

Venture Capital is Back on Track

An Overview and Update

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Presentation to the

Michigan Entrepreneurs

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Discussion Overview

- ▶ Overview of EDF Ventures
- ▶ Review of recent venture capital investment trends
- ▶ What venture capitalists look for in an investment
- ▶ Thoughts and suggestions
- ▶ A sample early stage company
- ▶ Questions and discussion

VCs are Private Equity Investors

- ▶ Invest in start-up (private) companies
- ▶ Purchase equity (stock) in exchange for money
- ▶ Usually critical to the strategic growth of the company
- ▶ Expect a significant return on their investment
- ▶ **Most expensive and professional form of financing for a start-up**

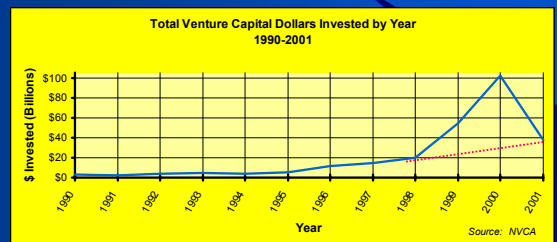
About EDF Ventures

- ▶ Based in Ann Arbor, MI
- ▶ Lead deals regionally and co-invest nationally
- ▶ \$85MM EDF III
- ▶ EDF IV coming in 2H 2002
- ▶ Early stage technology investors
- ▶ \$1 - 4MM 1st round, sometimes less; total of up to \$8MM per deal

About EDF Ventures

- ▶ Areas of interest:
 - Communications infrastructure
 - MEMS and microsystems
 - Life sciences
- ▶ Representative Investments:
 - Pixelworks (PXLW)
 - IntraLase
 - Xtera Communications
 - HandyLab

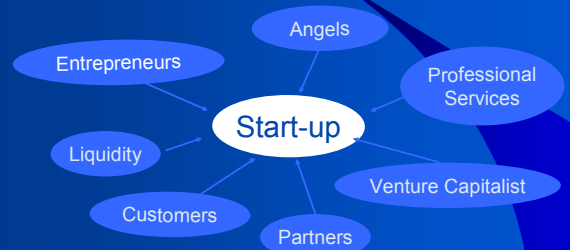
Investing is Back to Normal



Investing is Back to Normal

- ▶ Venture capitalists invested \$7.1B in Q4 2001
- ▶ \$36.5B in all of 2001 – third best year ever!
- ▶ Life Sciences (Biotechnology, medical devices, and HC services) doubled share to 18.5% from Q4 2000 to Q4 2001
- ▶ Retailing and distribution dropped from 18.4% to 10% during the same experience

Start-up Ecosystem



Types of VCs

- ▶ Technology Focus
 - Industry knowledge & connections
- ▶ Stage Focus
 - Value Added (Early)
 - Deep Pockets (Late)
- ▶ Geographical Focus
 - Ability to spend time
 - Know "local" resources

Where do VCs Find Deals?

- ▶ Referrals, Referrals, Referrals
 - Most common source!
 - Lawyers, Accountants, Bankers, Other VCs
- ▶ Conferences/Symposia
- ▶ "Walking the Halls"
- ▶ Unsolicited submissions are the least successful method

Choosing an Investment Opportunity

- ▶ VCs consider:
 - Market need and size
 - Management experience
 - Competitive Advantage
 - Business model
 - Milestones achieved, clear and measurable goals
 - "VC-type" of return expected/Exit Strategy

A Typical VC:

- ▶ Sees hundreds of BPs a year (500)
- ▶ Really reads ~ 20% of those (100)
- ▶ Invites < half of those to present (50)
- ▶ Invests in about <10% of those (4-5)

Only 1% actually get funding!

The DOs in Preparation and Approach

- ▶ Research the VC firm and its portfolio companies.
- ▶ Get help: advisors/referrals.
- ▶ Understand competition for VC dollars and attention.
- ▶ Understand your VC's niche.
- ▶ Have an idea of how investment fits in VC's portfolio.
- ▶ Have a well-thought-out business plan.

