



Equity Capitalization

Presented by JD Geneser



LWBJ Financial

- **Divisions**

- CPA and Business Advisors
- Premier Wealth
- Capital Advisors

- **Capital Advisors**

- Financing alternatives
- Mergers and acquisitions
- Business start up and growth services
- Valuations
- Turnaround and restructuring services
- Operational and financial consulting

Company Evolution and Funding Sources

- **Idea phase – self funded or customer funded**
- **Proof of concept phase (initial research)**
 - Self funded
 - Friends & Family
 - Angel Investor
 - SBA – debt
 - State of Iowa – debt

Company Evolution and Funding Sources

- **Development stage phase (product development)**

- Angel Investors
- State of Iowa
- Seed Funds
- Regional Venture Capital firms

Company Evolution and Funding Sources

- **Expansion stage phase (generating revenues)**

- Angel Investors
- State of Iowa
- Seed Funds
- Regional & National Venture Capital firms
- Investment banking firms

- **Growth stage phase (generating profits/cash flow)**

- All above +
- Commercial banks

Equity Capital

- **What is it?**

- Money invested in a business in return for **ownership**
- Permanent capital

What it Means to Have Investors

- **Ownership**

- Partner in your business
- Give up some ownership and future profits
- Funding to expand, thus increasing value of your business

- **Operations**

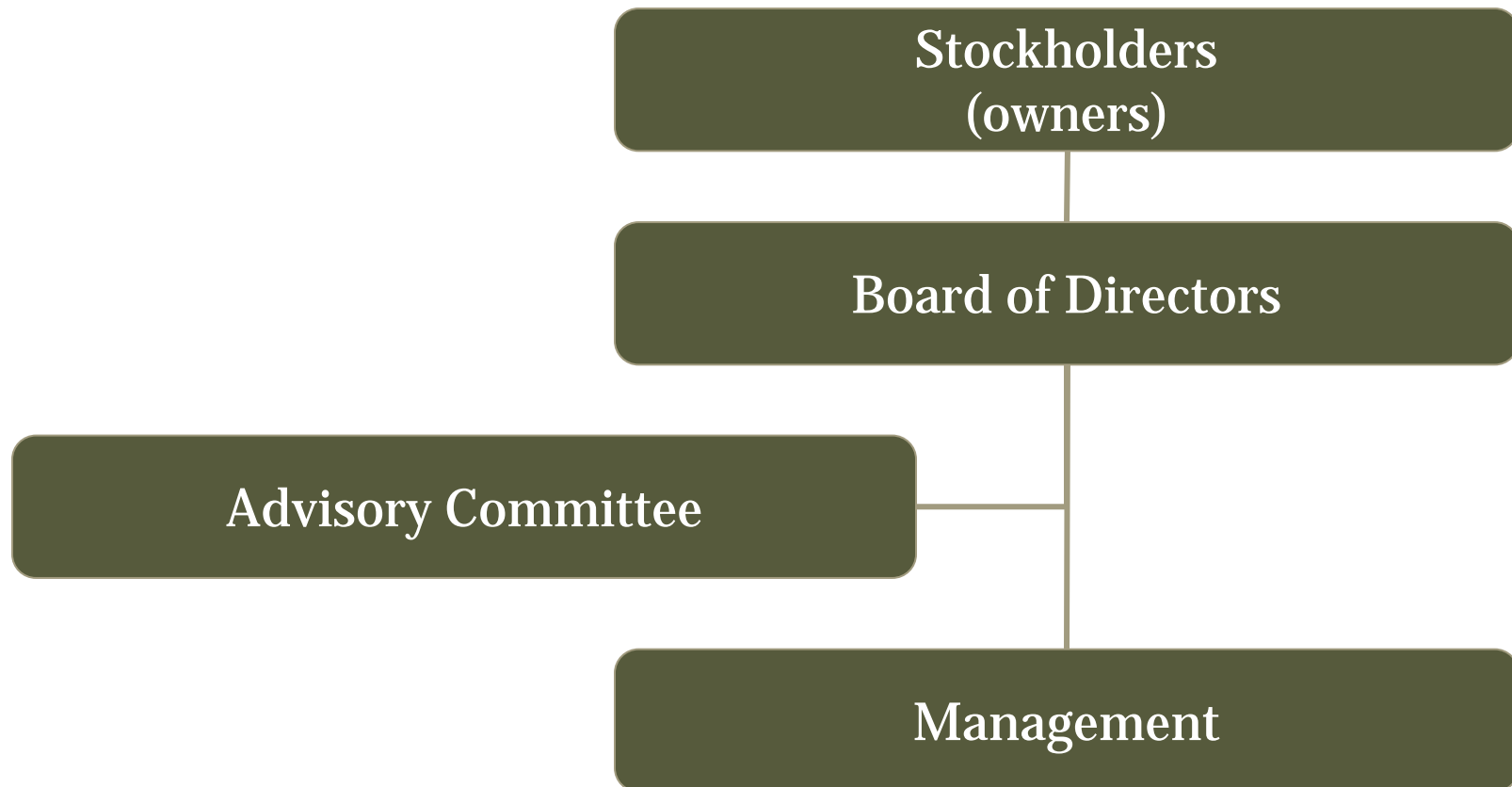
- Management Assistance / New “Bosses”
- Operational performance expected and return on investment
- Board of Directors / Steering Committee oversight

