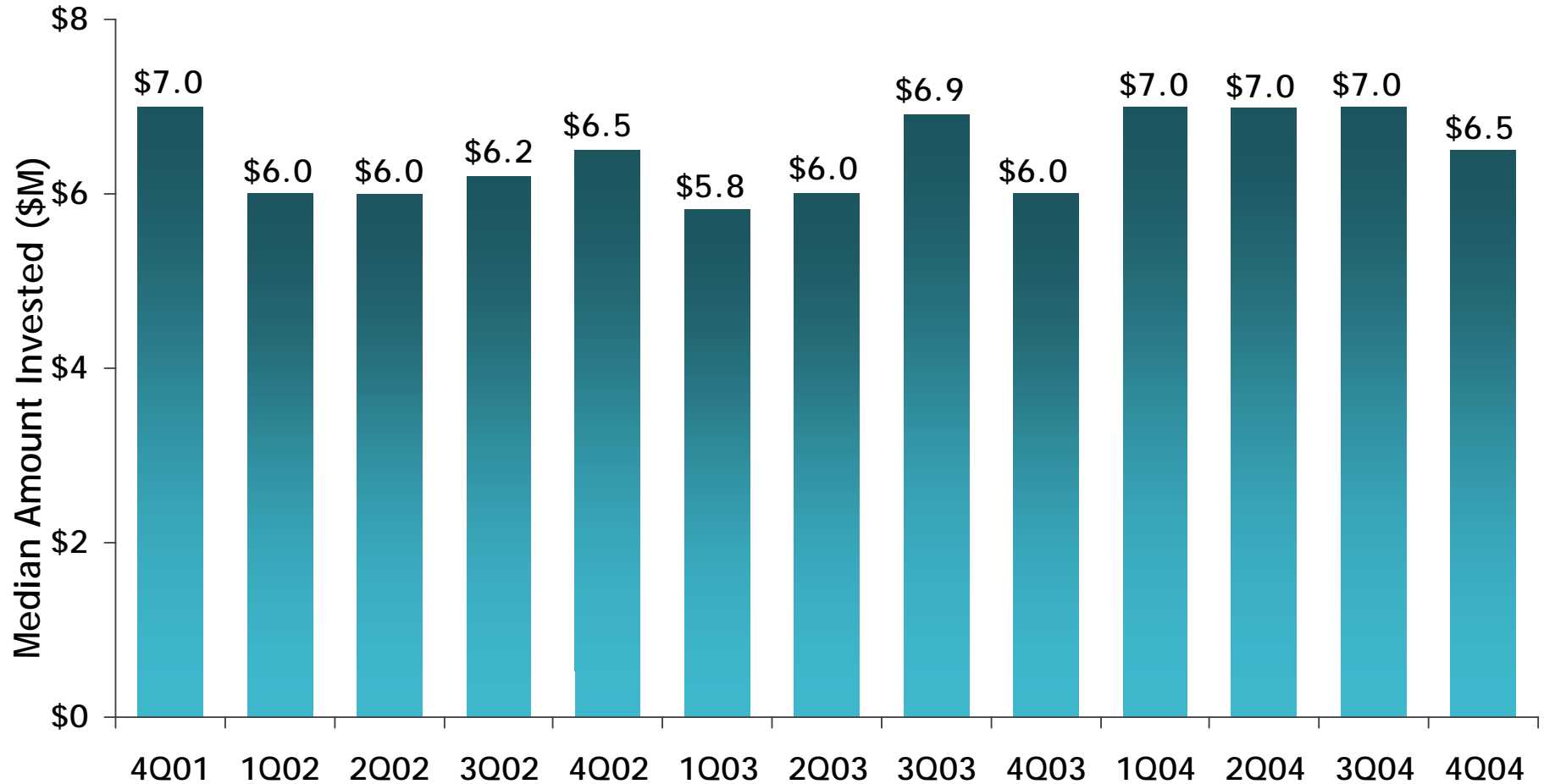
Investment Allocation by Round Class (Annual)

