

Still A Game of Winners

The Next Chapter in Venture Investing is Quantifying Stories in Scenarios



Understanding the Drivers of Value

The best venture investors are exceptional at identifying great founders, spotting breakout opportunities, and using their “6th sense” to imagine how one product or service may transform an industry or dominate a market. Truly understanding the drivers of value and providing real insight on strategic prioritization also makes the best VCs more attractive partners to the best founders.

Nonetheless, the majority of venture investments don't generate high multiples of capital, and VC success is typically defined by a handful of major decisions, the best of which end up “returning the Fund.” Many such decisions will be made in the next 6 months, including tough choices about which current portfolio companies to double down on and which new investments to make in these uncertain times.

Because there is so much uncertainty about the long-term future for any venture stage company and so little relevant historical data, serious financial analysis and valuation work is often an afterthought. We concur that it's folly to lock into a single simplified forecast of the long-term future. However, it seems prudent to directly translate the excellent insight VCs have about founders, markets, and product differentiation into quantified odds of upside success and downside risk. It also helps to keep these views current with the best available information in order to track execution progress and support portfolio company strategy during the life of the investment.



History has proven that when things go well for a business, they can go spectacularly well, and when things go poorly, the negatives can compound in disastrous ways. There are also multiple “middle case” combinations that require effective pivots. All of these cases amount to a wide range of different paths to success and failure. It is essential then to inform your decisions with the odds of different future scenarios that capture the decades of future activity that the entry price valuation represents.



Mike Ryan
Founder and CEO
Bullet Point Network



For almost a decade, surging pools of venture capital have been chasing a finite universe of attractive investment opportunities, nearly doubling valuations over the preceding 5 years across most industry sectors. Preqin estimates there was \$275 billion of VC “dry powder” at the start of 2020, which was triple the level of 2012, showing that opportunity exists but competition for the best deals may be fierce. Decisions made in the next 6 months can make or break returns for many funds. So, as a VC investor, why not have every tool at your disposal to help you outperform?

The best VCs make money in two simple ways: 1) back a great founder riding a powerful theme or trend, and profit as the valuation compounds with execution success or 2) be right about a contrarian view that the majority sees as improbable, and profit as the world recognizes that the odds of success are actually much higher. In both, it's important to properly estimate how much capital, time, and differentiation will be required to succeed and to execute against clear commercial milestones that provide proof of success. By quantifying the odds and milestones upfront, you not only make better investment decisions; you increase odds that the company hits those milestones over time.

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We encourage you to continue leveraging your expertise in identifying great founders, spotting opportunities, and sensing differentiation, but why not make your most important decisions with the power of BPN in your corner.

Very Truly Yours,

Mike

Venture Investing Before COVID-19

Before COVID-19 ("BC")

For years prior to COVID-19 ("BC"), many venture investors followed a simple and functional process for investment analysis: *Memo, Spreadsheet, Meeting*. Venture investment decisions are overwhelmingly driven by stories - qualitative views about the founder, the market, and the product. While effective, this process exposed the decision-maker to some gaps: the nuanced information in the memos wasn't mapped to the assumptions in the spreadsheet, and the only real connection between "gotta believe" drivers and their respective odds was the discussion at the meeting.

In the traditional BC process, updating spreadsheets to capture scenarios, even just for a few cases, was impractical. Updating the full memo after circulation hardly ever happened. When information or views changed, a blizzard of emails followed, some notes ended up in folders or CRM records, and the meeting to discuss qualitative conclusions rarely included any quantification of the updated outlook.

Not bad, but now we need to do much better.



COVID-19 Revealed Gaps

The gaps in the BC analysis process have grown wider and become more treacherous as the cone of uncertainty for venture investors and their portfolio companies has exploded. Consumer sentiment has tanked, production lines have halted, fears have multiplied, and capital markets have changed dramatically. Yes, COVID-19 is novel, but we've all seen this pattern before, to varying degrees. Unfortunately, none of this was in the typical memo, and the spreadsheets didn't contemplate the full range of outcomes.

For any business, the initial challenge was to estimate how long the lockdown would last and then estimate the recovery curve for different products, services, and activities. The first two tasks culminated in the third, and most important task, which was to consider the “permanent” changes in demand, competitive positioning, and structural dynamics (don't forget the value of a venture stage company discounts decades of future cash flows).

