TETRA

EQUITY FINANCING FOR YOUR VENTURE

WEBINAR #16: 31 MARCH 2021

IVAN FILUS, ANDREJ PETRUS
BIC BRATISLAVA, TETRA

NGI TETRA

NEXT GENERATION INTERNET

HUMAN INTERNET FOR A **BETTER FUTURE**

NGI Vision: Develop key human-centric internet technologies and infrastructure based on trust, resilience, decentralisation, inclusion and sustainability

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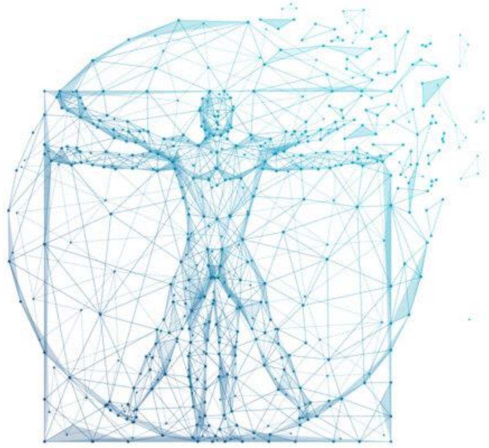
NGI.EU

NGI initiative is supported by:

- 11 Research and Innovation Actions (**Ledger**, **Dapsi**, **NGIAtlantic.eu**, **NGI Trust**, **NGI Pointer**, **eSSIF-Lab**, **NGI ZERO**, **Fed4FIRE+**, **ONTOCHAIN**, **NGI ASSURE**, **TruBlo**)
- 5 Coordination and Support Actions (**NGI4ALL**, **Think Nexus**, **NGI Explorers**, **NGI Forward** and **TETRA**)
- 7 multilingual NGI (**BERGAMOT**, **COMPRISE**, **ELITR**, **EMBEDDIA**, **GOURMET**, **PRÊT-A-LLOD**, **European**



548
INNOVATORS
SUPPORTED SO FAR

3414
APPLICANTS
TO OPEN CALLS

36
COUNTRIES
ON THE NGI MAP

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WHAT WE DO?

- **Coaching** during TETRA bootcamps
- **20 hours of mentoring** after TETRA bootcamps for the most promising businesses
- **Individual master plans**

More information:
https://business.ngi.eu/

TRAINING

Join our **bootcamps and webinars** on different topics such as intellectual property, sales and new markets, leadership skills, investments and much more.

MENTORING

Reiceive **individual mentoring** from experts, startup founders and investors.

BUILDING NETWORKS

Get access to **Digital Innovation Hubs**, **connect with investors and corporations** for collaboration.

TETRA NGI: OUR FOCUS

IPR ADVISORY

TRANSVERSAL COMPETENCES AND SOFT SKILLS

NEW MARKETS, SALES AND BUSINESS MODELS

INVESTMENT READINESS

ACCESS TO EQUITY FUNDING

ACCESS TO (INTERNATIONAL) PUBLIC CONTRACTS

FACILITATING PARTICIPATION IN A WELL-ESTABLISHED PITCHING COMPETITION

TECH-TRANSFER SERVICES TO DIGITAL INNOVATION HUBS

QUALIFIED INTRODUCTIONS AND MATCH-MAKING SERVICES

INDIVIDUAL MENTORING ON INNOVATION, BUSINESS DEVELOPMENT AND COMMERCIALISATION

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WHAT'S NEXT:
WEBINAR #17 (21 APRIL 2021)

Link: business.ngi.eu

- **Managing Copyright with Open Source Licenses and Creative Commons**

WHAT WILL YOU GET:

- basic copyright law and its relationship with open licenses;
- how to use open licenses in your professional practice;
- how to develop an open business model and integrate open access licenses in your projects.

HI, MY NAME IS ANDREJ!

Andrej Petrus

Investment Manager in **ZAKA Startups**
- VC/PE hybrid family office
- Early stage VC
- Occasional private equity in stable and profitable businesses

Consultant for **BIC** (Business & Innovation Centre) Bratislava

M&A and Strategy Consuling for **PwC** in Prague

Venture building in vertical AI startup studio **CEAi** in Prague.