*Seed and First Rounds Combined



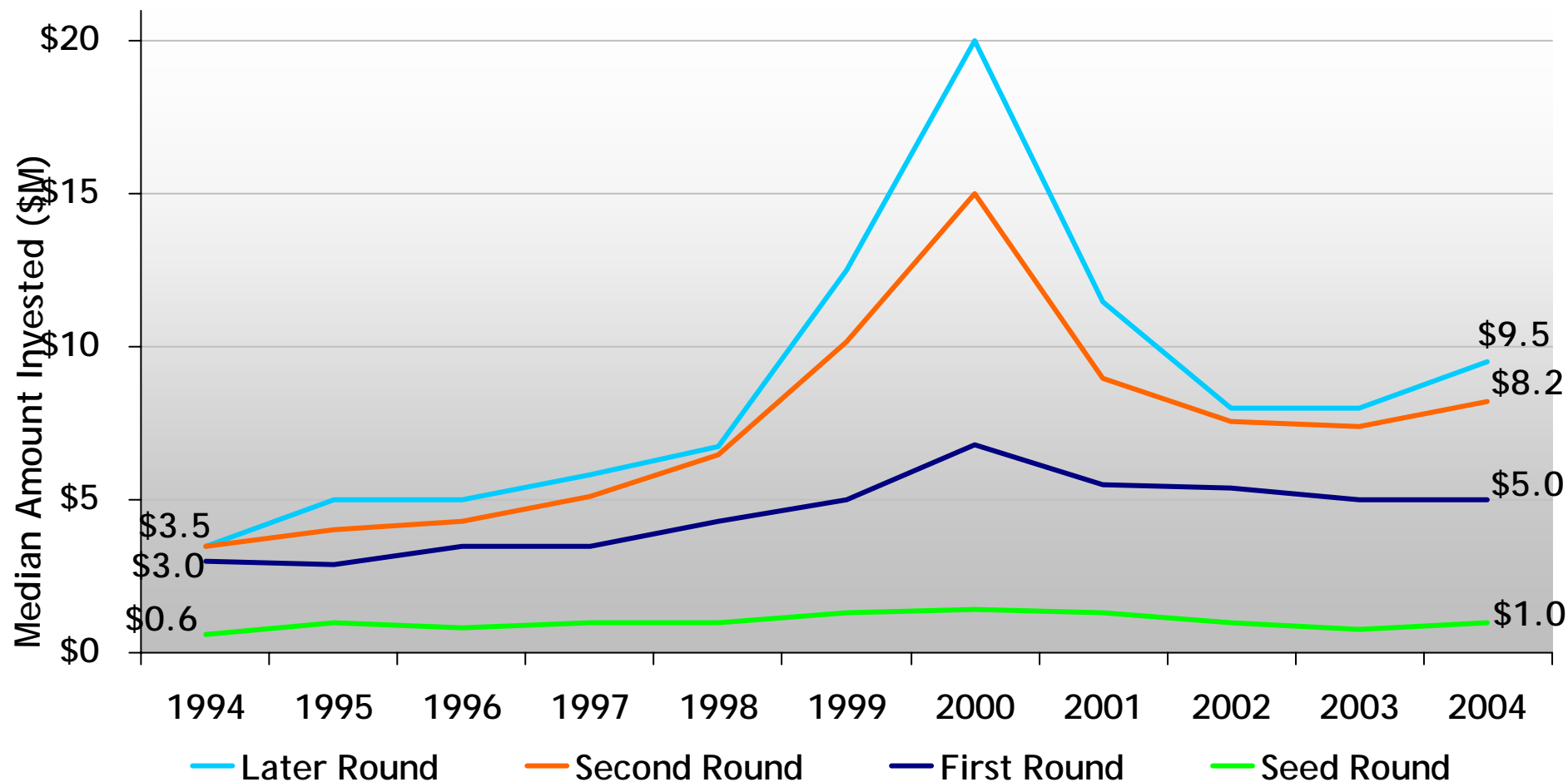
Median Deal Size Consistent in 2004

Median Amount Invested Per Financing Round



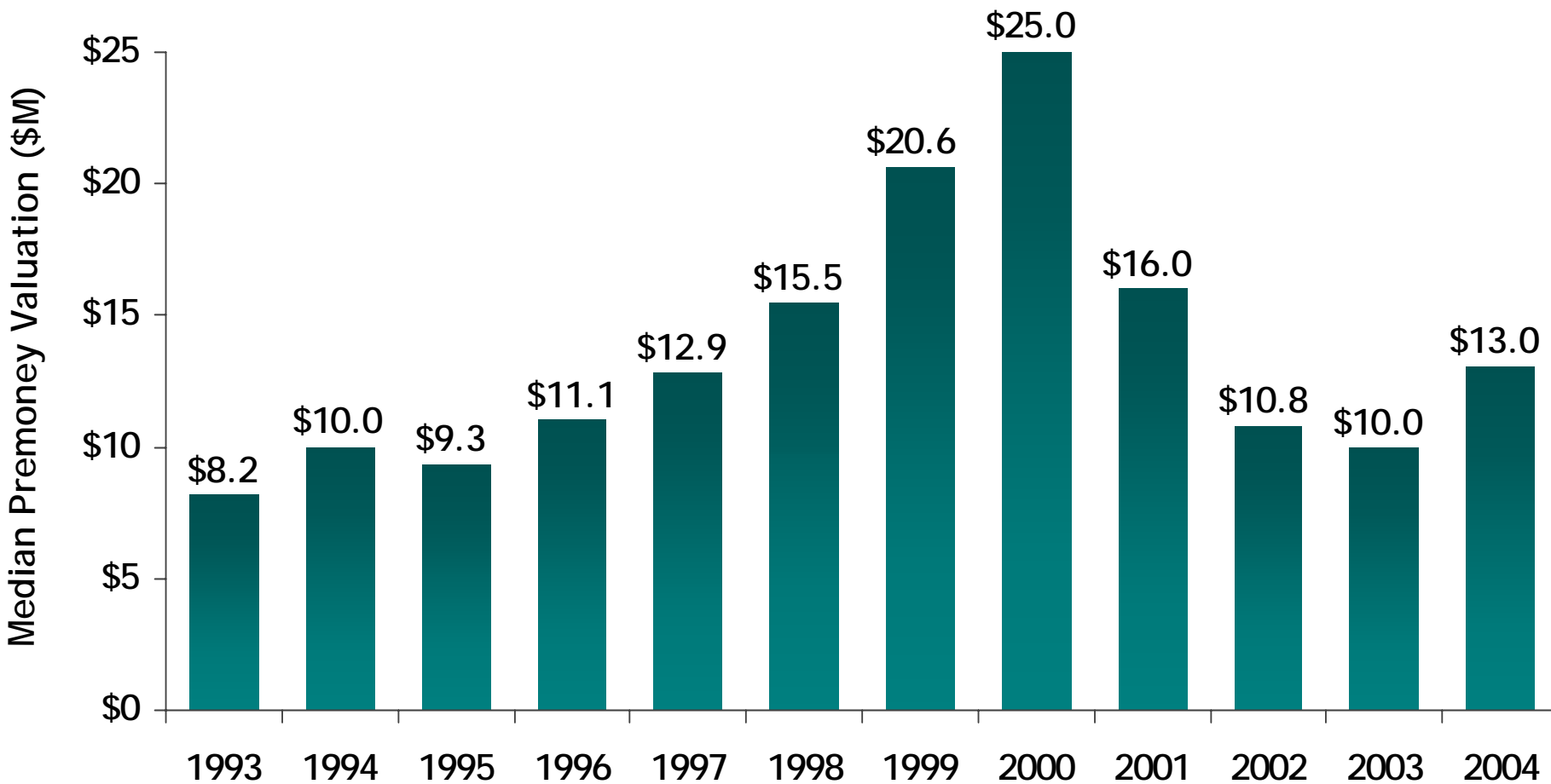
2nd & Later Stage Rounds Larger in 2004

Median Amount Invested by Round Class (Annual)



