Start Up Boot Camp
Session 2:
Money Matters

Presented by:

Hello everybody, welcome. My name is Cindy McManus and I'd like to personally welcome you to today's seminar, Start Up Boot Camp for University Tech Transfer Professionals and Investors, Session 2, Money Matters. It's my pleasure to introduce your moderator for today's session, Mr. Gerard Eldering of Innovate Tech Ventures. Hi Gerard.

Gerard Eldering: Hi Cindy, thank you very much. I'd also like to welcome everybody to today's session in the Start Up Boot Camp series. The series has been designed to help provide you with detailed guidance and advice that you need to get your startups beyond the survival point onto rapid growth and ultimately to that liquidity event and again, my name's Gerard Eldering and I'm the moderator today. I'm President of Innovate Tech Ventures, a tech transfer venture creation firm located outside of Washington, D.C. The last week, in our first session, we kind of talked about the big picture around university startups. We talked about issues such as the feasibility assessment, is this technology reasonable basis for a start up. We talked about some of the basic financing issues, bootstrapping companies versus raising capital and a lot of elements around the team building, getting the various potential members of the team on board and motivated to work on the startup.

Well today, we're going to dwell down into the money matters and really focus on a lot of the issues around that. We'll talk about angel funding versus VC funding and other strategies. We'll talk about valuation of companies, division of equity, how that's allocated and a variety of issues that come with that. Again, we have a terrific panel today, a great wealth of experience on university startups. Again, we have joining us Brian Cummings, who's the Executive Director of Technology Commercialization Office at the University of Utah and Assistant Vice President for their technologies ventures program. He's got extensive experience with the startups and has his hand in more than 100 technology based companies out of Utah. Also from Utah, Jack Brittain is joining us. He's the University's Vice President of Technology Venture Development and holds a PhD in business from the University of California at Berkeley. We've got Adam Klotz back with us, managing partner for GTC law firm and he heads the Los Angeles affiliate office. He specializes in business transactions and also joining us today is Troy D'Ambrosio and he's the co-founder of multiple startup companies that have attracted over $500 million in capital, so a lot of expertise on the capital section. So we're going to have a great presentation today and a lot of useful information. With that, I'm going to go ahead and turn it over to our presenters and ask them to take it away.

Adam Klotz: Hi, I'll talk about just, to set the stage in terms of the reality is, in what it takes to invent an extraordinary technology and what it takes to then take that technology and build a product from it and then to commercialize that product. There are very different skill sets and the typical inventor really needs a team around him or her to – of advisors and people to help commercialize and those advisors could be a prototyping company, consultant from the MBA type to marketing, sales, financial consultants, lawyers, accountants but it takes more than just going with a genius for creating a concept to build a company. Next slide please.

Brian Cummings: So this is kind of a graphical representation. So we wanted to make sure that people kind of understood the geographic issues that universities and inventors face when they're looking at starting companies. So the stat is that over 85% of all the venture capital is allocated to the coast, which some of you can clearly see from the map on the screen. It's a big problem. So if you're in the Midwest or you're in these, one of regional universities, it's very difficult to get to VCs to come to you and it's, as most universities know, when a deal's done, the company usually moves to where the money is. So early on you want to make sure that you know where these relationships are, how you establish these relationships, how you attract venture capital and if you can't have access to the venture capital, what you need to do internally, either to start your own programs as we've done here at the University of Utah or access some of the angel groups or some creative ways you can access capital and we'll talk about that in the next slide.

So these are some of the common myths that are associated with starting companies, with trying to access capital when getting involved in this process. So, as was mentioned early on, the University of Utah started quite a few companies, almost 100 in the last, close to five years at this point. So we hear a lot of these myths and the first one and this is, I guess, common of the industry is that you want to avoid VCs like the plague and clearly there are some pros and cons to getting involved with venture capitalists but as anything in life and as CNN will tell you in why they run their business, more people are attracted to negative news than positive news and you hear a lot of negatives when you deal with venture capitalists but this goes again with how you establish the relationships. So the more companies that you start, the more your university TTO or TCO is involved with venture capital, the more you can build a better relationship and have it be a win-win.