MY TODAY'S AGENDA

1. **Fundraising**
    - **How to prepare and fundraising tips**
2. **VC investment model and cycle**
3. **Convertible Debt**
4. **Equity investments**
    - **SHA parts**
5. **Q&A**

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WHY WOULD YOU CONSIDER EQUITY INVESTMENT?

- You are “**unbankable**” – too risky, early stages of a company
- **Cashflow negative** – high R&D and development costs, in the process of validation
- Interest payments are fixed costs which raise the company’s break-even point
- Equity investment might serve as a **financial pillow** during difficult financial periods (and market periods)
- Company has no assets which could be **pledged as collateral** to the lenders and founders are not willing to personally guarantee the repayment of a loan
- Equity investor (angel, VC, strategic) is not only providing money but also contacts, **experience and expertise** from the field.
- Certain business models are not an ideal fir for debt financing – usual case of a tech start-up at early stage (no assets and no stable contracts)

ONE MONTH OF RUNWAY LEFT – TIME TO QUICKLY RAISE SOME MONEY?

PREPARING FOR FUNDRAISING

- Fundraising is a complex activity which needs time for preparation, negotiation and closing

One month of runway left – time to quickly raise some money?

  - Don't get timing wrong. Minimum time required for the whole fundraising process is 3 months, **usually three to six months.**
  - Plan ahead, ensure a longer runway

- Prepare and gather all needed financial and legal documents before the fundraising. This will spare your time and bring a dynamic to the process of **due diligence.**
- List of all needed documents and data for both debt and equity financing is extensive

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PREPARATION FOR EQUITY FINANCING

1 week	2 weeks	1-2 weeks	2 weeks	6-10 weeks	1-X weeks	1-4 weeks
Pitch deck →	1-2 meetings →	Internal analysis →	Termsheet negotiation →	Due diligence →	Red flags →	SHA negotiation

Required documents:

- Past financial statements, business plan and **financial projections** (how is the investment used)
- Innovative and competitive product or service **with strong validation**
- Competition analysis and go-to-market strategy
- Demonstration of a **strong team** and leadership
- Intellectual property ownership and employee contracts
- Cap table, leases, equity holders and convertible loans

FUNDRAISING TIPS

- Personalized and numbers oriented intro mails. Send updates prior fundraising
- Always **ask for advice and feedback**
- Find an investor who you want to build the company with
- Know which investors fit you with their investment strategy
- **Show validation** - MVP or product ready? Customer insights/feedback is not validation yet but might be enough for a pre-seed
- Market insights - **catalysators**, size, competitiveness in the field
- How to acquire customers – any **competitive edge** in the go-to-market strategy?
- Team's experience - **Product/Founder/Market fit**
- Know your numbers, **metrics**, market sizing and substitutes
- Understand market standards for Termsheets / Convertible notes

VC INVESTMENT MODEL

Portfolio of few wins and many losses

- High-risk high-reward strategy:
  - Ex. Portfolio of 20: 2 are returning the fund, 3 are moderate returns through trade sales and 15 are write-offs
- Looking for (depending on investment stage) at least **10x+ returns**, even higher in early stages
- Aiming for **scalable and big market size** opportunities
- Small market sizes or limited geographical focus could be a no-go for traditional VCs but that doesn’t mean the business is not investable

VC IS NOT FOR EVERY BUSINESS

Not every business is able to scale as quickly as VC demands, not every business is in big enough market