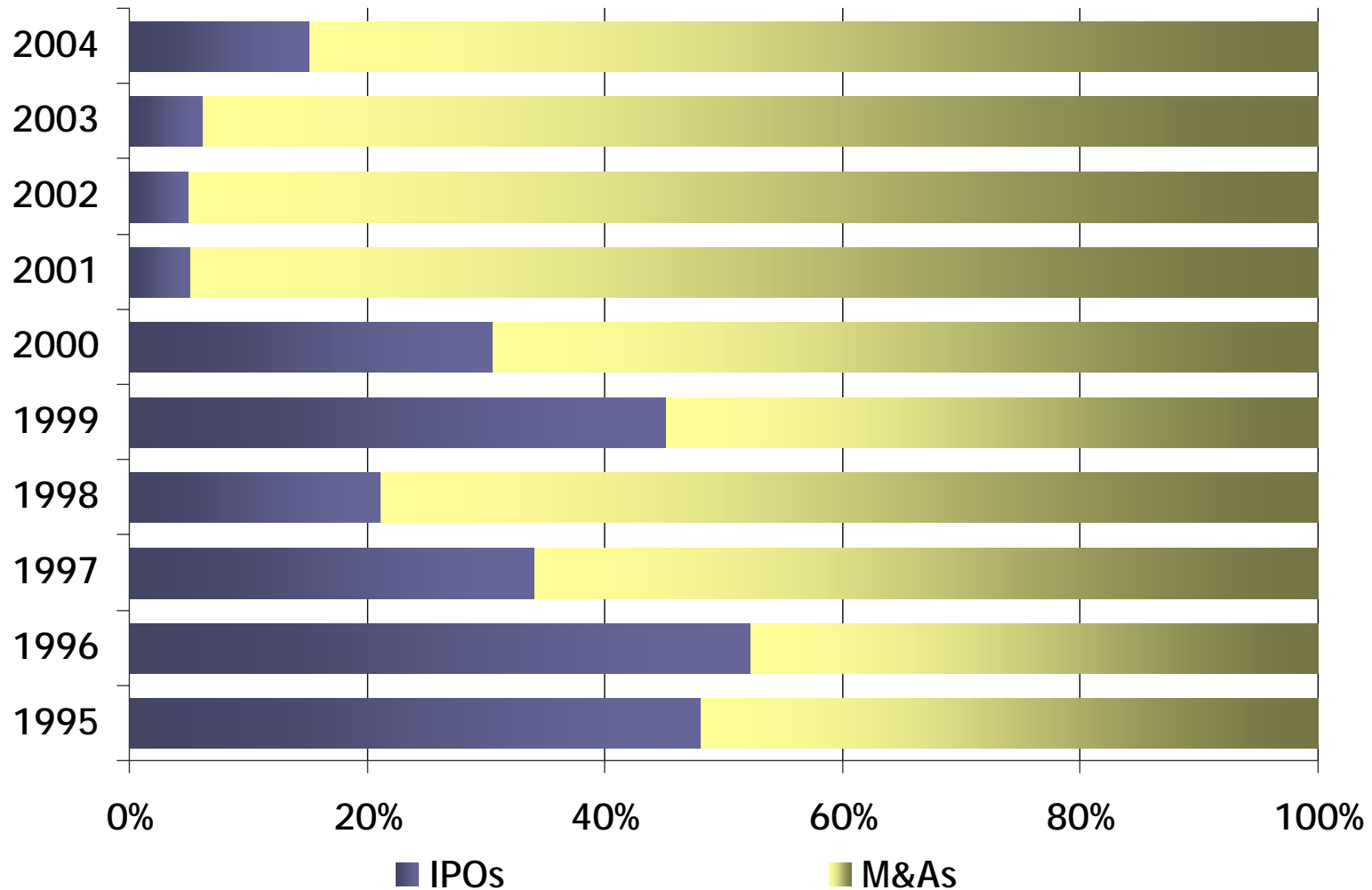
Valuations Rise to Pre-Bubble Levels in 2004

Median Premoney Valuation by Year



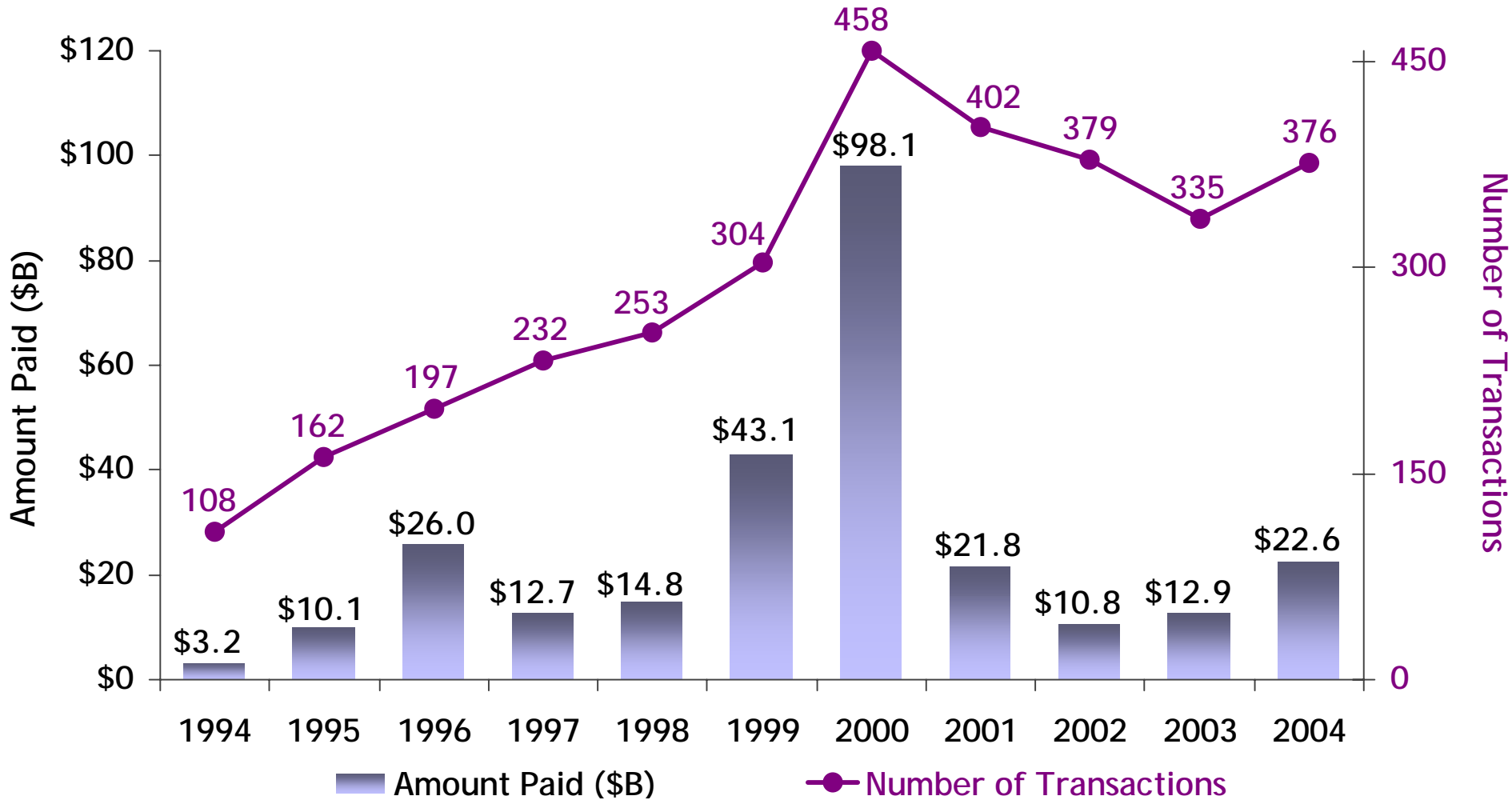
Despite 2004 IPO Revival, M&A Still Most Likely Exit

