



Singles vs. Homeruns

No company left behind!

Overall institutional venture capital is a hits driven business



However, it turns out they're not that easy to get



You can have a winning season, even with a bunch of singles



...and the occasional diving catch



What is a startup?

“A startup is a temporary organization designed to search for a repeatable and scalable business model.”

- Steve Blank

Things that are really, really hard are tough to predict



"The timing (for starting a new venture) is you wait until the world changes, so that a **really important problem moves from being impossible to just being really, really hard**. And then you execute."

Phil Libin, Founder of Evernote
At Vator Splash in 2013

Be self aware enough to recognize when you do and do not have control

“Control is an illusion, you infantile egomaniac. Nobody knows what's gonna’ happen next: not on a freeway, not in an airplane, not inside our own bodies and certainly not on a racetrack with 40 other infantile egomaniacs.”

- Dr. Claire Lewicki in Days of Thunder

Sometimes that \$1b company turns into a \$100mm company – how do we get more \$50's?

	Amount Invested	% Ownership	Homerun		Warning Track		Moneyball	
			Exit Value	End Position	Exit Value	End Position	Exit Value	End Position
Super Tech, Inc.	\$ 3,000,000	15%	\$ 1,000,000,000	\$ 150,000,000	\$ 100,000,000	\$ 15,000,000	\$ 50,000,000	\$ 7,500,000
Awesome Stuff, Inc.	\$ 3,000,000	15%	\$ 10,000,000	\$ 3,000,000	\$ 10,000,000	\$ 3,000,000	\$ 50,000,000	\$ 7,500,000
Cool Shizzle, Inc.	\$ 3,000,000	15%	\$ 10,000,000	\$ 3,000,000	\$ 10,000,000	\$ 3,000,000	\$ 50,000,000	\$ 7,500,000
Big Play, Inc.	\$ 3,000,000	15%	\$ 10,000,000	\$ 3,000,000	\$ 10,000,000	\$ 3,000,000	\$ 50,000,000	\$ 7,500,000
Killer Toys, Inc.	\$ 3,000,000	15%	\$ 10,000,000	\$ 3,000,000	\$ 10,000,000	\$ 3,000,000	\$ 50,000,000	\$ 7,500,000
Stalk My Friends, Inc.	\$ 3,000,000	15%	\$ 10,000,000	\$ 3,000,000	\$ 10,000,000	\$ 3,000,000	\$ 50,000,000	\$ 7,500,000
Shoulda Woulda, Inc.	\$ 3,000,000	15%	\$ 10,000,000	\$ 3,000,000	\$ 10,000,000	\$ 3,000,000	\$ 50,000,000	\$ 7,500,000
This Rocks, Inc.	\$ 3,000,000	15%	\$ 10,000,000	\$ 3,000,000	\$ 10,000,000	\$ 3,000,000	\$ 50,000,000	\$ 7,500,000
Killing It, Inc.	\$ 3,000,000	15%	\$ 10,000,000	\$ 3,000,000	\$ 10,000,000	\$ 3,000,000	\$ 50,000,000	\$ 7,500,000
Swish, Inc.	\$ 3,000,000	15%	\$ 10,000,000	\$ 3,000,000	\$ 10,000,000	\$ 3,000,000	\$ 50,000,000	\$ 7,500,000
Total	\$ 30,000,000		\$ 1,090,000,000	\$ 177,000,000	\$ 190,000,000	\$ 42,000,000	\$ 500,000,000	\$ 75,000,000
IRR (on investments, excluding fees)			105%		11%		30%	
Profit			\$ 147,000,000		\$ 12,000,000		\$ 45,000,000	
Carry (@20%)			\$ 29,400,000		\$ 2,400,000		\$ 9,000,000	

Notes

- Highlevel estimates (doesn't include interest, etc.)
- Down scenarios include 30% carve-out
- Basic liquidation stack dynamics
- IRR is highly dependent on timing of exits

Sometimes there's almost no difference between a company that gets a \$10mm and a \$50mm exit...



Depending on where you live in the capital stack, different exits could mean very different outcomes



**In order for most startups to
become billion dollar companies
they have to independently
commercialize their innovation**



The challenge is that for most \$50mm exits – it's the R&D team and the product which hold the value

“How hard is it to get rid of these customers?”

Product looks good – let's scale this puppy!