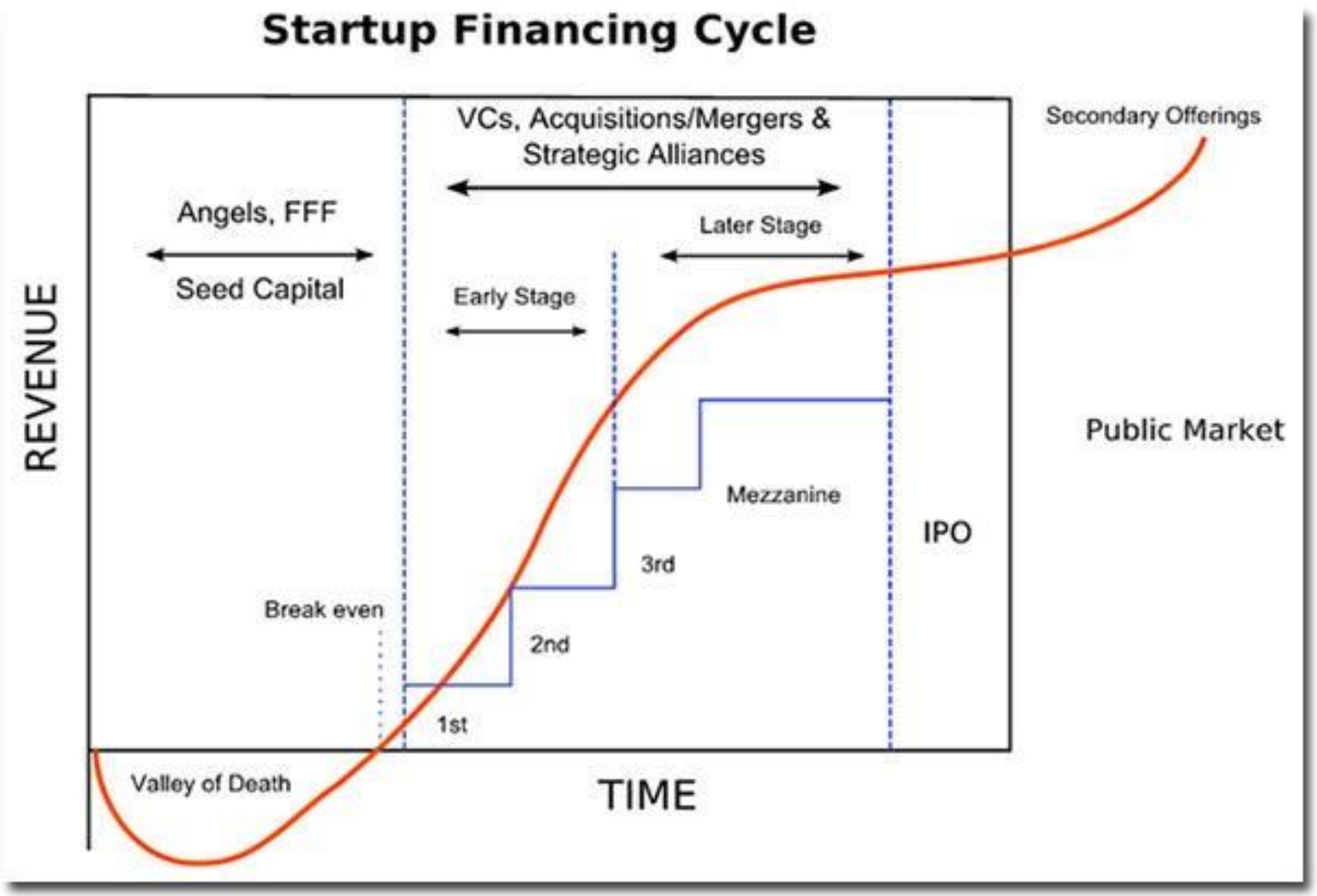
And that is completely OK

Don't forget to focus on stability and profitability, not only on growth

Different investor types with different strategies:

- **strategic investor** adding synergies to your business (future potential exit partner)
- **financial investor** - VC style (high growth, exit in few years)
- **financial investor** - also dividend based models - aiming for higher company stakes (PE model)
- high net-worth individuals / **local angel investors**
- **Target them by understanding your exit strategies, risk-return profiles and value added or expertise (possible synergies)**