% Breakdown of Venture Backed Liquidity Events: IPO vs. M&A



Acquirers Pay Higher Prices for M&As in 2004

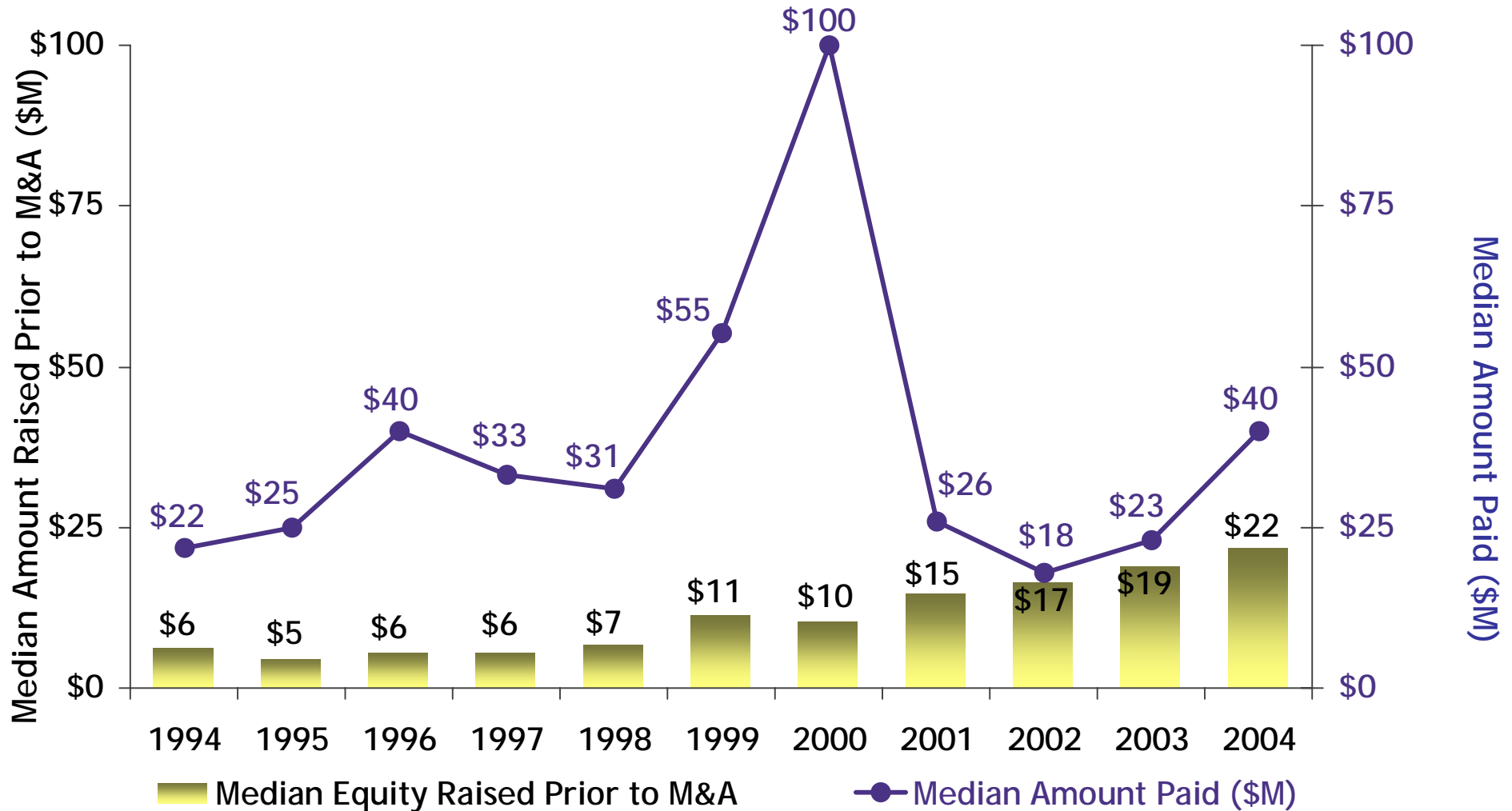
Transactions and Amount Paid in M&As