So there're clearly horror stories where venture capitalists come in and they just beat everybody down, they control the company, they take the bulk of the equity and everybody gets crammed down in the subsequent rounds and it's a lose-lose situation. What's a "lose" for the university and the inventor and

it's a "win" usually for the venture capital but ultimately, it's not because he really did burn some bridges. So we hear this is a lot that I don't want to get venture money, they're just going to beat me down and it's going to horrible. Well, they're in this for a reason, they have a great wealth of expertise, they usually have access to excellent management talent and if you can get them involved, then they have a vested interest in building the community. So we're heard some bad things but if you can again establish those relationships, there's great benefits from being involved with local venture capital or angel groups.

Jack Brittain: I want to add to that, that you know, you can have VCs involved without necessarily taking their money sometimes also. They can give very good feedback. I think you really got to understand the nature of the partnership and what you want to be doing is building enduring partnerships where you're working closely with them, even pre-funding rounds but a lot of the negatives are when outside money comes in, there is no partnership and all they want to do is make a deal and so there's lots of advantages to the inventors, to the university and even to the VCs to have longer term partnerships where you're actually, collectively trying to create good deals flow for the VCs and they can also enhance the non-funded deal flow for the university.

Adam Klotz: If I can chime in for a moment. I think it's also helpful to a lot of people don't really know what a VC is. I mean, the typical venture capital fund, the people that the general partners, the people running the business are, in a sense, they are employees or hired themselves. They go out, they find money for people to invest and they get paid to invest that money and a small amount of money in terms of salary effectively and their win is on making good investments and getting a percentage of the increase in value of what they've invested in. I often describe the clients that they're really, you know, in a sense, bankers in that they are investing other people's money and they're responsible for an institution, as an institution for doing that as best they can.

Troy D'Ambrosio: You know, Brian said I've raised money from different groups and the reason you got to VCs is cause they have the money and if you got to raise capital for your business and you don't have it yourself, it's who you go to weapon. Usually the reason things go bad with the VCs is because you've missed executing on your business plan. That's when you get crammed down because they want to incent you property and the mistake that we made and I think a lot of people make the first time they raise capital is they over negotiate the value and the terms on the first round and then when you go back and ask for more money, you have to deal with that and then, if you, particularly if you miss your business plan execution and you need more money from your investors, that's when they really take it out on you because you've now really beat them up in the first round and as Jack mentioned, this is a

partnership, you're not selling something and leaving. You're actually joining up in forces and trying to work together. So, I think, you know, one of the things is you're exchanging a promise that you're going to make money in the future for money that is today, has value and you've got to be realistic about what the risk are associated with that and realize you're getting in bed with somebody that you don't want to use all your good will up on the early negotiations because you may need them later when things don't go well which, inevitably, they probably won't.

Brian Cummings: Very good point. So back to the myths of second points. So again, if you really don't want to access venture capital, there's no need to dilute the pool of equity early on. There's a common theme, there's no such thing as free money but in fact there's actually quite a bit of free money out there which won't dilute the overall equity pool that you've invested in. So we set up companies normally that we have SBIR type companies and I think most people know what the SBIR companies are. The federal agencies allocate a certain portion toward the SBIR in a TTR pool and so at universities you can access that money and it's non diluted capital. So we have actual grant writers that write SBIR and STTR grants for our companies. You can access foundations which specifically want to invest and sometimes they have strings and sometimes they don't but more often they're just trying to solve a disease or a disease state or something very, very quickly and they'll put very simple terms into the contract. I was at a university conference this past week and it was about, we had a session on startups and we did an informal poll and 60% of the universities and their state had state grants, same thing, non dilutive capital. So free money based on the state like North Carolina doubles, they'll double the amount of an SBIR grant. I know Idaho and Iowa have state grants. Utah also has a state grant you can access upwards of $200,000. So you should really look around your local region just to see what is available in this pool.

Troy D'Ambrosio: Yeah, the one thing I would say about the SBIR program is it takes a long time to get into that and a lot of times when you're a startup business, time's your enemy and you know, it's just cause you can go through multiple rounds before you can get funded on those with – that's my only.