	Year 1	Year 2	Year 3	
Revenue	\$ 5,000,000	\$ 10,000,000	\$ 20,000,000	
COGS	750,000	1,250,000	2,000,000	
Gross Profit	4,250,000	8,750,000	18,000,000	
R&D	2,500,000	3,500,000	4,000,000	
S&M	2,500,000	4,000,000	7,000,000	
G&A	1,000,000	1,500,000	2,000,000	
Operating Profit/Loss	\$ (1,750,000)	\$ (250,000)	\$ 5,000,000	The cost of commercialization
Cumulative	\$ (1,750,000)	\$ (2,000,000)	\$ 3,000,000	
COGS	15%	13%	10%	
R&D	50%	35%	20%	
S&M	50%	40%	35%	
G&A	20%	15%	10%	
Money into R&D	\$ 2,500,000	\$ 3,500,000	\$ 4,000,000	
Money into Not R&D	\$ 4,250,000	\$ 6,750,000	\$ 11,000,000	

Make sure your course is correct, because it's tough to turn the commercialization ship



Houston we have a problem...

	Year 1	Year 2	Year 3
Revenue	\$ 2,500,000	\$ 5,000,000	\$ 10,000,000
COGS	<u>375,000</u>	<u>625,000</u>	<u>1,000,000</u>
Gross Profit	2,125,000	4,375,000	9,000,000
R&D	2,500,000	3,500,000	3,000,000
S&M	2,500,000	4,000,000	4,000,000
G&A	<u>1,000,000</u>	<u>1,500,000</u>	<u>1,250,000</u>
Operating Profit/Loss	\$ (3,875,000)	\$ (4,625,000)	\$ 750,000
Cumulative	\$ (3,875,000)	\$ (8,500,000)	\$ (7,750,000)

This company is actually still doing respectably well – and they were able to throttle back expenses in Year 3

Even so, they went from **requiring no additional money by Year 3 and a low point of \$2mm** – to **requiring \$7.75mm in Year 3 and a low point of \$8.5mm**

But if we build it, they (customers) will come...

Probably not...



I have to invest in commercialization to get a homerun, but if I commercialize I hurt my chances of a single, WTF?

Is it possible to commercialize in phases – it's rarely as much of a race as people think

Your ecosystem and distribution channel – are they really ready for this innovation?

A great product requires fewer sales people, and less support

Forecasting madness – Let's work the problem, people

Try to employ a repeatable methodology around forecasting – solve for multiple vectors and solutions

Even in the absence of hockey-stick growth, teams need to focus on demonstrating progress in order to attract additional equity

OK – so the business is growing, but we likely have a single on our hands



The brutal self assessment – is my pet actually ugly?

What have we really developed?

Do we have IP?

Where is the value?

Do we really have the people in place to be successful?

What is the company really worth?



What are the options?

Financing

Complete product suite

Ability to create
independent distribution
channel

Endemic and effective
monetization

M&A

Compelling technology

Significant leverage from
existing commercial
platforms

Dramatically improved
monetization in
combination

Strategic BD

Logical fits with partners

Ability to unlock
opportunities and create
dependencies

Easily attainable
improvements to
monetization

Or, Should we just punt or drastically change course

Struggle of “sunk cost” versus the reality of actual trajectory

Re-starts, major pivots, and restructurings take massive time and effort – Is it worth it? Are you willing to dedicate serious time? Do you have the resources to support your conviction? What’s the status of the syndicate?

Call Sherwood Partners or just a silent wind down...