COVID-19 also brought changes to capital market conditions. If a company needs external funding or seeks an exit, capital market effects can be just as important as the long-term fundamental outlook during volatile times.

Notwithstanding the uncertainty, venture investors and portfolio companies alike are looking to better understand two major questions: *What is the long-term outlook for growth rates, profitability, and scale? And how does that outlook compare to the current valuation?*

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How Decision-Making Needs to Change

Thinking Needs to Change

Venture investors and their portfolio companies were forced into read and react mode by COVID-19. Since virtually no one predicted the timing of this pandemic, many investors think that advanced planning would have been futile. However, you didn't need to label a "pandemic case" to benefit from a more comprehensive set of scenarios, including some with dramatic reductions in demand, the extension of sales cycles, changes in working capital, and reduced access to external financing.

So how do venture investors and their portfolio companies forecast the future from here? The cone of uncertainty is much wider than it was BC, but making great decisions amidst that uncertainty can be done well with good judgment and the right tools.

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Tools to Bridge the Gap

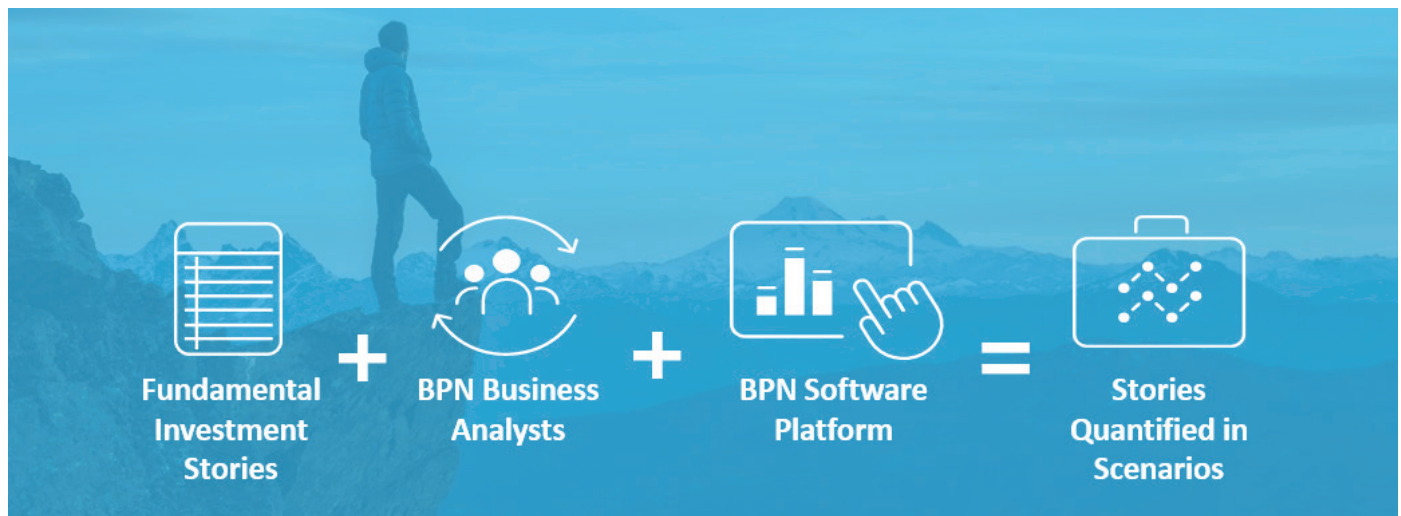
Many venture investors do scenario analysis to some degree, whether in a spreadsheet tab, a data table, their heads, or during the all-important discussion at the investment meeting. We often see memos that consider a base case plus one upside case and one downside case. In some instances, they may expand to consider 4 or 5 cases.

That said, when uncertainty is high, 3 to 5 cases are not enough, but investors are hamstrung by the dimensional limitations of a spreadsheet and the computational limitations of their brains. Modeling a proper range of logical cases and assigning realistic odds to each is so unwieldy that it simply isn't done.

To be useful for decision-makers, scenarios need to be both logical (based on your views) and probabilistic (based on realistic odds).

But it is possible to project a wide range of scenarios across that wider spectrum of uncertainty. Those cases can be a logical combination of key drivers, each supported by attached evidence, and they can be updated as information changes or judgments are refined. To be useful for decision-makers, scenarios need to be both logical (based on your views) and probabilistic (based on realistic odds). This was always true in the BC world. However, it's now far more obvious as venture investors prepare to navigate a volatile market and make the kinds of decisions that will drive their performance.