Brian Cummings: Yeah, it can 9 to 12 months easily whether you even hear and then you might have to resubmit again. So if you are going to look at that, you want to look early in the process. The next point Angels Are Better Than Venture Capitalists. So if we can go back to the, go back one slide. So Angels Are Better Than Venture Capitalists, so obviously angel groups are a lot more accessible than venture capitalists because there's a lot more regional groups, there's a lot more alumni associations now that we've heard from universities that are trying to put these groups of alumni together to invest their capital

at their universities. So I know Notre Dame has this successful program, Indiana, Baylor, Purdue is putting a program together. Sometimes they're good, their hearts in the right place but they don't tend to be overly sophisticate and I think Troy had the point early on was what they do bring is they're usually successful entrepreneurs. So, they're much better at helping the entrepreneurs but as far as the level and sophistication of the capital, it can sometimes hurt because if you need follow on funding, they tend to sometimes complicate the cap table when the venture capitalists come on if you need a Series A or Series B round. So they're not going to have the expertise, they might not have the sophistication. Again, their hearts in the right place, it's good money but you sometimes want to be leery and do your due diligence about who you're actually building these early relationships with.

Troy D'Ambrosio: They really do invest in different stages because if, you know, VCs and angels are really different stage investors. You have to get sophisticated enough, as a company, to be able to access VC money and angel money may be the bridge to get there.

Brian Cummings: In these next two points I thought were interesting, these come from national stats, from the Department of Commerce. So you look at it, startups can't be financed with debt. The majority of small startup companies that are less than 10 people are actually 52% you can see are financed directly with debt. So going to banks on a prototype, I've heard companies that have actually monetized their intellectual property and they've got debt on that. There's firms that will specifically do debt, not equity deals, convertible debt deals. So you got to think about, you know, what you're basing that collateral on. So is it, maybe it's a PO, maybe it's a first sale, maybe it's projected sales, maybe it is your intellectual property but there's a number of things you can actually build debt on that are much more advantageous and again, doesn't dilute the initial equity pool and then, lastly, it doesn't take a lot of money to finance a company. Now clearly this is not a drug development type company or even possibly, a medical device but when we're talking about engineering or incremental companies or definitely software companies. Again, the majority of the companies that typically takes around $25,000 to get a company going and so, if you can move a company along just with small pool of money, you're obviously going to add a lot more value to that company and that's going to affect the valuation when you do need capital but you can do quite a bit with a small amount of money and you should look for those milestone based companies cause you're going to really add value when you go talk to the venture capitalists. Next slide.

Adam Klotz: So, the time you really go to a venture capitalist is when you need a large amount of money and you want to get to market quickly and you're willing to give up a significant portion of the upside to do it. I often describe it as swinging for the fences. If you're really trying to grow and build

fast, there are large amounts of money out there for large scalable businesses but it's going to cost you. With the great recession of 2008, 2009 all capital sources really have become more conservative and so well in the dot com bubble, you could get basically a concept of a business financed with a large amount of money very much so now, venture capitalists are looking for further development and further traction before they write the check. It's not universally the case but quite often they would like to see some customers. They'd like to see at least the prototype, not just the concept or the patent. Sometimes they'd even like to see revenue. The other thing that's happened with the large amounts of money that have been put into venture capital funds and funds have gotten bigger and bigger, the average fund, say 10, 15 years ago was significantly smaller. There was no such thing as a billion dollar venture capital fund 20 years ago. They were 100 million, 200, maybe three or four. What happens as the funds get larger is they need to deploy larger and larger amounts of money for it to make sense because, again, there's the people running the funds are effectively bankers and they only get paid, they only make money if they're investing the money they have. So whatever their size funded is going to definitely affect the size of the investments they want to make.

There are funds now who are going back to the smaller size investments but for a while many of the very established funds didn't even want to talk to you if you didn't want at least three or five million dollars and often a business doesn't need that. We talked already about the angels as another source. Next slide, please. So, it's an interesting affect because the large institutional funds are wanting more and more mature companies or further along, at least, in developing. You will find a lot of the professionals out there are getting involved earlier in helping in a non cash basis or whether saying, well, you know, we'll get your companies set up and we'll file your patents and do these things and pay us when you raise money cause we have confidence or pay us when you raise money and give us a little bit of warrant coverage or a little bonus and you'll see accounting firms, consulting firms, engineering firms, software developers. You can do hybrid deals and effectively get financing from the people who are going to make your company valuable. In different ways than the traditional, go to a venture capital fund, get money and then pay everyone you need to execute. Next slide, please.