A few things to ponder



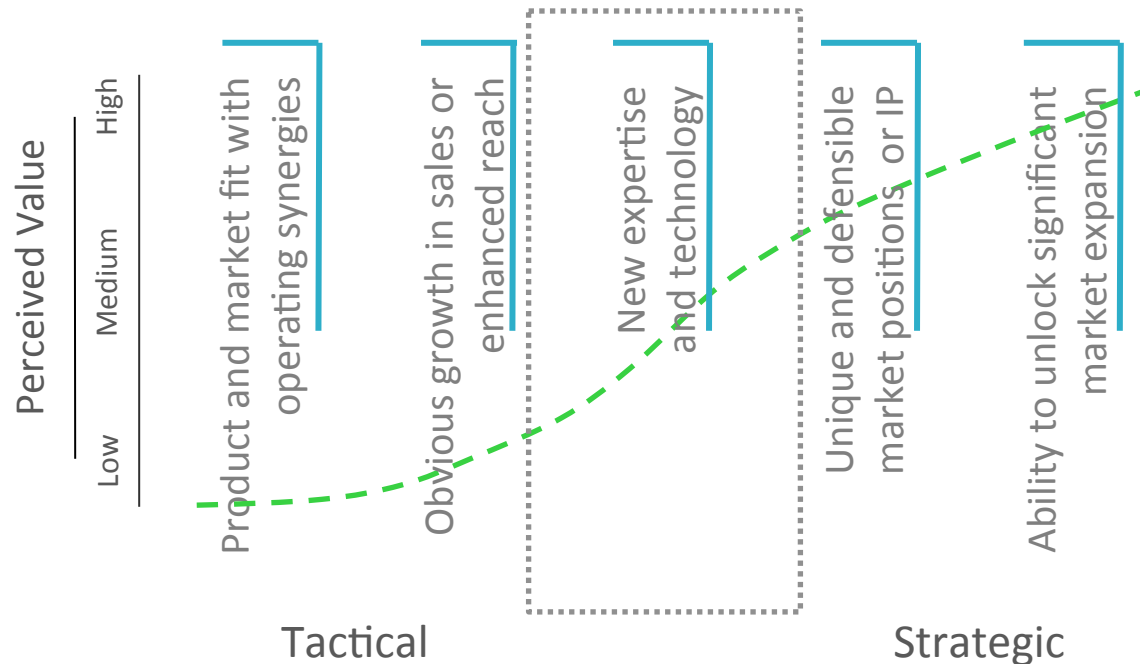
The acquisition thesis for most mid-tier, earlier-stage companies is centered on product (and occasionally audience/reach/consumption) – but you're **surest bet is technology and product team**

Ironically – most buyers aren't looking for exactly what you do – but instead are looking **“directionally”**

Almost every company tackling a hard problem, with a great team, is worth something – the question comes down to how much **time** do they have to find out how much...

Acquisitions are driven by **buyer, not seller, timing**

Valuation topography

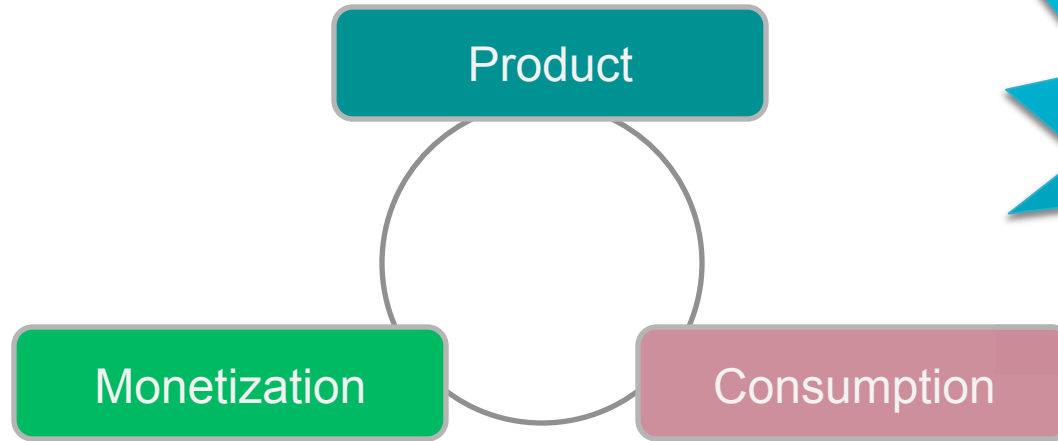


The most challenging zone is getting up the incline from “tactical” to “strategic” - once a buyer sees an acquisition as strategic, the degree of difficulty for increasing value decreases significantly and a company can make rapid gains in valuation through negotiation.

It's how you enter the room



The triad



Distribution is hard

Endemic monetization may not accompany a new innovation – but it doesn't mean it's not out there...

