Cource 3

Week 1

Early Stage Investment Landscape

TOTAL POINTS 10

1. Anti-dilution provisions in financing documents protect:

   - (a) founders, by preventing their ownership in a company from being significantly reduced by new investors
   - (b) investors from dilution in the event of stock splits, stock dividends or sales of stock at a price lower than that the investor paid
   - (c) employees who have options issued from the company's option pool
   - (d) both (a) and (b)

2. Bridge financing is a term that means:

   - An interim financing round that provides cash to a company that is anticipating either a larger financing round, a merger or an initial public offering

3. The key components of a business plan are:

   - Income Statement, Balance Sheet, Cash Flow Statement
   - Company Description, Product Description, Market Analysis, Headcount Plan, Customer List, Patents
   - Executive Summary, Company Description, Product/Service Description, Market Opportunity, Sales & Marketing Plan, Management Team, Financial Projections
   - Early-stage companies do not need to write business plans because they new to the market and too many variables are unknown

4. The 4 "M's" that investors look for in a company are:

   - Momentum, Management Team, Market Potential, Money
   - Monthly Sales, Management Team, Money, Mystery
   - Momentum, Monthly Sales, Money, Management Team
   - None of the above

5. Which of the following is false about a Term Sheet?

- ○ It includes the pre-money valuation of the company.
- ◉ It is binding on the investor for 60 days.
- ○ It specifies the use of proceeds.
- ○ It specifies the form of investment.

6. The primary purpose of the 'cap' in a convertible note is:

- ○ To convert into equity at the value of the next round of financing, regardless of the valuation of that round.
- ○ To delay the valuation of an early-stage company.
- ○ To establish an arbitrary valuation of an early-stage company.
- ◉ To place a ceiling on the valuation at which the note converts into equity.

7. Series A, Series B and Series C preferred refers to the:

- ○ Value of the preferred stock.
- ○ Priority of the preferred stock in liquidation.
- ◉ Class of the preferred stock.
- ○ Nothing - they are simply given a letter to distinguish each preferred stock issuance.

8. An investor invests $2.5 million on $5 million post-money valuation in a participating Preferred Stock. The company subsequently sells for $10 million. What is the ownership of the Preferred investor and how much of the $10 million will the investor receive?

- ○ 33%; $3.3 million.
- ○ 50%; $5 million.
- ◉ 50%; $6.25 million.
- ○ 33%; $5 million.

9. Which of the following statements about a balance sheet is correct?

- ( ) Assets = Liabilities + Equity
- ( ) Equity = Assets - Liabilities
- ( ) Liabilities = Assets - Equity
- (•) All of the above

10. What is the simplest form of corporate structure?

- ( ) General partnership
- ( ) Limited partnership
- (•) Unincorporated sole proprietorship
- ( ) Limited liability company (LLC)

NEWCO Project

1)34

2)165

3)116

4)loss 117

5)220

6)8

Week-2

Sources of Capital

1. Early stage companies, owing to the lack of history and collateral, rarely raise money via debt with one notable exception, which is:

- ( ) Shareholder loans
- ( ) Preferred stock, with a dividend that acts like an interest rate
- (•) Convertible notes, which are a hybrid, more closely related to equity
- ( ) Common stock

2. Which of the following is TRUE regarding intermediary sources of capital? (Select all that apply.)

- [x] This category includes investment bankers.
- [x] They can introduce you to other financing sources.
- [x] They are a prime source of early-stage capital.
- [x] They may charge a fee for their services.

3. Strategic or corporate venture capital firms make investments:

- ( ) Only to achieve financial returns
- ( ) To build risk portfolios with excess cash of the corporation
- (•) Within their core businesses to achieve financial and strategic returns
- ( ) Primarily outside of their core businesses to diversify their risk

4. The primary sources of seed and early stage capital include the following: (Select all that apply.)

- [x] Management team
- [x] Angel investors
- [ ] IPO's
- [x] Founders

5. Which of the following statements is CORRECT about friends and family investors? (Select all that apply.)

- [x] They invest because of the relationship to the founder(s)
- [x] Terms should always be put into writing
- [x] Only equity investments are allowed given the relationship to the founder
- [x] When discussing an investment with a friends and family investor, the entrepreneur should clearly discuss risk versus reward