The DON'Ts in Preparation and Approach

- ▶ Nondisclosure agreement.
- ▶ Spam e-mail.
- ▶ Value your company based on future best-case scenario.
- ▶ Look for passive, "dumb" money.

The DOs in Business Plan

- ▶ Spend sufficient time on marketing plan.
- ▶ Have realistic financial projections.
- ▶ Show understanding of marketplace.
- ▶ Show understanding of direct and indirect competition.
- ▶ Show long-term plans, not just first product.
- ▶ Honest discussion of management strengths and weaknesses.

The DON'Ts in Business Plan

- ▶ Overemphasis on the technology.
- ▶ Unrealistic financial projections.
- ▶ Ignoring competitive analysis.
- ▶ Overemphasis on current stock prices to compensate for poor business model.

BP Common Weaknesses

- ▶ I read the plan and still don't know what the company does.
- ▶ I know the competition better than the company does.
- ▶ No timeline, milestones...
- ▶ How are you going to spend MY money?
- ▶ The team's not committed to the company.

What EDF Looks For

- ▶ People. Must be EXPERTS in their space. Must be "good" people to work with.
- ▶ Business model that makes sense regardless of stock prices and latest fads - investor vs. "trader"
- ▶ Long-term planning and commitment.
- ▶ Market leadership potential

Is There Capital Available?

- ▶ Yes. But,
- ▶ It will take more than “two guys, their computer and a power point presentation” to get funding.
- ▶ Most VC’s are starting to look outward after triaging their existing portfolio.
- ▶ You’re going to have to work much harder.
- ▶ It will take longer.

What Do You Have to Do to Attract Funding?

- ▶ Be patient.
- ▶ Put together a TEAM. Experience matters.
- ▶ Have something to show.
- ▶ Get a paying customer.
- ▶ Invest in yourself.
- ▶ Be realistic on valuations.
- ▶ Find Angels....

What Angels Bring to the Start-up

- ▶ Dedication – time to coach, mentor and strategize with the founders
- ▶ Experience – previous successful start-ups or operations in a similar industry
- ▶ Contacts – a rich rolodex that they are willing to share
- ▶ Capital – your own, and referrals to additional sources of quality co-investors

What VCs Like to See From Angel-Backed Companies

- ▶ Coaching by the Angels so the company is prepared for the “Venture Capital League”
- ▶ An informed referral and a desire to work with venture capitalists
- ▶ A company that has achieved value-added milestones
- ▶ Limited number of shareholders
- ▶ Reasonable valuations
- ▶ Legal work performed by an attorney with venture capital deal experience

Example Early Stage Company

- ▶ Three founders – a professor and two students
- ▶ No prior investment in company
- ▶ Early prototype that “works”
- ▶ One “friendly customer” is an alpha site
- ▶ The market for this product is now \$400MM annually and growing to \$1.2B in three years
- ▶ 3 patents on product technology with University license
- ▶ \$1.0MM will take the company to beta level product and customer trials. Will last ~ 1 year.

Example Early Stage Company

	Starting Capitalization		Series A Preferred			Total Shares
	Common Stock		New Money	New Shares	% of New Shares	
Combined Founders	850,000	65%				850,000
Series A Investor #1		0%	\$ 500,000	500,000	50.0%	500,000
Series A Investor #2		0%	\$ 500,000	500,000	50.0%	500,000
University	66,000	5%				66,000
Option Pool (common)	400,000	30%			0.0%	400,000
TOTAL	1,316,000	100%	\$ 1,000,000	1,000,000	100%	2,316,000
			Price/share	\$ 1.00		
			% Purchased by New Round	43%		
			Pre-Money Value	\$ 1,316,000		
			Post-Money Value	\$ 2,316,000		

Thanks!

Questions and discussion

For a copy of this presentation please send an
e-mail to Kseglund@edfvc.com