STARTUP FINANCING CYCLE



UNDERSTANDING THE CYCLE

Think long-term, focus on every next step

Pre-seed
- Early validation
- Prototype
- Key hirings

Seed round
- PMF
- Early traction signs

Series A
- Revenue growth evidence
- Solid unit-economics

Series B
- Scaling
- Expensive hires
- Strong market position

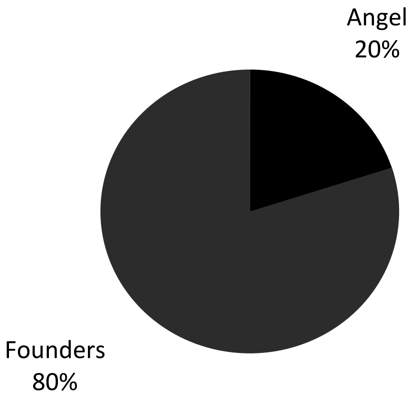
Series C+
- New markets
- Acquisitions
- IPO or stable dividend business

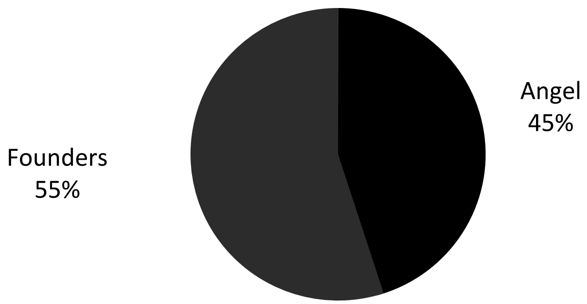
Investment size in ths. EUR for minority (10-30%) and runway

25-100 ths. EUR	100-500 ths. EUR	1m-2.5m EUR	2.5m + EUR	5m + EUR
6-12 months	12-18 months	18-24 months	18-24 months	24+ months