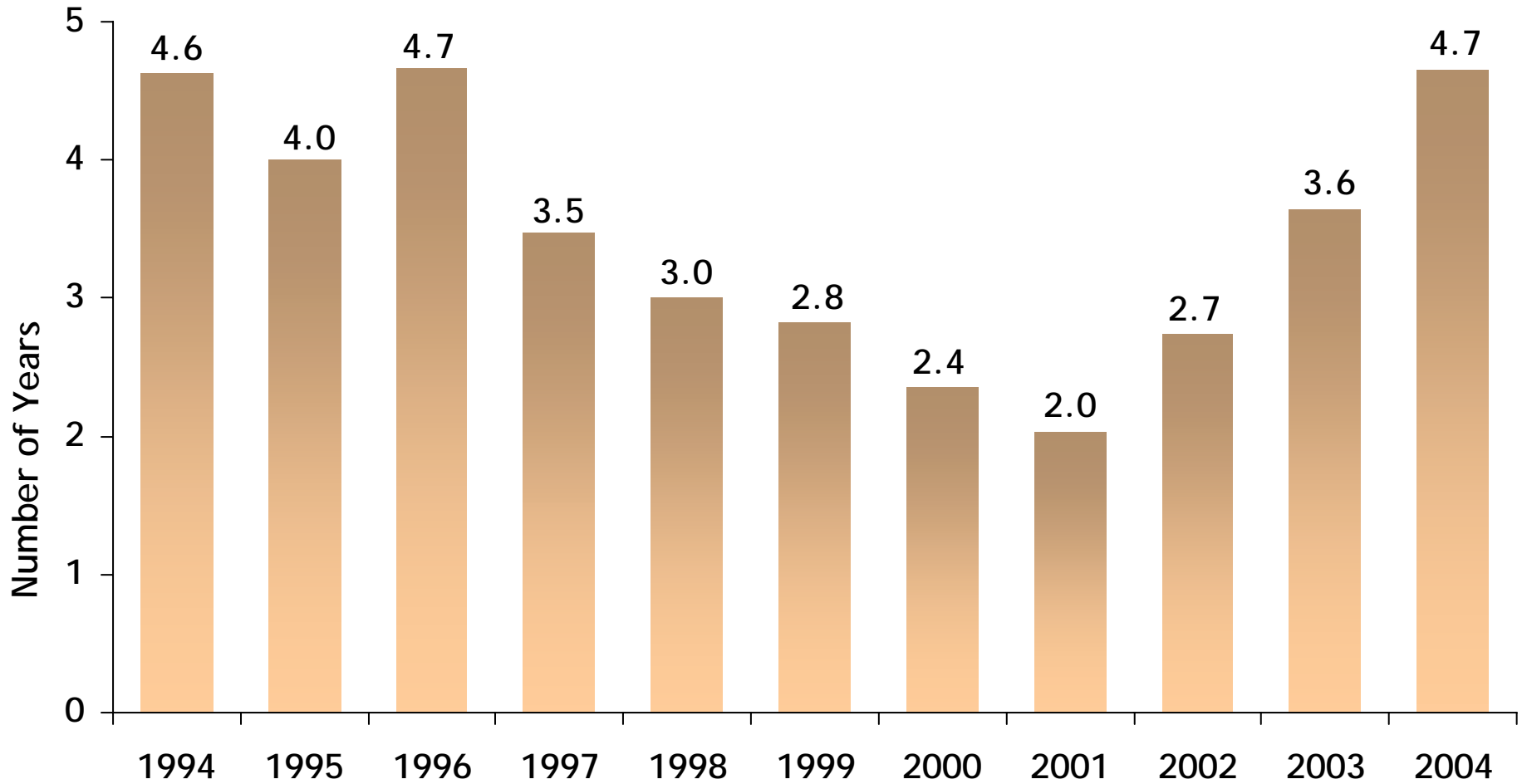




Gains from M&A Exits Return, Mirror '01 Levels

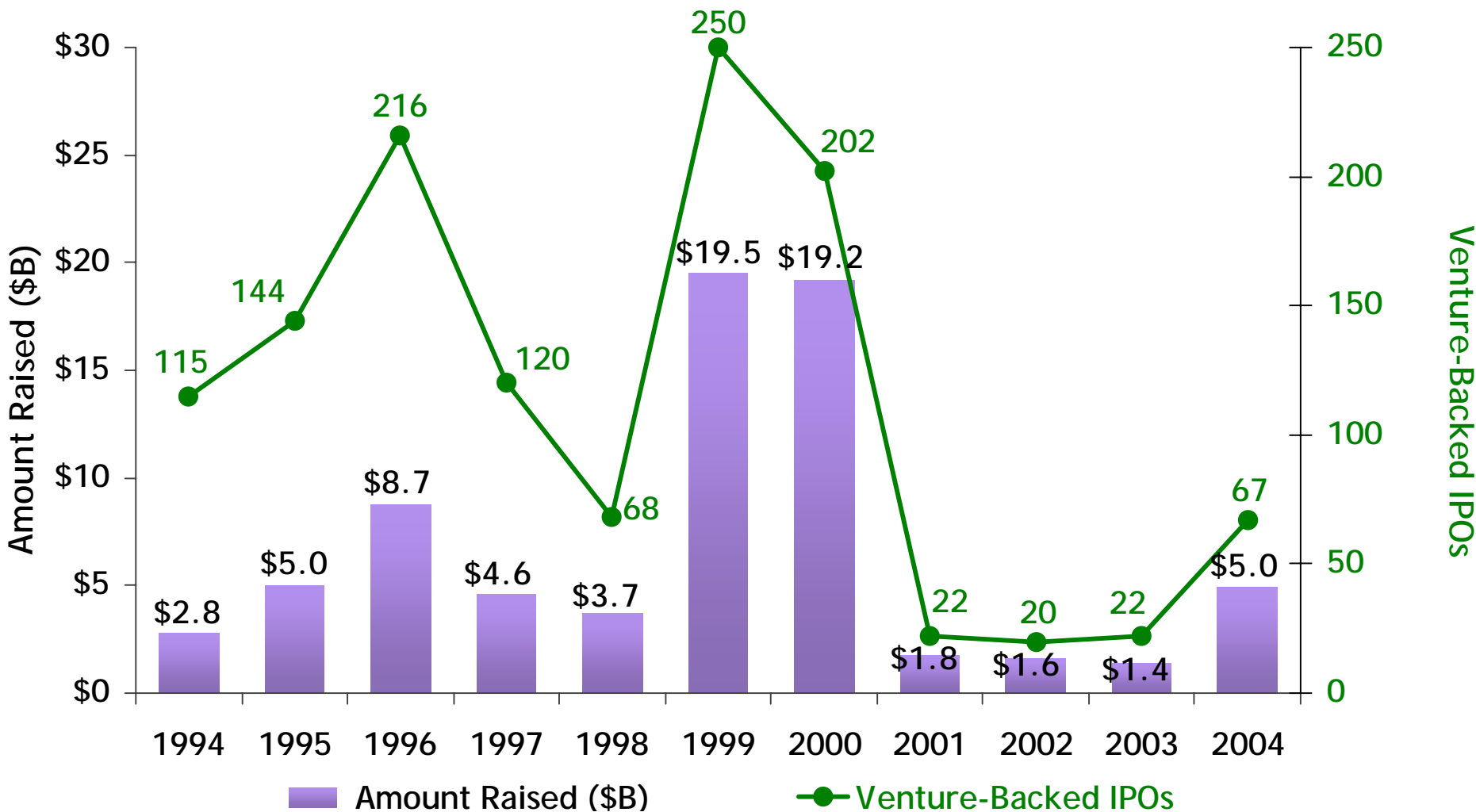
Median Amount Paid in M&As vs. Median Amount Raised Prior to M&A