How Can BPN Help Venture Capital Funds?



BPN Helps Bridge the Gap

BPN created a process that modernizes the BC method of “Memo, Spreadsheet, Meeting” by making it practical to *Quantify Stories in Scenarios*.

Our software integrates Research Management and Scenario Modeling by organizing data, research, and qualitative insight to produce probabilistic scenarios based on logic rather than a random Monte Carlo simulation, simplistic extrapolation of past data, or presumed comparables.

Fundamental Investment Stories

Our process captures your fundamental insight and research and enhances it with the help of our team and our platform. Under NDA, we gather any spreadsheets, memos, pitch decks, and notes you are using to build and support an interactive strategic model in our platform.

BPN Business Analysts

While not sector or subject matter experts, our business analysts work alongside your team to build a model of your current or prospective portfolio company. Led by Mike Ryan, who was a partner at Goldman Sachs and investment committee member at the Harvard endowment, our analyst team has similar skills

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and training to the investment professionals you hire, making communication very efficient. We take your inputs, complement them with additional research and critical thinking, and produce an interactive strategic model in our patented BPN software.

BPN Software Platform

Peter Moore, BPN co-founder, worked with Mike at both Goldman and Harvard and spent over 10 years with National Science Foundation grants to build our patented software platform called BPN Writer.

BPN Writer makes it practical to use a Logical Graphical Model to organize stories about issues more scalably than with folders and tags. It also translates this information into a Probabilistic Graphical Model that produces many scenarios without creating spreadsheets for all of them.

Through easy-to-use data visualization output, investors and portfolio companies can hone in on specific cases, drill down on their key drivers, and see the odds of upside and downside to make better-informed decisions. The BPN Feed enables investors and portfolio companies to easily see the assumptions driving the model, browse the attached research, and comment on the analysis.

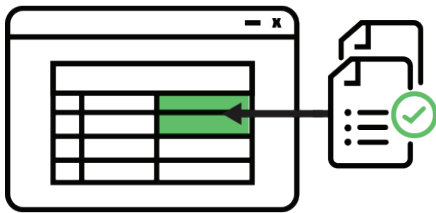
Stories Quantified in Scenarios

Credible scenario analysis is crucial to making great decisions, particularly when uncertainty is high - as it always is in venture capital. Investors that have extensive discussion about possibilities and probabilities or model a few cases in a spreadsheet are on the right track. That said, a flexible model that allows for continual updates is key to making certain that your insights are quantified to drive your most important decisions.

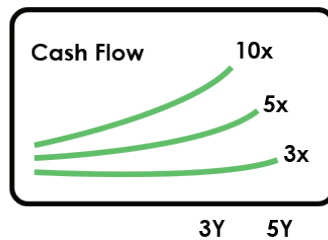
Nothing will ever replace human judgment about founders, breakout market opportunities, and differentiated product winners. Still, with the BPN platform and team, venture investors can use their judgment to generate logical and probabilistic scenarios to see the odds of success and failure more clearly than ever. **Quantifying Stories in Scenarios** is essential for weighing whether and how much to invest, as well as for providing a roadmap for a portfolio company's future.



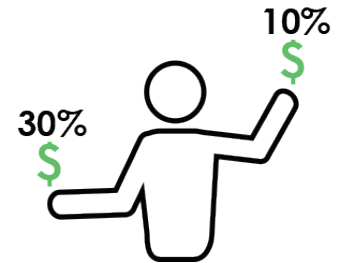
The Five Benefits of BPN's Process



Attach and map research directly to the key drivers in a traditional three statement financial model with BPN's patented software platform



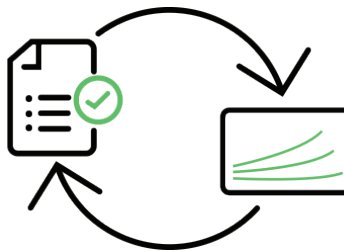
Model scenarios for actual cash flows and how multiple may change over different time horizons



Calculate odds of upside and downside to returns based on your insight



Rate the impact of key drivers and test your conviction on them over time and under different conditions/frameworks



Keep the model 'living and breathing' with new research in the BPN Feed

Case Study and Further Analysis

For more analysis and information please check out www.bulletpoint.network