Brian Cummings: That's a really good point though, from the university's perspective too, because you're really trying to leverage as many of these relationships as possible. So the University of Utah started a program called Venture Bench but it really is, a lot of it is based on third party providers. So we'll set up the company, we'll pay for the incorporation docs, the by-laws, you know, we'll do graphic design for our companies and web development. We'll do the accounting, we'll do secretarial, corporate governance services and marketing and business plans but it's all based on those relationships we've

developed in the community. So to go to a law firm and we call them, we said, we want boiler plate docs. They were more than happy to provide boiler plate docs at no cost to us so we could set up the really standard structure for an LLC, for a C corp., even an S corp. I mean, they really are willing to participate because they want to be good stewards and they want the potential business. Same thing with the CPA firm we went with. So they're all willing to say wow, this is a great deal because university companies are valuable. If I'm a university for low cost or no cost, my hope is that I'll get that company's business down the road and that's worked really well for us.

Jack Brittain: I want to follow up on that and actually point out to the folks that are associated with universities. The universities have a unique advantage over an individual entrepreneur in the fact that we can cultivate these relationships over time cause we're consolidating deal flow and so the kind of points that Adam made of it makes a company more marketable in the financing community, if you've build a prototype, if you've got some customers, universities are in a unique position oftentimes to provide that support to a start-up and we have internal markets. We can sell products internally to the university and having users who've evaluated the product, maybe it's not highly profitable at this point, maybe you're just giving it at cost but you still have an installed base to go talk to when you're raising the financing and then also on the professional firm relationships also because the university is possibly already paying them, it's much more palatable for them to give things away and then, they're building their customer development and this is actually from a professional firm standpoint, a very efficient way of marketing how much they have to spend to get new clients and versus just doing a subsidized process in the university. This is high value to them, you never need to be apologizing for offering them this opportunity cause you're a value generator and you're not necessarily have to say you're doing, it feel like you're getting it for free. You're really providing an access to these professional firms cause it's highly cost efficient for them from a customer development standpoint.

Adam Klotz: What I would say also is, building a company is really about building an ecosystem and you'll find the most successful serial entrepreneurs have built relationships with every aspect of what it needs to support and build a business, whether it's money or professionals or anything in between such that when you call your lawyer, you know your lawyer's going to help you find some good executives or have relationships with banks or with venture capital funds and the same thing, venture capital funds have investments in other strategic companies that could help you and be potential joint venture partners or a university that is going to have access to other talent that you really need or facilities and it's about crafting and using what's available to you to build something that's going to support your company in every aspect and so, whatever part of the group you're involved in, choosing the partners and choosing

the people you do business with, with a view toward other businesses and other relationships being built, is what's going to get you the most leverage to succeed. Next slide, please.

So, this is at the point where you have – the first thing, it's like shopping for a house, the first thing you're discussing, you know, you're looking in a general price range but you don't start negotiating the price until you decide you like the house. So when you are with a venture capitalist, the first thing you're trying to do is explain and get them to understand the value proposition of what this invention or idea or product, what it could be, three, five, seven years from now. The typical venture capital investment window is five to seven years and the typical venture capitalist is looking at a minimum to a high 20% internal return so compounded annual growth rate on their money, at least in the 20 something percent range, very often in the 30 so what you have to do is just create a perception and an understanding that however much money you're taking in today, the value of what that's going to be five to seven years from now is going to be 7, 10 or more times that and fundamentally, before you get to negotiation, it's about building that story and getting someone comfortable that there's a real need in the market that you are going to be able to satisfy but it is not scientific.

Troy D'Ambrosio: Maybe Adam and that's where, you know, when, particularly in you're in a really early stage company that's coming out based on technology and it may be having a new market. You can put together a bunch of very sophisticated financial models with discount and cash flow analysis that come up with a present value to invest in the company but don't get overly wet to those and fall in love with your projections and their numbers because it is a negotiation and you've got a, what people often felt the figure into that is what the risk profile of that investment is and how that substantially discounts it and if you're taking two million dollars for somebody today and you're trying to create a 30% annual rate of return, you've got to create a company worth, you know, if you sell them half the company, then you can create A company where it's, you know, 40 or 50 million dollars five years from now and that's a big hurdle to overcome and this is like, I said earlier, this is where people make a big mistake is they over negotiate and hold too much value here because and specifically, if you need subsequent rounds of money, you've got to understand how those different milestones hit the bump value up and it's a very, very complicated, very, very and it'll ultimately it comes down to somebody with the gut feel of saying, I feel good about you and your investment and I'm going to make that jump and risk with you, take that risk with you.