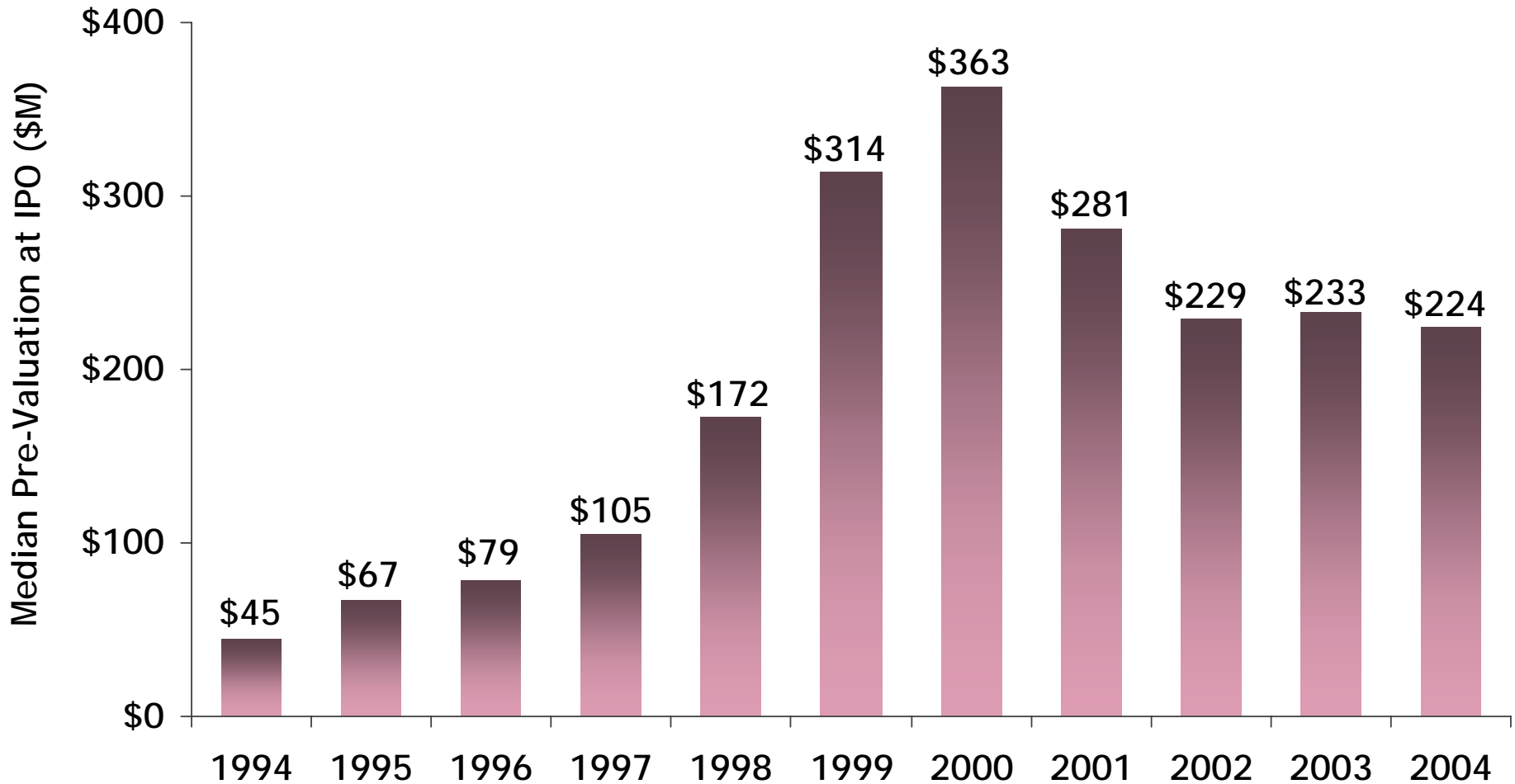
IPO Market Recovering from Historic Lows

