



The Latest in Funding for Early Stage Start-ups:

Investment Strategies and Vehicles

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Beginner-Friendly Financing

- I. Introduction to basic financing deals
 - Differences between stock and non-stock investment deals
- II. Different types of investors
 - Investor preferences for different deal types



You Must be a C-Corporation

What else might the company be?

LLC:

- Owners are responsible for company's tax
- Big investors reject this responsibility

S Corporation:

- Investment funds prohibited from investing
- Investors will make these switch to Delaware C Corporation
- Do this before getting too big



FINANCING MECHANISMS

SBIR Grants

- Government funding for small technology companies
- Can obtain \$Millions
- Does not affect stock ownership
- Must manufacture product in US



SBIR/STTR
SMALL BUSINESS INNOVATION RESEARCH
SMALL BUSINESS TECHNOLOGY TRANSFER



Convertible Notes

- Also called **Bridge** or **Convertible Debt**
- Investor loans money to the company
- Good for raising up to \$500,000
- Mechanically simple and inexpensive
- Offers few protections to the investor
- Investor does not gain control in company

Convertible Notes

- Repay the loan in stock at the next stock sale
 - Always repaid with a bonus
 - Typical bonus is 20%
 - Industry term is “20% discount”
- Loan often pays interest in the form of extra stock
 - 2-15% interest is common



SAFE

- SAFE: Simple Agreement for Future Equity
- Simpler than a convertible note
- Layperson friendly
- Accessibility is prioritized over comprehensiveness

SAFE

- Used only for small investments
- Provides essentially zero protection to investor
- Professional investors may refuse this vehicle
- Does not provide a 20% discount
- Does not pay interest

Stock



- Vehicle for large investments
- Investor usually gains influence over company management
- Provides strong protections to investor
- Deals usually preceded by thorough diligence
- Often obtain a convertible note to raise the money to pay for this process

Seed Round

- An early round of stock
- Usually up to \$1M
- Enough capital for 12-18 months
- Lower cost, lesser legal complexity than later stock deals
- Fewer protections for investors than later stock deals





Series A Round, and Beyond

- Usually \$2-10M
- Investors require extensive protections
- Investor often gets a Board seat
- Investor may replace management, or fill gaps
- Companies commonly go as far as Series D before IPO or merger

ABCD

Tranches

- Sometimes a stock deal does not happen in a lump sum
- More common for multi-million dollar investments
- Investment is paid by installments
- Payment of next installment is often contingent upon hitting a milestone



Valuations

- Stock deals require a valuation of the company prior to investment
- Convertible notes and SAFE do not
- Often based on value of comparable companies
- Three possible scenarios:
 - Up Round
 - Down Round
 - Flat Round