Brian Cummings: Everybody's point, you get so many opinions on valuation and what should I value it at and how should I do this and the average that we tend to see is, you know, if we're

going to value something and how we justify it, is really in the one to two million range and you can make a lot of cases for what's the IP worth and maybe what's my prototype worth and all the value that I've added but the best valuation I've seen was a deal we did out of the University of Texas. They spent a good year getting all the right people involved, getting a third party for them. They got a $24 million pre-money valuation which is really unheard of. It did have, it had, I think 36 patents in it so it was a huge patent portfolio. They were jumping off the airplanes and they were so excited they got this valuation and they got funded at that valuation but two rounds later, they got beat down and they had to revalue the company. It made $8 million and everybody lost big time because of that, you know, early valuation that they were so excited about. So don't, I guess don't set your expectations too high and it was an interesting question we had at this past conference, somebody said, well, it's so complicated, isn't it better to just not value the company early on and then try to take money and maybe somebody else who's more educated sets it. Well, that actually doesn't work so you want to, at least, take a stab at what a realistic valuation is cause if it's high, you've lost out in not participating in setting what you believe is a realistic valuation and if it's low, you'll lose also. So, it's not an exact science as everybody's talked about but I think you can put some realistic parameters in place.

Adam Klotz: I would refine that point just slightly in terms of, if it's a company that knows it's going to, if you know that you're going to be needing a large amount of money, a million, two million or substantially more to build out in full and you have someone interested and willing to fund the very initial stages of say, 100,000 or 250,000 dollars. In that limited situation, it can be worthwhile to do something where you don't value the company. You do some kind of bridge loan where you borrow money for say, a year and it automatically converts when you raise that million dollars and give some warrant coverage to the lender to reward them to give them an effective discount. So when the million dollars comes in and the company's valued and the company's valued at $3 million, the lender, often an uncle gets invested at their $250,000 loan invest converts at the same valuation as the million dollar investor but they also get a warrant to buy another $50,000 of company stock at a discounted price. So effectively they are getting a discount from what the later investor did.

Troy D'Ambrosio: Yeah, and we've used that in a number of early rounds too. It's a convertible note that goes on a – converts at a value in a larger round. The other thing that every investor's going to ask you initially when you're asking them to put in money, they're going to ask you how much money you put in and you're going to say, well, I put in my IP and I put in my sweat equity and they're going to say no, how much – have you written a check? Have you actually invested money? And if you haven't, then it makes the negotiations different. If you've got somebody that's done like a bridge like Adam said, it shows that there's been real hard, tangible dollars and the first dollars that's invested are always the hardest ones to get people like to have money in front of them that both take some of the risk out and so, somebody else smart cause looked at this and put their money at risk with it.

Adam Klotz: Next slide, please. So further to that, getting, from the inventor perspective, getting the company started and actually getting toward commercializing and getting in business, it should be the focus. I have very often, I have and particularly inventors come and they have 12 worksheet deep, spreadsheet calculating what their cap table is going to be when they go public five years from how and what percent they're going to won and what their kids are going to own and it's really not the best place to focus your time. Hope it happens but what you want to focus on is getting to market and building business and building revenue and it's much better to own a smaller percentage of a huge company than to own 100% of something that never gets started and I can't emphasize enough that focusing on the size of the pie is much better than focusing on what percentage of the slice you're going to own.

Troy D'Ambrosio: Adam, I agree if the first question out of somebody's mouth is how much of the company I'm going to have to give up before any other work or anything's been done is a red flag on getting up for success.

Adam Klotz: And I think Troy and Adam, if you could each say that three more times, I think it would be really, really valuable.

[Laughter]

Jack Brittain: I will say in our experience however, you can say that a bunch of times and everybody understands Bill Gates and a small share of Microsoft and everybody understands 100% of zero is zero but those in between parts are still tough for them and especially to go back to the discussion we just had about the valuation side, I think there's a tendency for the inventors to over value early on, anyway and they're seeing some of the biggest dilution early on anyway and so, we found that, you know, it's really useful to sit down and say, okay, you got zero, you know, now you have 250,000. Yes, it's a much smaller share of you had before but you know, on the university side, working with new inventors, you really need to walk people through this whole process and so they really understand how the value creation is occurring and I agree with you absolutely, Adam, you got to look at the valuation that people are holding personally that's being created and you can say this a hundred times and they'll understand it absolutely but the in between parts are still problematic.