Deals and Amount Raised Through IPOs



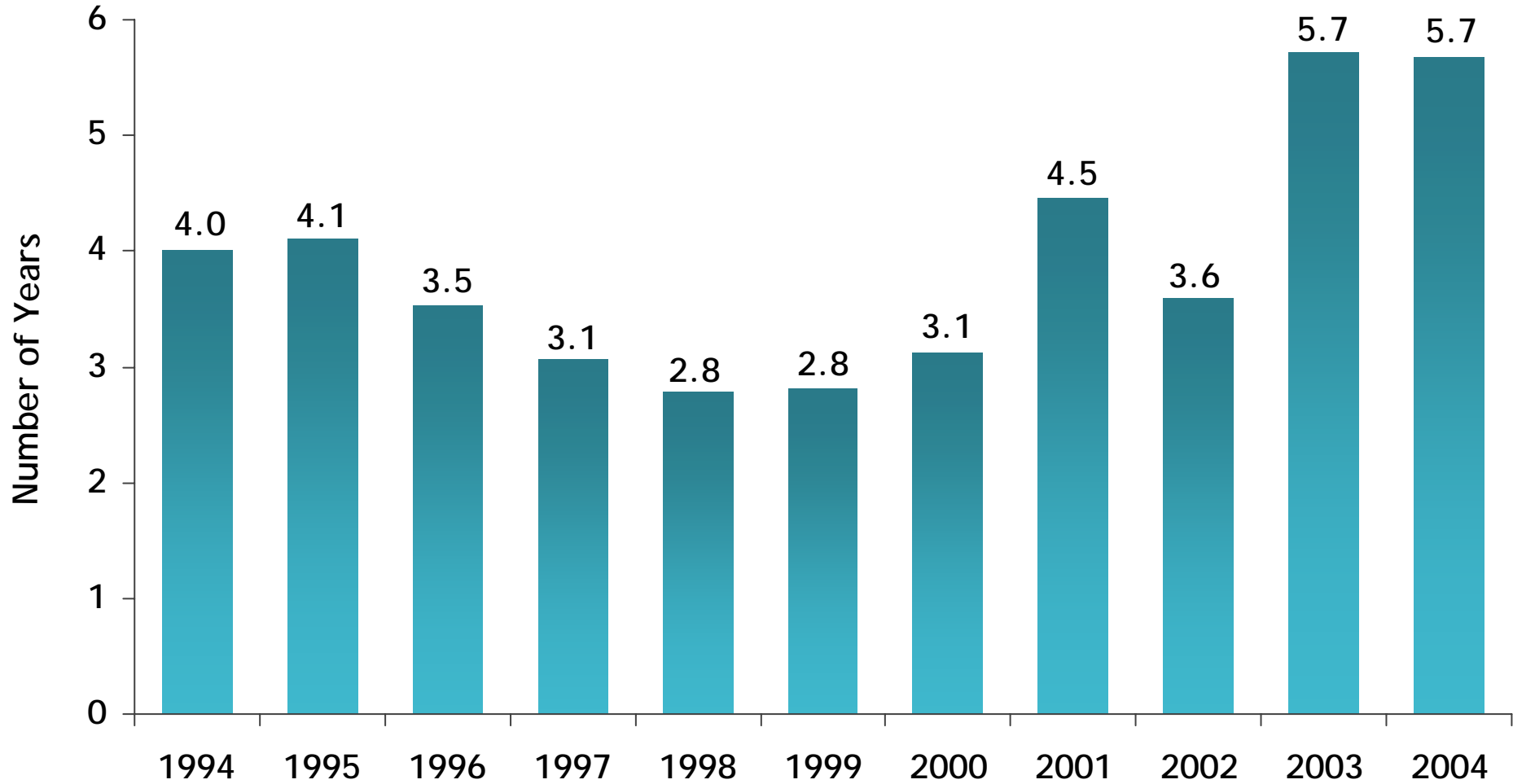
IPO Valuations Remain Steady

Median Pre-Valuation at IPO



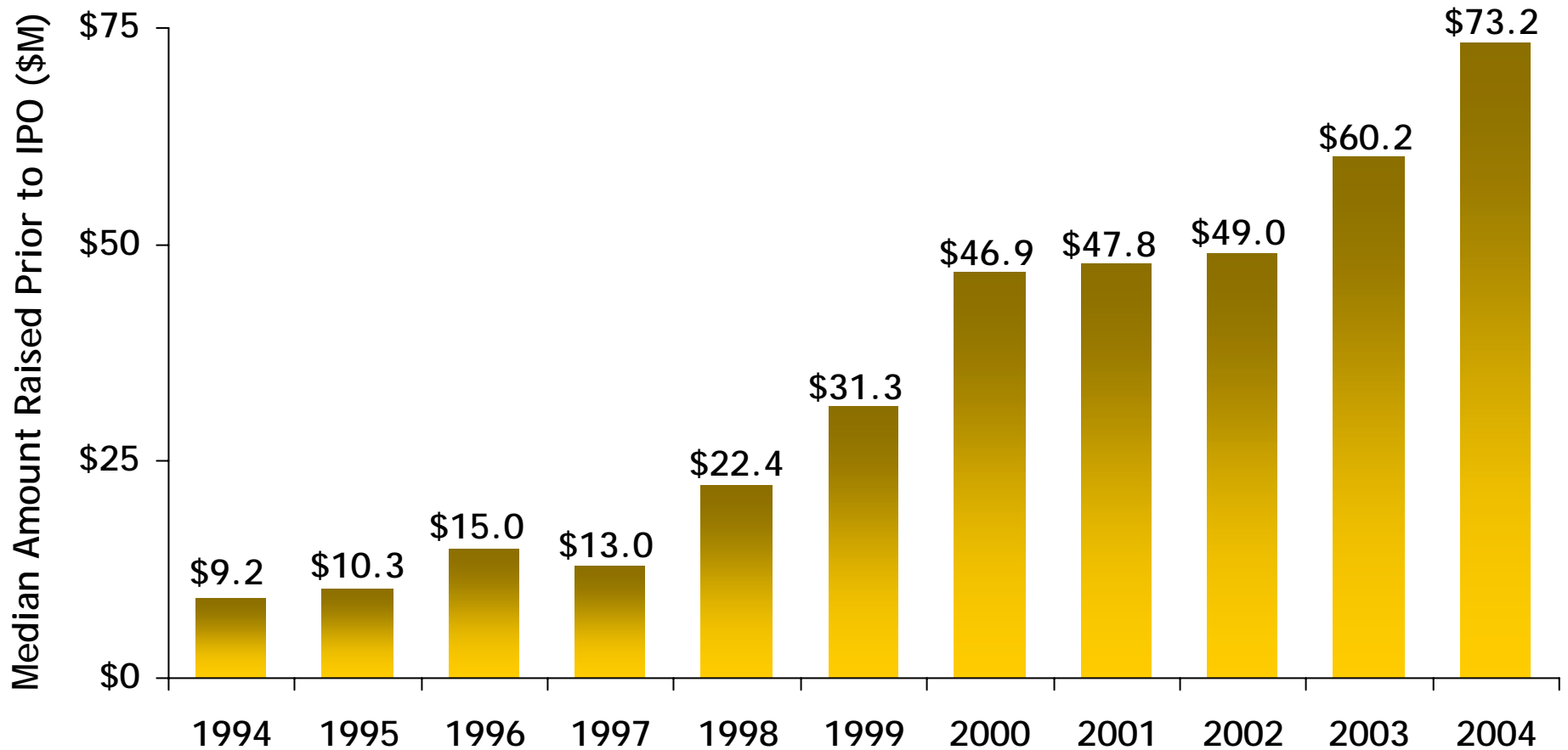
Time to IPO Increases in '03-'04

Median Time From Initial Equity Funding to IPO



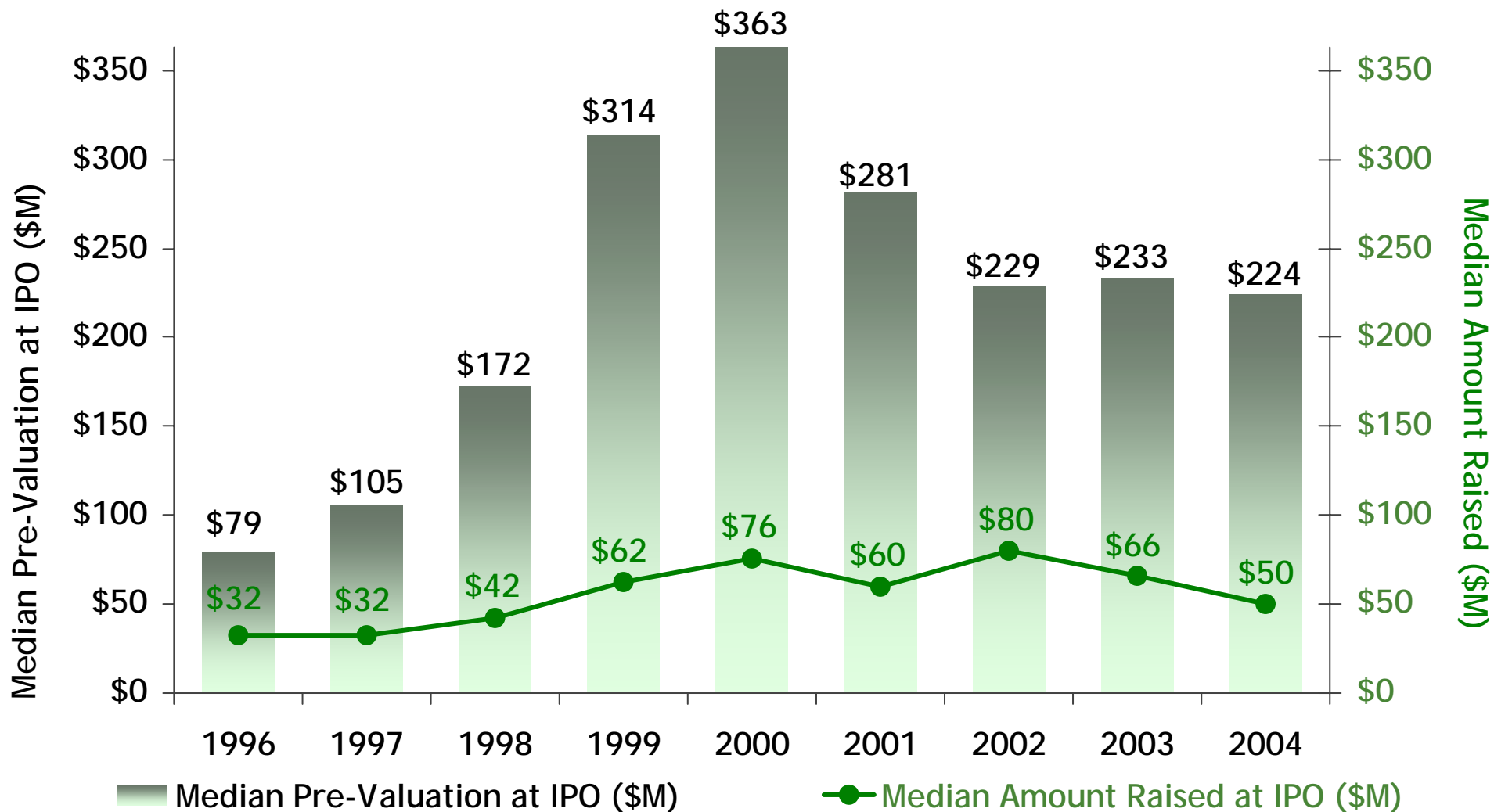