What it Means to Have Investors

- **Added risks**

- Loss of control
- Dilution

Organizational Structure



Valuation - Types

- **Equity Value – underlying stock**
- **Enterprise Value – operating business**
- **Enterprise Value – Equity value adjusted for debt and cash**
 - Start with Equity Value
 - Increased for Debt
 - Decreased for Cash

Fair Market Value

- **Defined – amount an asset/stock can be bought or sold between willing parties in an arms length transaction.**
- **Highly subjective. Don't truly know until you close a deal with an investor (Negotiated).**
- **Need other options in negotiations to maximize your valuation.**

Valuation – Techniques

- **General-3x to 5x annual cash flow**
- **Financial analysis based on current and projected financial information**
 - Discounted cash flows based on required rate of return
- **Transactions completed by comparable companies**
- **Comparable company analysis (primarily “public” companies)**
 - Lack of marketability discount
 - Minority interest discount
- **Auction method-keep open and have investors propose (need to have right circumstances)**

Types of Investors and Valuation Expectations

- **Friends & Family**

- Investment type varies and valuation based on more subjective matters

- **Angel Investors**

- High net worth individuals
 - Usually 10%-40% of Company
 - May be passive or active (Board Seat or Advisor)

Types of Investors and Valuation Expectations

- **Regional Seed funds**

- Institutions tied geographically or to industry
- Fund with defined purpose
- More sophisticated (may demand certain preferences and rights)
- Usually 10%-50% of Company