Know your likely buyers

Major strategics

Less valuation sensitive

Lots of competition

• Mid-tier publics

– Highly sensitive to losses

– Ability to move faster

• Hot private companies

– Get ready for some stock

– Increasing access to capital

	Enterprise Value	Revenue	EBITDA	Long Term Debt	Current Assets	Current Liabilities	EV/EBITDA
Google	\$ 220,000,000,000	\$ 50,000,000,000	\$ 16,000,000,000	\$ 7,000,000,000	\$ 60,000,000,000	\$ 14,000,000,000	13.8x
Microsoft	\$ 175,000,000,000	\$ 73,000,000,000	\$ 29,000,000,000	\$ 14,000,000,000	\$ 85,000,000,000	\$ 33,000,000,000	6.0x
Facebook	\$ 58,000,000,000	\$ 5,000,000,000	\$ 1,200,000,000	\$ 2,000,000,000	\$ 11,000,000,000	\$ 1,000,000,000	48.3x
ReachLocal	\$ 250,000,000	\$ 455,000,000	\$ 16,000,000	\$ -	\$ 99,000,000	\$ 81,000,000	15.6x
OpenTable	\$ 1,100,000,000	\$ 162,000,000	\$ 49,000,000	\$ -	\$ 83,000,000	\$ 34,000,000	22.4x
Groupon	\$ 3,900,000,000	\$ 2,200,000,000	\$ 147,000,000	\$ -	\$ 1,300,000,000	\$ 900,000,000	26.5x

Approximations from Yahoo! Finance Feb 27 2013

The Edge of Positive EBITDA

	EBITDA	Revenue	Enterprise Value
Brightcove	-\$8.93mm	\$88mm	\$148mm
Limelight	-\$4.72mm	\$180mm	\$89mm
Millennial Media	-\$1.82mm	\$177mm	\$582mm
Bazaarvoice	-\$35.9mm	\$148mm	\$366mm

Major strategics are great buyers – but there aren't very many of them

Most small public companies are intensely sensitive to EBITDA

Hot private companies can move fast, and are less EBITDA sensitive – but will push hard for equity to be a substantial part of transaction proceeds

Start early, look for resources – a structured sale is a last resort

30 to 90 Days

Phase 1 – Discussion Mode

- Identify candidates
- Initiate open ended discussions
- Look for those looking for you
- Find the outlier

30 to 365 Days

Phase 2 – Ping Mode

- Make periodic updates
- Identify creative opportunities
- Develop commercial relationships
- Be at the right place at right time

60 Days

Phase 3 – Sales Mode

- Time to complete transaction
- Leverage large base of relationships
- Provide aggressive guidance
- Make incremental improvements
- Establish structured process

Closing typically takes 45 to 60 days

Companies are bought not sold

Be on the radar when the timing is right for the buyer

Be constantly educating the market

Don't be a d*ck



Venture investing is a multi-game-game; it's not just about you

Liquidation preferences are a guide not a rule book; other factors to consider

Focus on the good of the collective

Work fast, be flexible, focus on getting an outcome

Influence is a blend of credibility and experience



Learn how to manage the endgame – you are the sage leader

Build a network of go-to advisors (attorneys, bankers, ...)

Understand the true motivations of the management team

Your voice is louder than you think – choose your words carefully

Summary

\$1.0B exits are nice, but unfortunately rare, so spend time generating portfolio outcomes in realistic ranges

Understand the business model, the multiple ways to solve the equation and how to drive value and optionality for exits

Be intellectually honest about the asset you have created, think creatively, and act as a good steward of LP capital

The innovation ecosystem is small, so be a team player



Appendix

Dealing with Pain

Fall from grace...it will happen every so often



Life lessons from being in the maelstrom

It's part of what we do, so it's going to happen. No one talks about it, but everyone deals with these situations

Focus on the business problem and try not to take it personal, even though feelings of embarrassment and disappointment will occur

Be realistic about your part in flying the plane – take some responsibility, but realize it's complicated. Play a role in determining the next steps

Be open to ideas on how to solve the problem, be realistic and focused on the end game

Challenging situations take a disproportionate amount of time and effort, so be prepared

Don't market to your investors how hard you work in crappy situations. Limited Partners don't want to hear you spend your time on recoveries. They want you investing in winners, not turning around losers

Call-in the first response team!



Stop, breath and be rational. Realize others will not be so balanced.

Understand your creditors/liabilities. Where are you?

Determine the cash needs of your business. Does it need a bridge?

Open communication with banks and other providers. No one likes to be snowed

Understand employee obligations

Be smart, be diligent, and take the time to do this right...

Make sure to have a CFO/VP Finance or competent controller in the mix. If not, get a consultant

How messy is it? What's the asset-liability mis-match? Do creditors really own the business or the equity holders?

State, federal and international rules

Chapt 7/11, ABC or whither to nothing?

Minutes and written record

Counsel your counselors; find the money to get good advice



Sometimes, putting the house back together also makes sense

Recaps, down-rounds and restarts!

Figure-out who is “on the investor team.” Understand your cap table and voting thresholds

Scalpel, not hand grenade

Run a thorough process and market check/analysis

Team-up and brings skills to the table



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