Example Valuation

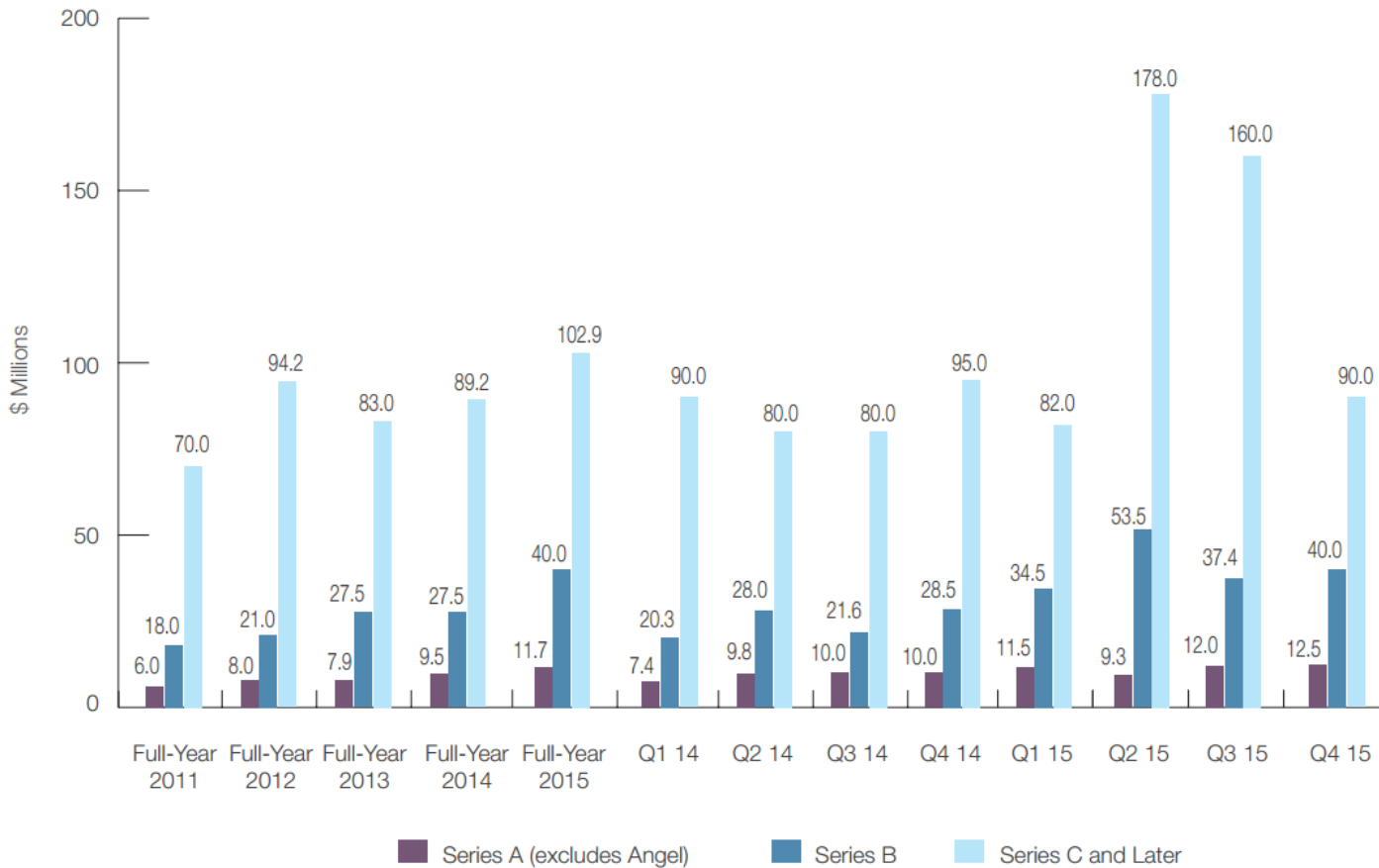
VC thinks:

- We want to own 40% of this company
- We want to invest \$8M

<u>Company</u>		<u>Investor</u>		<u>Post-investment</u>
All existing equity will be		Wants the investment to be		
60% of post-investment value	+	40% of post-investment value	=	100% of post-investment value
<u>Pre-Money Valuation</u>		<u>Investment Value</u>		<u>Post-Money Valuation</u>
\$12M	+	\$8M	=	\$20M