Adam Klotz: Absolutely and I'd say that what I try and get my clients to focus on is the last point and really, in terms of aligning incentives what every – for the thing to succeed, you want everybody to feel that they are getting properly rewarded for what it is they're contributing, whether it's money or services or the idea that started the thing, that it is a negotiation and there's a balancing act and there's going to be compromise on all sides but fundamentally, what you want for the thing to work, is everyone to feel that they are being incentivized and rewarded for what they've contributed or are contributing.

Troy D'Ambrosio: The one thing I would add in that balancing act is you can have the best idea in the world and the best IP in the world. If you don't have the capital to drive it forward, that IP is devaluing every day cause somebody else is catching up with you and the markets are moving past you so, there is a time value to money on both sides of the equation and that you got to say it's like having a car, you can have a brand new Mercedes but without gasoline in the tank, it's just a depreciated of metal and the capital's worth that the gas that drives the value forward.

Adam Klotz: I'll extend the metaphor and say in many cases so is the, you know, experienced race car driver and that to translate, you know, you need three things. You need the good idea and product, you need the capital to execute and then you need someone who knows how to put

those two things together and make it actually work and some of the difficult conversations early on or even before there's money in, some times are you finding an experience manager and sharing a good part of the pie with that person to give them an incentive to turn this into a money making business.

Troy D'Ambrosio: I agree and to recognize that you may not be that person is a tough thing to come to realization that you have to say to yourself, I'm better off putting my future and my invention or my idea into somebody else's hands.

Adam Klotz: Yes, the successful inventors, I mean, I have clients who, you know, their first invention, they turned into a company and now they are running, you know, $150 million a year revenue business and they're phenomenal CEOs and I've clients who have done that and tried, even succeeded and realized, that's just not what they enjoy doing, they'd rather be starting new things and then, you know, I've had the client who absolutely believes herself to be, you know, capable of everything and finds out the really hard way that there's some things she's really good at and some that she's not. They can be hard lessons but to the extent you can really consider not just what you're good at but how do you want to spend your time. The sooner you do that, the better. Next slide, please.

So, this is a - people always want to talk about the valuation they got and there are a lot of moving parts that go into what does it mean to get a valuation and a key issue there, particularly in an earlier stage company before it's attracted all the management it needs, is setting up an option pool. So you've got, and I'll walk through in a little more detail that the end, some examples but a key thing to talk about in one of these negotiations is how much of the equity do you need to reserve to attract management team, other service providers and is the money going to share in that dilution or is that only going to come out of the founder's chair? Next slide, please.

Another thing is and to be very careful of, is the – and this is, I don't want to say it's a VC trick but very often VCs will make offers for amounts of money that are staged over time, in a way that you really can't be assured you're going to get the full amount of the money and I'd say

even you see this more often in less sophisticated angel groups. You need to understand what money is actually being committed and coming in now and what money you might never see.

Troy D'Ambrosio: Adam, I agree. I think I would be very leering of signing up that particular with angel groups on that kind of tranche investment because if they don't have any capital pool that can be drawn on automatically, they have to write individual checks and even with VCs, there's usually enough outs in the tranche investment that if the money's very problematic, whether it'd actually ever be invested or not.

Adam Klotz: Next slide, please. So on that, if there're going to be milestones which generally I try to avoid, they have to be objective milestones that there's not going to be arguments about whether they were achieved or not and they have to be ones that you're confident you can achieve. You need to make sure that the milestone matches the amount of capital you're going to need at the time and whatever you think that is, increase it by 20 to 50% because there's going to six things you didn't think of sucking cash and don't be too conservative and lastly, there need to real teeth in the obligation to fund because, and I have seen venture capital funds simply default, you know, all the objectives criteria simply, you know, completely met, company clearly needs the money and the VC just says no or the VC, you know, and sometimes that no is because the VC's limited partners who are supposed to put in the money, refuse or for whatever reason, things change and you need legal remedies of whatever equity the company already, the VC or the investor already has, has to affected. It can't just be an option on the investors' part to invest over time and if they don't like what they see, they can stop investing because the more the company is dependent on and needs the money, the harder it is to raise the money and the worst valuation is going to get even if it's accomplished a lot. If it ends up in a point where it's counting on money coming in but it doesn't, it really starts to spiral and be difficult. Next slide, please.