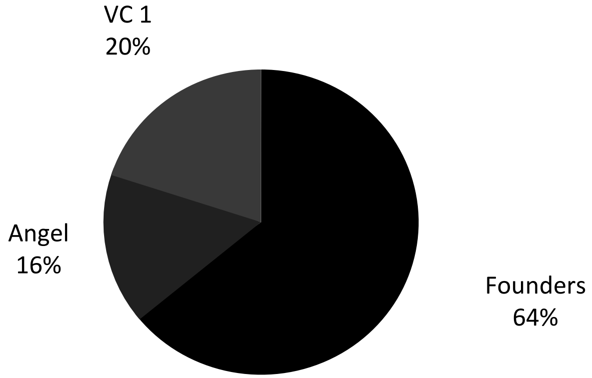
CAP TABLE SUSTAINABILITY

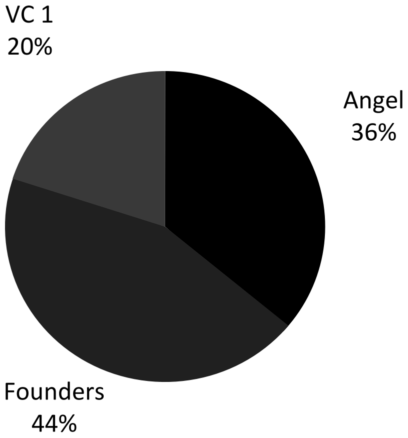
Pre-seed



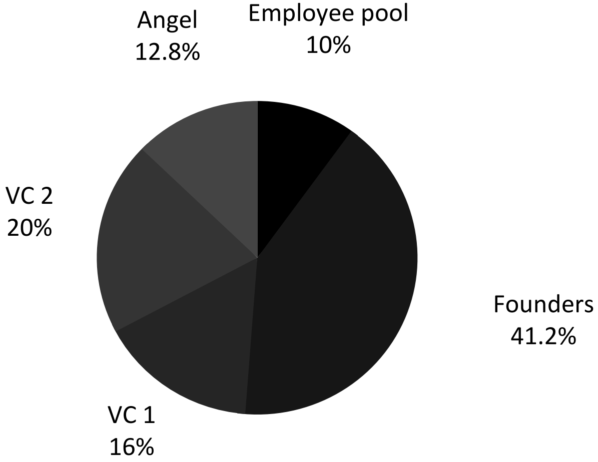


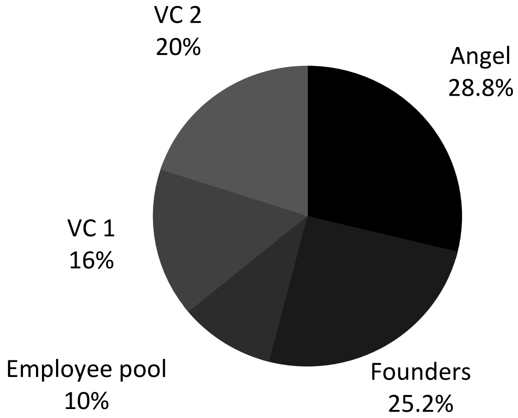
Seed





Series A





EQUITY INVESTMENT VS. CONVERTIBLE DEBT

Convertible debt is a short-term loan that converts into equity, typically with a future financing round. It is usually used in pre-seed and seed rounds prior the “priced” VC equity round, typically Series A

Key advantages:

- Faster investment process
- Valuation doesn’t need to be set – only minimum and maximum valuation at conversion
- Usually a 20% conversion discount on the valuation of next funding round for convertible debt holder
- No cash interest payments, the interest typically accrues to the principal invested, increasing the number of shares issued upon conversion.
- At maturity either converts with agreed valuation or needs to be paid back (if no equity round happened)

CONVERTIBLE NOTE EXAMPLE

200 ths. EUR Convertible note, 20% conversion discount, Valuation cap at 5 mil EUR

A/ next investment round (equity round) of **500 ths. EUR @ 4mil EUR** pre-money valuation

- Price per share is 40Eur, 100 ths. shares
- Conversion discount of 20% -> 32 Eur price per share for convertible loan holder
- 200 ths. / 32 = 6255 shares
- The convertible loan investment of 200 ths. Eur turns to **250 ths. Eur** worth of shares after the equity round

B/ next investment round (equity round) of **500 ths. EUR @ 8mil EUR** pre-money valuation

- 100 ths. Shares, price per share 80 Eur
- Valuation cap 5 Mil Eur, convertible note converts at 50 Eur price per share (at the 5 mil. Eur valuation of shares)
- 200 ths. / 50 = 4 000 shares
- The convertible loan investment of 200 ths. Eur turns to **320 ths. Eur** worth of shares after the equity round

SHAREHOLDER’S AGREEMENT

- Termsheet is non-binding and explains briefly conditions of the future equity deal
- Final terms of the deal can be renegotiated after the due diligence phase and identification of red-flags
- Shareholder's agreement is a binding contract
- Core Shareholders agreement parts:

Pre-money valuation	**Investment + tranches**	**Liquidation preference**
Anti-dilution	**Tag and Drag Along**	**Management Control**
Lock-up and vesting	**Right of first refusal**	**ESOP**