Valuation Trends for 2015

Median Pre-Money Valuation



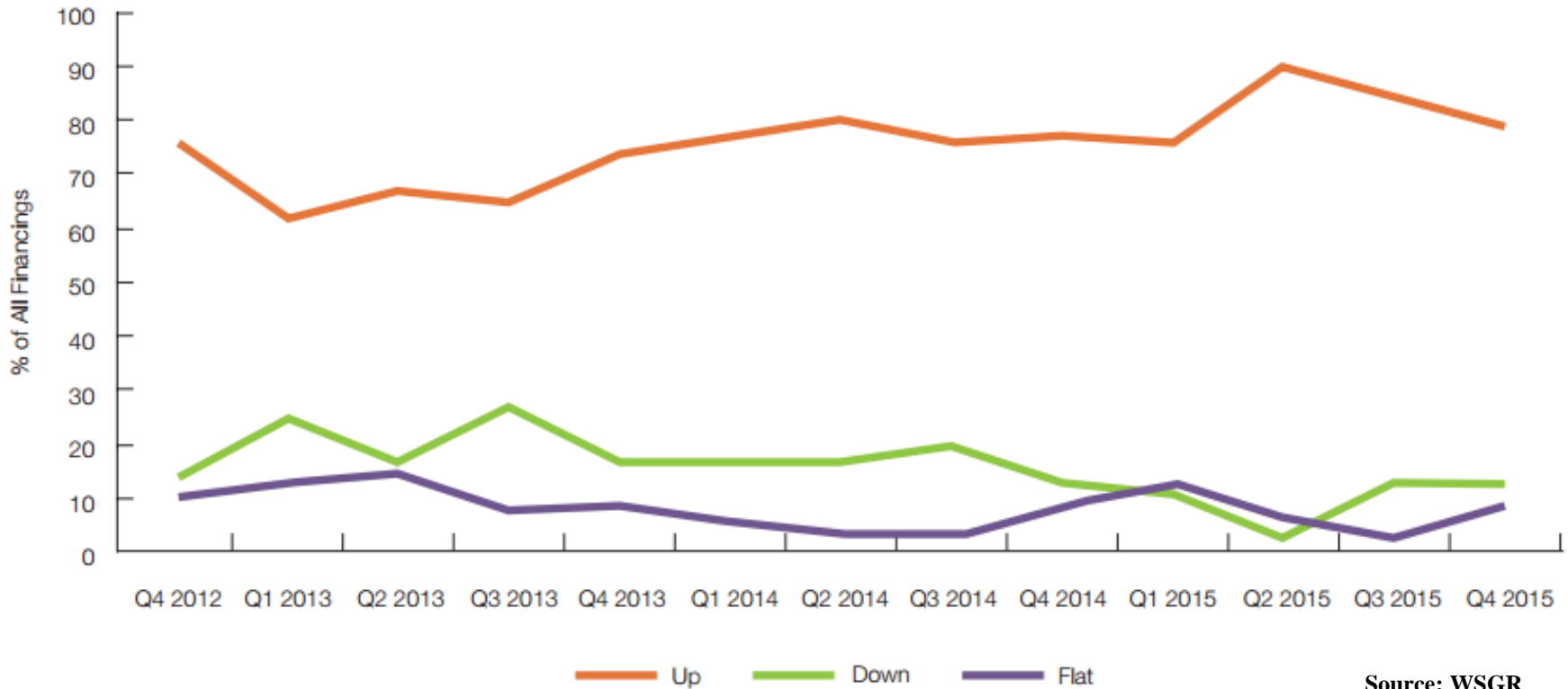
Median Investment

- Series A: \$2.7M
- Series B: \$7.5M
- Series C: \$16M

Source: VentureSource

Valuation Trends

Up and Down Rounds by Quarter



Source: WSGR

FUNDING SOURCES



W&GR Types of Professional Investors

<u>Investor Preferences</u>	<u>Angels</u>	<u>Venture Capital Funds</u>	<u>Investment Banks</u>	<u>Major Industry Partners</u>
<u>Amounts</u>	Up to \$2M	Many \$Million	Many \$Million	Varies
<u>Invest Early Stage?</u>	YES	MAYBE	NO	NO
<u>Invest in small market tech?</u>	YES	NO	NO	NO
<u>Invest in mega market tech?</u>	MAYBE	YES	YES	YES
<u>Tolerate gaps in management?</u>	YES	YES	NO	NO
<u>Deep Pre-Financing Diligence?</u>	NO	YES	YES	N/A

Friends and Family



- Very small investments
- Personal relationships can interfere with the business deal
- Usually have no ability to help run the company
- Poor documentation is a major problem

Angels

- Often your first investor
- Individual persons investing their own money
- Not a fund
- Sometimes invest as a group



Angels

- Experienced industry professionals or health care providers
- Want products that can be advanced for a few \$Million
- Look for short-term cash-out



Angels

- Normally not involved in company management
- Negotiations are usually fast and inexpensive
- Legal demand is usually light
- Sometimes dabble in non-life science sectors

Venture Capital Funds

- Investment professionals, managing a pool of money from others:
 - Insurance companies
 - Universities
 - Retirement funds
 - Super-rich individuals
- Hold long term for merger or IPO
- Seek huge, expanding markets
- Avoid low-margin products



Venture Capital Funds

- Often require a seat on the Board of Directors
- Will fill gaps in company leadership
- Look for a VC who wants to help run the company
- Negotiations are usually long and expensive
- Legal demands are heavy



Investment Banks

- Not a fund
- Manages / brokers investments for other big investors
- Finance IPOs for mature companies
- For young companies:
 - Might introduce a small investor
 - May charge the company a success fee



Industry Partnership

- Big Pharma helps develop a product
- Product must already show potential
- Big Pharma is paid from future product revenue
- Does not purchase stock
- Often a good strategy for a two-product company