Brian Cummings: This is the transition over to the university stake. One of the panelists made a comment that the university, that slide was blank because the university gets so little in this process but I know venture capitalists and angel groups would obviously disagree with this. So the next points we're talking about are how the university and the inventors get directly involved

in this process and some of the points that we see that are real sticking points in the negotiation as we're setting up the license agreements with venture capital groups or maybe even an acquirer and again, what the inventor and the university want to look out for in this process, probably there's some real disparity about how you set this up. When we do a start-up company and we've done obviously quite a few of these, we actually try to take preferred stock in the process and that is a big, big issue for the venture capitalists so it's just our standard starting point. I would say we probably get in about 30% of the cases and anybody can comment against this point but we get real strong opposition sometimes because the venture capitalist say no, we're putting in our direct cash into this, you need to put your direct cash in too. So our comment is, we actually are an early investor. A lot of times the services that we contribute, you can actually monetize, you can put a cash value on. We put direct grant money, we put the university and the foundation's dollars into those companies with the intellectual property, with some of the grants that we do, we have three different granting type programs.

So we try to make a case for preferred stock and like I said, we don't get it every time but it's valuable because if the company goes wrong or there's may be a liquidation or a bankruptcy preference, the preferred stockholders are the ones that usually, obviously get the first return on their investment and when the inventors get involved in this process, that's a more difficult situation too and I only say this because we've had two instances which were very interesting case studies that they were long term companies, one company was around for four years and one company was around for seven years but they ultimately were acquired. They weren't acquired for a huge, huge valuation. It was almost basically a break even on the investment dollars. Only the preferred shareholders were cashed out so we weren't actually involved but the inventors came to us and said, we didn't have preferred stock, we put obviously seven years of our life into this company and we didn't have preferred stocks so they didn't get any return on their stock but it's something you want to think about. You're going to get a log of push back from the venture groups and the angel groups on how you can say that why should you get preferred stock but there obviously are preferences to getting that class of stock. I don't know if there were any comments to that point because we do a lot of opposition to that.

When you look at equities versus royalties and how you want to structure the deals, obviously these things trade so we don't charge our companies when we look at royalties and royalty fees and upfront fees. The companies are obviously starting from scratch, they're really strapped for cash. I know universities are also in TTOs and TTOs are strapped for cash but nobody needs the money more than the company so we try to defer patent costs, we try to defer our fees in that, we try to defer annual fees, license fees, ongoing fees and then try to hold up on any types of collection as long as possible and when we look at okay, what are we going to trade for equity so we obviously convert all those fees into what we believe is a fair equity stake and we base all our equity stake on, and royalty stake on kind of industry standard. So we just pull a lot of public databases and that makes the negotiation go much more faster and hopefully, we're trying to align ourselves with the venture groups because ultimately and I think Troy had this point was these guys are the really the ones that are driving the initiative so they're adding the value. The intellectual property's important but without that great management team, the best technology's going, it's going nowhere so you want to make sure that you're aligned with the inventor's interest, you don't want to have to fight all the time with them. So get the deal done and then get out of their way and make it in their best interest to move forward quickly.

So we look at it as, you know, anything from, you know, a 2 to 10 percent is pretty average for what we can actually negotiate, as far as converting those fees into equity and then how you structure that. So more and more we're looking at more all equity deals in some cases but we'll do a combination of equity and royalty but we are seeing people come to us and say, can you do all equity and in some cases we do all equity deals and take that royalty out and then we talked a lot about valuation in this. This point is actually – we hold our equity to a certain valuation so at least the university and inventors know where they're coming into the capitalization table. So if we say we want two percent of the company held to a valuation of $2 million, we know exactly what our cash value is in that company and then where we're getting into that company and this is more just because we've done enough deals where we've seen somewhere it just break down. If you don't have sophisticated inventors, I'm sorry, venture capitalists or angel groups or the inventors are doing some strange deal or the founders are doing a strange deal, they can recapitalize the table, they can recapitalize the company, they can transition to a different entity

and you really don't know what's going on behind the scenes and you can really lose a lot of value. So this is something that we tend to get. Most people understand this point so we again, we try to get this into the license agreement and it really does help the inventors and it really does help the university to know where you're coming into the first round of capitalization.