6. According to the U.S. Federal Reserve, what percentage of all startups are bootstraped?

- ( ) Less than 20%
- ( ) About 50%
- (•) More than 70%
- ( ) Almost 90%

7. What is the primary benefit to the entrepreneur of bootstrapping his/her company:

- ( ) The longer time it takes to get to market allows the entrepreneur time to make sure the product works perfectly
- ( ) It allows the entrepreneur to be creative in finding ways to achieve progress without money
- (•) If successful, the entrepreneur retains a greater share of the exit value (or a higher valuation during fund raising)
- ( ) Bartering with established companies develop lasting relationships that would not otherwise be developed

8. One of the disadvantages of an entrepreneur going into an accelerator program is that the entrepreneur:

- ( ) Is often provided new office space
- ( ) Spends a lot of time meeting investors interested in future financing rounds
- (•) Must give up equity to participate
- ( ) Spends too much time receiving training that strengthens his/her business expertise

9. Which of the following is true about angel investors:

- [ ] They invest twice as much as venture capital funds do each year
- [ ] They provide critical seed capital that other funding sources do not focus on
- [ ] They are often motivated by factors other than financial return
- [x] All of the above

10. Seed or early stage investors typically invest in companies that have all of the following attributes: (Select all that apply.)

- [x] Early customer validation
- [x] Is at cash flow break even
- [x] A promising product concept
- [x] Is seeking funding of $5 million or less

Project - Sources of Capital

Week-2

Quiz-2

1)

As I plan to operate a restaurant with a nice ambiance I would require premises, renovation and internal decor, furniture, electric setup, a couple of computers, staff, their uniforms, chefs, food supply, tables, chairs and couches, brochures and menu cards, marketing and advertising. Premises and land= $196.3K Renovation and internal decor= $49K Furniture, tables and chair= $20K Staff(2 waiters 1 on the counter 2 cooks)= $16K Uniforms, brochures, menu cards= $500 Food supply= Everyday return, so not included. Marketing and advertising= $20K

Does the amount of cash needed in item 1 above fall within the â€œreasonableness rangeâ€• for an early stage company (i.e., up to $5 million)? Please include your numeric answer and an explanation of several sentences.

Total required amount is $301.8K which falls under the reasonable range.

What is your monthly cash burn rate - both gross and net burn (gross burn is the average of total expenses each month; net burn is gross burn offset by the average monthly cash generated from revenues). Please include your numeric answer and an explanation of several sentences.

Three workers at $200 per month and two workers of $300 per month (That's what the salaries are where I live). $1,200 salary, $300 for the electric, maintenance, gas and marketing etc every month. If in the starting months 20 people visits the restaurant and spends at least 7$ per person on food on average, they would bring $140 revenue everyday and in 30 days, $4,200, which is the revenue generated including 60% profit that the food items would generate. $2625 on the food that is being sold. A total of $4,125 is expected to be spent in the first few months, which is the gross burn. The $2,625 food that is sold will at least give 60% profit, that's calculated to be $1575. So the revenue earned each month for a first few months would be $4,200. This estimates that the net burn would be something around (4,125-4200) viz "-$75" every month for a first few months. The negative sign shows it's a profit, and that even at the estimated value their would be some room (of $75) for the accounts to balance and the venture to not fall off into loss. This is the minimum sale calculation which shows no loss. 20 people to visit in one day is a very small figure. Such a business offers an everyday recovery.

How long will you be able to operate at the end of the 12 months forecast before you need to raise additional funding? Please include your numeric answer and an explanation of several sentences.

As we will start gaining more costumers due to marketing and best quality provided, we will start making wholesome profits. At the rate of 50 costumers per day shopping at the average of $8 per costumer, we would make a revenue of

$400 per day and $12,000 per month, which after deduction of food cost and other bills would give a profit of $3,000 every month, and hopefully at the end of the 12th month we will be making $6000 per month. Such a profit will help recovering the amount invested and in a few more months the business will be able to recover all the investment except the cost of the land and premises, which will of course be there as an asset.

2)

Total required amount is $177.4k which falls under the reasonable range

3.