Companies Raise More Prior To Going Public

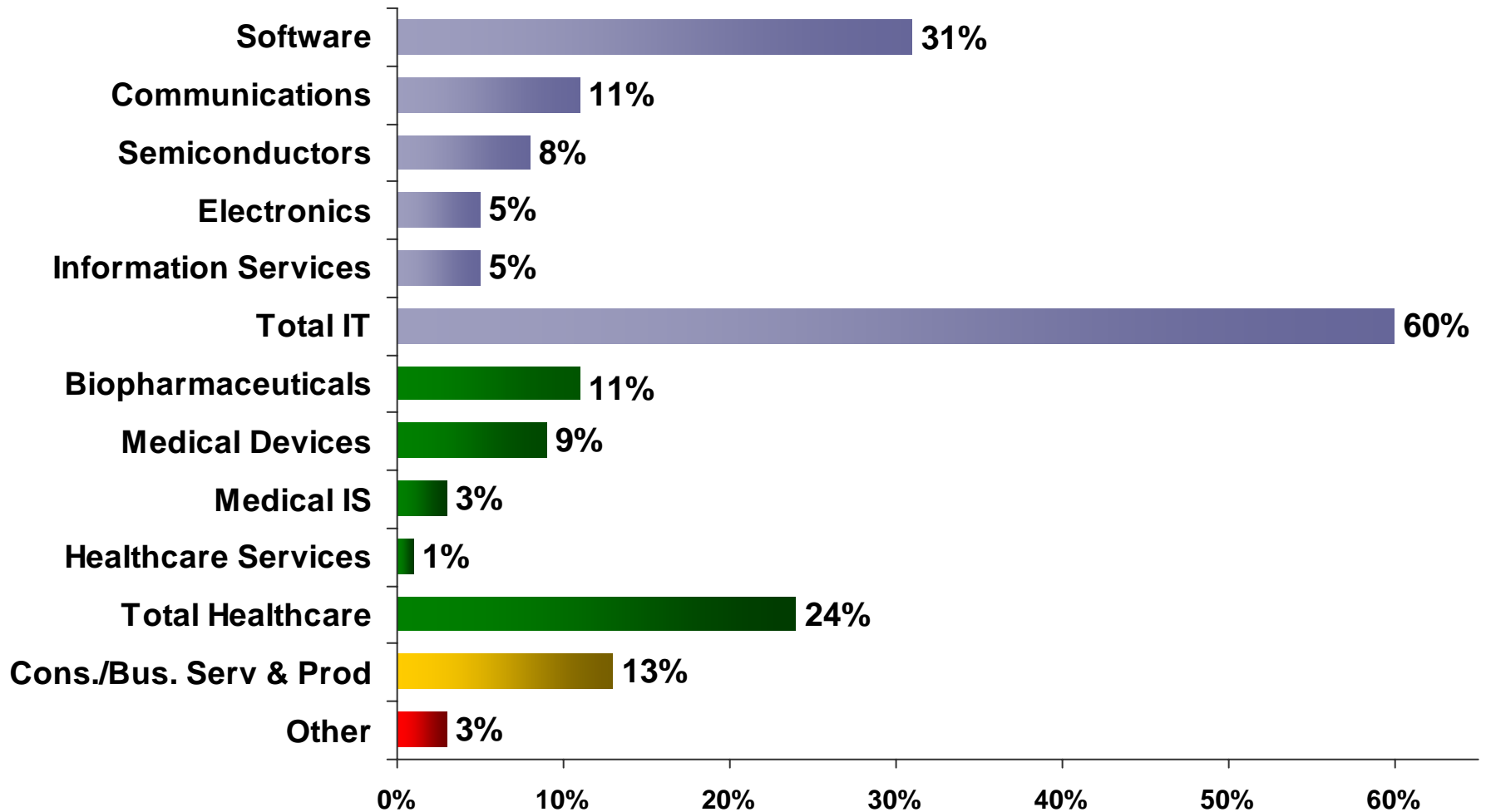
Median Amount Raised Prior to IPO



Smaller Offering Sizes Seen in 2004

Median Amount Raised at IPO vs. Median Pre-Valuation at IPO





Thank You
Comments, Criticisms, Feedback ??