Types of Investors and Valuation Expectations

- **Regional or National Venture Capital firms**

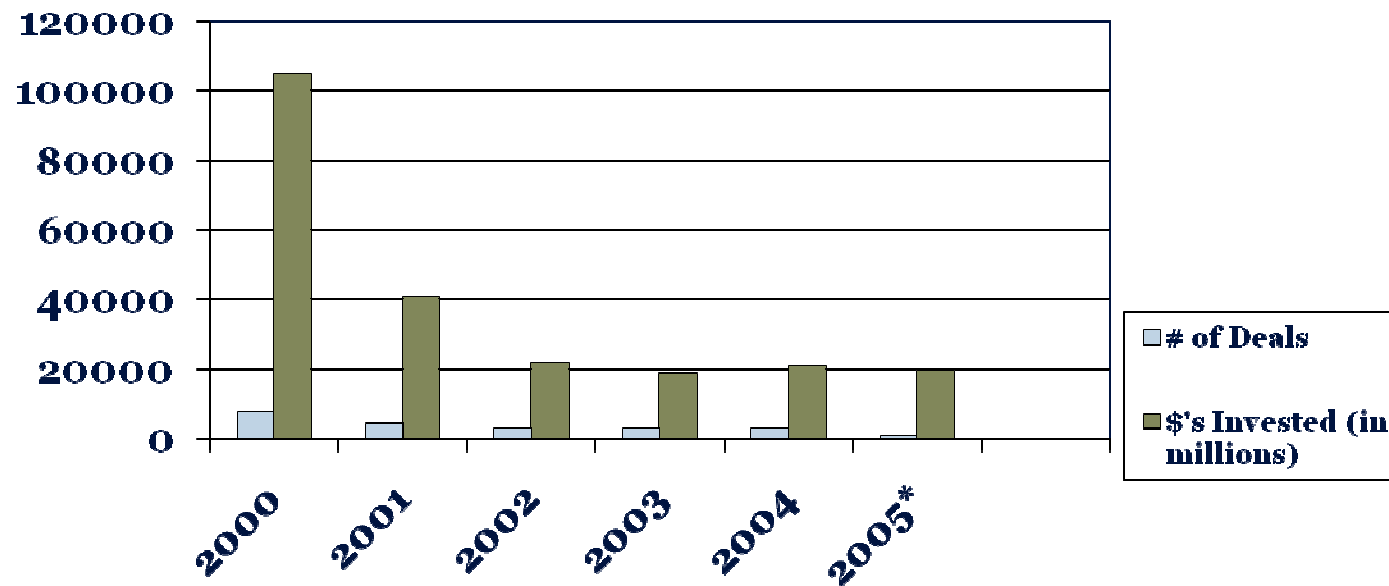
- Funds that pool resources of their investment partners
- Board seat and operational oversight
- Sophisticated (demand certain preferences and rights)
- 50%+ of Company

What is Equity Capital?

- **High-risk capital invested with an expectation of a high rate return**
 - Liquidation preference
- **A business partner who expects to be informed and involved in business decisions**
- **Requires an exit strategy in 5 to 7 years**

Venture Capital Trend Data

US Venture Capital Investment by Year



•2005 annualized

Source: PWC/Venture Economics/NVCA MoneyTree Survey

Capital – How do you get it?

- **Need a compelling idea that meets a need in a targeted marketplace**
- **Need a detailed business plan and executive summary**
- **Need financial projections with realistic assumptions**
- **Need to knock on a lot of doors / Network, Network, Network !!!**
 - Patience & persistence
 - Listen and learn from what you hear from marketplace

Capital – How do you get it?

- **Six fundamental criteria that must be addressed in a business plan for any investment consideration**
- **Know your business plan**

Business Plan

1. Understanding the business concept

- Is it sustainable over time?

2. What is the product or service’s “*unique selling proposition*”

- Defined as the “differentiator”
 - Preferably, not a commodity, but if a commodity, why you?

Business Plan

3. Is there outside validation?

- Customers
- Testimonials
- Strategic partners
 - OEM strategy vs. self-branded image
- Outside professional assessment
 - Relating to patents, manufacturing, financial viability

Business Plan

4. Management Team

- Depth and experience
- Space knowledge
- Incentivized
- Investing in the “Jockey”

5. Predictable business model?

- Grow to:
 - Cash flow (+)
 - Enable follow on financing at stepped up valuation
 - Additional investors
- Create enterprise value

Business Plan

6. Exit strategy

- Sale?
- IPO?
- M & A financing:
 - You acquire
 - You are acquired
- Mezzanine financing:
 - Additional equity
 - Exit for original investors

Venture Capital – Do you really want it?

•Is not a right fit for every company

- Valuation of company is always an issue
- Liquidation preference:
 - Preferred stock versus founder common stock
 - Anti-dilution ratchets
 - Exercise rights to control board of directors
- Need an exit strategy with a minimum IRR of 23% to 35% minimum in 5 to 7 years

Summary – Equity partners

- **Major decision for Company-timing is critical**
- **Do investors add more than just \$?**
 - Technical expertise
 - Industry expertise
- **Patience and persistence is needed**
- **Negotiated-need leverage in discussions**



Questions?