3 –2 developers at $10k per month and rent plus marketing = $2700 per month. If in the starting month daily 20 people download the application and spends $25, they would bring $500 revenue everyday and in 30 days, $15000 so profit is $2300 per month

4.

As we will start gaining more customers due to marketing and best features provided, we will start making wholesome profits. At the rate of 100 customers per day shopping at the average of $25 per customer we would make a revenue of $2500 per day and $75000 per month which after deduction of developer cost and other bills would give a profit of $62500 every month which hopefully at the end of 12th month we will be making $100000 per month. Such a profit will help recovering the amount invested and in few more months the business will be able to recover all the investment.

Week 3

Quiz-1

Principles of Funding Strategies

TOTAL POINTS 10

1. Which of the following statements is correct about the due diligence process? (Select all that apply.)

- [x] Due diligence is a two-way process
- [ ] Due diligence is not time consuming if done properly
- [x] Prospective investors will want to investigate legal, financial and strategic matters
- [x] The key to success in due diligence is advance preparation and cooperation among the parties

2. Which of the following items discovered in the due diligence process could be a cause for concern by an investor, which could ultimately lead to a decision by the investor to NOT invest?

- ◯ Significant related party transactions that are properly documented and performed on an arms-length basis
- ◉ A large shareholder loan that will be paid upon completion of the current financing
- ◯ Accounts receivable from 20 very small customers which are 10 days past due
- ◯ Large accounts payable for goods and services that are all "current" (i.e., within the terms offered by the vendor)

3. When negotiating terms sheets with prospective investors, which of the following are correct? (Select all that apply.)

- [ ] Experience from past deals should be used to negotiate the current term sheet.
- [x] Don't take everything the other side says at face value - they may be posturing.
- [x] Both the investor and entrepreneur need to win.

4. Valuation of startup companies can be done objectively by following traditional valuation methods.

- ◯ True
- ◉ False

5. Choose the statement that is NOT correct?

- ◉ The Wiltbank Study indicates that investors expect an IRR of 15% in six years
- ◯ If the average PE ratio of companies similar to your company in the industry in which you will operate is 15X, and your projected after tax earnings in year 5 is $3 million, a reasonable exit valuation for your company in year 5 is $45 million
- ◯ Post-money valuation = Exit Value ÷ ROI
- ◯ ROI = Exit Value ÷ Post-money valuation

6. What factor(s) can impact the valuation of your company?

- ( ) Hot sectors
- ( ) Management team experience
- ( ) Early traction (revenues, partnerships, etc.)
- ( ) A well developed V1 product
- (•) All of the above

7. Which of the following statements about term sheets is correct? (Select all that apply.)

- [x] They normally include a statement on the use of the proceeds of the investment.
- [ ] No shop clauses are beneficial to the investor but not the company.
- [ ] They state the pre-money valuation and the amount of the investment.
- [x] They are binding on the investor for 60 days.

8. Equity securities include all of the following: (Select all that apply.)

- [x] Warrants
- [ ] Preferred stock
- [ ] Convertible notes
- [x] Options

9. A cap on a convertible note is used to:

- ○ Put a value on the company
- ○ Secure the payment of the note upon liquidation
- ◉ Establish the maximum pre-money valulation at which the note will convert
- ○ Put a limit on the maximum interest rate payable on the note

10. Which of the following is not a characteristic of Preferred Stock?

- ○ Preferred stock is an equity instrument with some characteristic of debt
- ◉ Anti-dilution provisions protect the preferred shareholder's pro-rata interests
- ○ It is the financing vehicle of choice for venture capitalists
- ○ Preferred stock shareholders receive the greater of the original purchase plus accrued dividends OR a percentage of the liquidation proceeds on an 'as-converted" basis in a standard liquidation of the company

Quiz-2

1)

Estimated revenues in year 5 (assumed exit year) - $25 million After tax earnings (based on industry comps) = 15% of revenues, or $3.75M. PE ratio is 15X or $56.25M exit value. Software companies sell at 2X revenues, thus exit value = $25M ×2, or $50M. Average exit values: ($56.25M + $50M) ÷2 = $53.125M. The average exit value is independent of the amount of money invested by the investor. Instead it depends upon the revenues and earnings in the future, in 5-8 years of time.