SHA PARTS IN MORE DETAIL

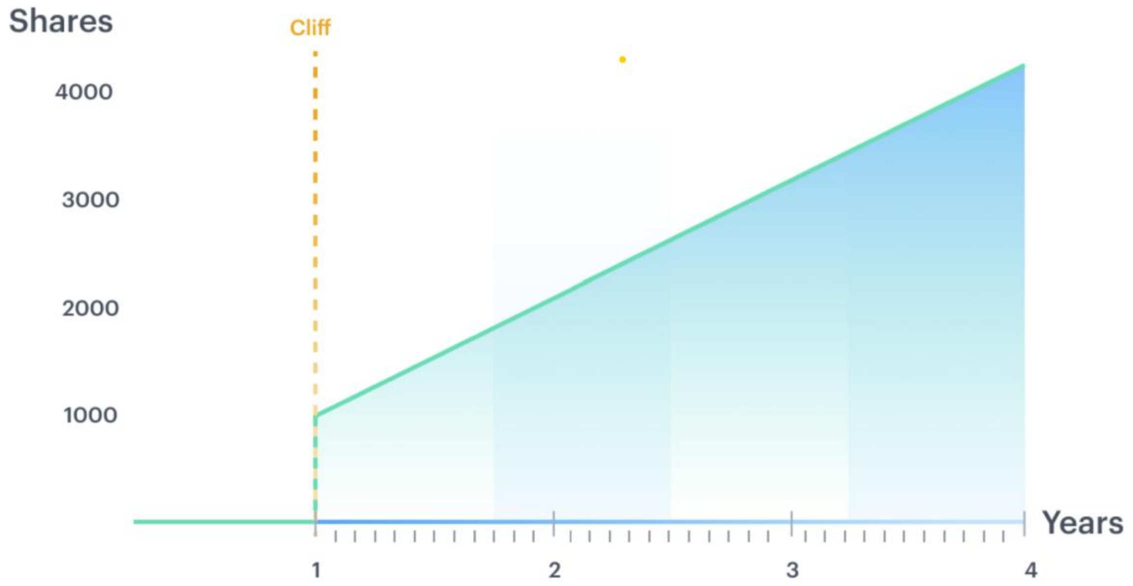
- **Investment size and investment tranches**
  - Total investment divided into few parts and paid when milestones are achieved (revenue, users, customers, product, POC, key hiring, CAC…)
- **Liquidation preference** (usually (and fair) **1x of the investment**)
  - Preference to any distribution of proceeds. Protects investor’s downside financial risk
  - Example:
    - Investment of 500 ths. Eur for 20% in a company
    - Liquidation proceeds of 1.5 mil EUR
    - Investor calls the option and gets 500 ths. Eur out of the exit price, not 20% of 1.5 mil Eur (300 ths. Eur)
- **Management Control**
  - Minority investor controls “reserved matters” through veto irghts on the board, derisking of his investment

SHA PARTS IN MORE DETAIL

- **Founder share vesting**
  - Very sensitive topic but a standard in VC investments and also in cases of an acquisition
  - VCs don't invest in existing assets or a business, **they invest in the future business** and future of it's assets
  - Minimizing the risk of founding team to depart after the investment and if that happens, it lessens its impact.
  - Founders own some part of their equity after the investment directly and some part is **vested over a longer period** – they earn the rest of their proportion of the equity by working for the company and increasing its value
  - Usually 25% is owned after the investment and the rest of 75% is vested over 36-48 months (depending on the investment stage) with a monthly or quarterly frequence
  - In case of departure of the founder, he looses all of his unvested shares which will be bought back by the company and either distributed among other founders, granted to new team member or new investor without diluting all other shareholders
  - Vesting might be reset during the next investment stage as a requirement by new investor

SHA PARTS IN MORE DETAIL

- **Employee stock option plan (ESOP) – vesting is applied typically as well**
  - ESOP forming is a common requirement in VC investments at Series A and beyond
  - Incentivizes employees to:
    - A. Join the company
    - B. Stay with the company long term and increase its value
    - C. Participate on the financial upside of the company in case of an exit



SHA IN MORE DETAIL

- **Tag-along - used to protect minority shareholders (investors)**
  - If a shareholder or a group of shareholders decide to sell their stake, the minority shareholder has a right to sell a proportion of his shares under same terms and conditions
- **Drag-along – used to protect majority shareholders (founders against investors or employees)**
  - This enables the majority of shareholders to force the minority shareholders to join the sale of the company under same terms and conditions. It prevents the minority shareholder to block a deal.
- **Anti-dilution**
  - In case of issuance of new shares to new shareholders at a price lower than the purchase price of the previous round (Down-round / lower valuation), investor will be awarded additional shares from current shareholders (founders) at no price to maintain his ownership percentage and not to be diluted
  - This clause brings balance to the deal when the valuation requirement of founders is high and therefore it is uncertain if the next investment round will be closed at a higher valuation.

Questions & Answers Session

THANK YOU
&
GOOD LUCK WITH YOUR BUSINESS!

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