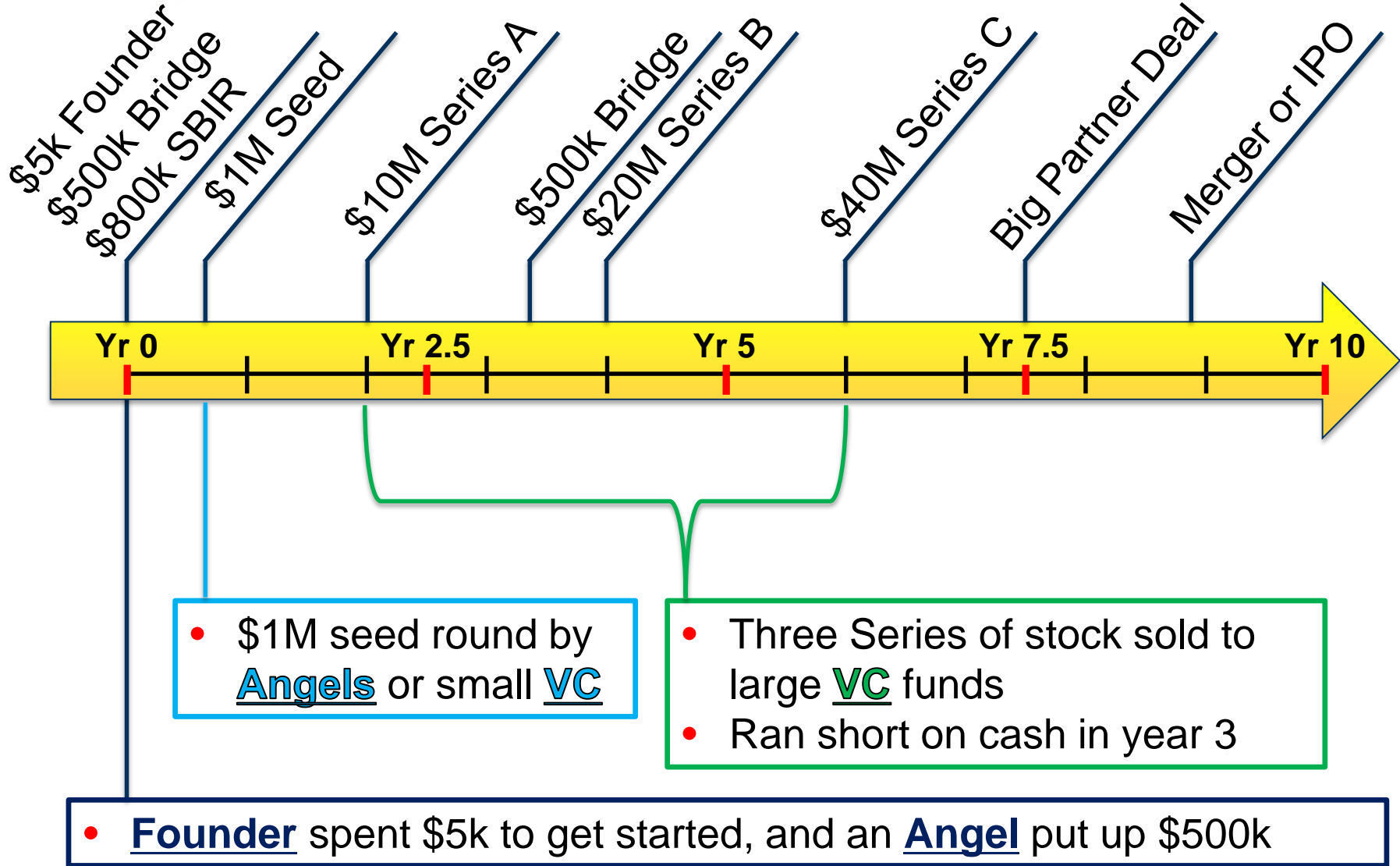


Investor Preferences

<u>Investor Preferences</u>	<u>Friends and Family</u>	<u>Angels</u>	<u>Venture Capital Funds</u>
<u>Amounts</u>	Small	Up to \$2M	Many \$Million
<u>Undocumented Deals (trouble)</u>	YES	NO	NO
<u>SAFE</u>	YES	MAYBE	NO
<u>Convertible Notes</u>	YES	YES	MAYBE
<u>Seed Round</u>	MAYBE	YES	YES
<u>Series A and Later</u>	NO	NO	YES



Example Investment Timeline





Thank you

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