2)

Assume investment of $750K. Post-money = exit value ÷ROI yields or $2.656M ($53.125M ÷20X) Consistent with 'typical' deals. Investors expect a 27% IRR in six years (WiltbankStudy). This equates to 10-30X, depending on actual experience.

3)

Pre-money = Post-money –Investment or $1.906M ($2.656M -$0.75M). It is simply the difference between the post money and the investment by the investor. Of course the post money valuation will be greater than the invested amount. A pre-money valuation referring to the valuation of a company or asset prior to an investment or financing. If an investment adds cash to a company, the company will have different valuations before and after the investment.

4) and 5)

Post-money: Investor owns 28.23% ($0.75M ÷$2.656M). The amount that an investor will own would be the percentage of the amount invested by him in terms of the average exit valuation of the company. In this case the investor would own 28.23% of the total post money.

Week-4

Quiz-1

1. Which of the following statements is correct about what prospective investors want to see when you pitch your company to them? (Select all that apply.)

- [ ] Your company should be in a new industry where the investor has not made previous investments to enable the investor to diversify his/her risk
- [x] Investors don't care how or if your product works because they assume it does or will
- [x] Why customers will buy your product/solution
- [x] You and your team have an in-depth knowledge of the market

2. When an entrepreneur tells an investor "I have no competition", what the investor hears and thinks is:

- ○ (a) The market the entrepreneur is going after must not be very big if no other competitors are entering it
- ○ (b) That's great! This entrepreneur is pretty smart to have built a product in a big market that has no competing products to worry about
- ○ (c) This entrepreneur doesn't know the market very well
- ◉ (d) Both a and c

3. What is Guy Kawasaki's 10/20/30 rule?

- (selected) 10 slides, 20 minutes, 30-point font
- 10-point font, 20 slides, 30 minutes
- 10 minutes, 20-point font, 30 slides
- None of the above

4. What is the one attribute of every "perfect" pitch deck, regardless of its size?

- They all have at least one embedded video.
- They have bright colors, professional fonts and creative graphics to enhance the presentation.
- (selected) They tell a compelling story.
- They have an appendix with additional slides not covered during the actual pitch session.

5. When discussing/presenting the Competition slide in a pitch deck, which of the following statements is correct?

- If there is no competition in your market, this slide is unnecessary.
- Highlight how bad the competitors' product is.
- (selected) Point out why your product or solution is better but never "knock" the competition.
- Never discuss competitive products by name - otherwise, your prospective investors may seek out your competitors and invest in their products.

6. The appendix is useful for:

- Nothing - an appendix should never be included in your pitch deck.
- Putting information into the deck that you want to have available in the event questions arise after the pitch to which these slides relate.
- (selected) Hiding problematic information that you'd rather not talk about.
- Providing a list of all slides in the deck.

7. When you “tell your story” to prospectors, you should do all of the following: (Select all that apply.)

- [ ] Be prepared to go into great details, especially if your business is complicated.
- [x] Be genuine, passionate and try to connect directly with the audience.
- [x] Discuss who you are, where you’re from and why you’re starting the company.
- [x] Tell interesting stories constructed from anecdotes from your life that an investor might think is interesting.

8. Which of the following is a “Don’t” that should be avoided in making an investor pitch?

- ○ Reading your slides
- ○ Exaggerating
- ○ Focusing only on positives
- ◉ All of the above

9. Which of the following are “Do’s” of making a pitch: (Select all that apply.)

- [x] Connect emotionally with the investor.
- [x] Highlight your and your management team’s prior successes.
- [ ] Forecast ‘hockey stick’ growth to ensure the investor sees that market as having significant potential.
- [x] Give a product demo, if applicable.

10. Assuming that an entrepreneur must speak to between 10 to 15 prospective investors to actually have one investor “close”; that the amount of each investor’s investment is $50,000; and you are trying to raise a minimum of $1 million. How many prospective investors must the entrepreneur speak to before they successfully raise $1 million?

- ○ 100
- ○ 10 to 15
- ◉ 200 to 300
- ○ It is impossible to estimate based on the data provided.