And then a couple other points, we try to get options and warrants, if we can, into the agreement so these are just things that well, if the company's doing well and our point is, well, if the company's doing's great and benefitting, hopefully, the university inventors can benefit also. So we'll try to get future options and maybe we can participate in future rounds to these next few points and it's just at a fair market value. So if they're doing, say a Series A or a Series B round and then they'll give us a right to also participate in that round. So they'll come to us and say, okay, we're raising $5 million, do you want to participate at the fair market value? It's not that we can and we definitely don't want to hold up the round but if we can, we think it's in everybody's best interest. In a lot of universities, they don't have the capabilities to this because it does require some due diligence. It's even tough, sometimes tough for us but there is an upside to the university inventors if they can do this.

Troy D'Ambrosio: Brian, just quickly, the one thing I would just caution – capital's always difficult to raise and not putting too many impediments in that are going to be issues that you're going to have to revisit with the VC is something to kind of keep in mind because if they look at an agreement and say there's, you know, that's preferred or there's owners of royalties or anything else in there that is an issue, then they're going to have to, it's just easier, unless they really love the deal to move on than trying to figure out if they can go renegotiate or get over those points or they're going to just extract it in the value equation in some way.

Brian Cummings: Yeah, again, you want to try to align and get out of the way. The people that are really going to add value and do the product development not put up too many barriers.

Adam Klotz: Yeah, what my recommendation is to always try and have as few moving economic parts as possible to the relationship among the parties, you know inevitably in the negotiation you start adding bells and whistles as compromises but to the extent you can have, you know, the ideal from a transaction point of view in going forward, is to, you know, to

basically determine relative value contributions and own in that proportion between investor, excuse me, inventor and university or initial funder and university and then be as clean and simple as possible going into the round where you're trying to get large amounts of institutional capital because the more different royalty streams and options and warrants and participation of future round rights that there are among multiple parties, the harder it is simply to get a deal done with the next investor.

Troy D'Ambrosio: Exactly.

Brian Cummings: Yeah, you don't want to inhibit it and usually if we can get some of these, there's really strict time frames. You have to move within two weeks or 30-days because yeah, you don't want to be a hindrance to the other people that want to put in their money and get this deal done quickly.

Adam Klotz: That's a good point.

Jack Brittain: I think we're raising the point that when you have a university involved, it's really a multiparty negotiation and so part of the role of tech commercialization is to get our team aligned which is not always easy to do that. That kind of makes the financing negotiations go more smoothly if we have an alignment on our side but the reality of the university deals is they're really multi party and oftentimes multiple rounds of negotiation, other than just, you know, what the financing deal's going to be and it's very important to be attentive to all of those parties, all of the interest and again, the two CO can generate a lot of value by getting the team aligned before you go in so you don't have disagreements at the point where you're trying actually bring in the funding.

Brian Cummings: Excellent. So the inventors, I mean, what they should be thinking about is obviously they're critical to this process so I can't think of any start up or any early stage company that was based on a technology that the VCs or the group funding the company didn't say, we're not going to do this if we don't have the inventors involved in. We need them to be 100% on board and we know in most of the cases they have full time jobs at the university and I mean, that's what they do great and we hate this, we dislike it when inventors leave to go with

companies because, I mean, we're part of the university, we love to see them, they're very inventive, they contribute to the university and the education mission but it's a fine line but everybody understands their role is critical to the success of that company. It's especially because it's early stage, there're so many moving parts to do prototype and product development and the next round, maybe it's a software or medical device but you have to be involved but we brought up the point many times, you have to understand what your role is in that company and how you want to participate. So you're just one member and as Jack just said, you really want to be aligned in those multiple parties so although it's critical, you want to make sure that you understand where you fit into this whole process and you're not actually running the company in the most part so because you're not actively involved in day-to-day operations, most of the venture guys in the angel groups will give you a smaller piece of the company and you want to make sure that you address the conflicts in that situation and I believe probably every university had a conflict of interest policy and how you would participate in that.

So we have it where we're fairly flexible because we believe the conflict is what really is creating the value. I know some universities are very, very strict about conflicts so you want to look into your policies and your procedures and see what you need to do but I would imagine in most cases you need to disclose it early on that you're thinking about starting a company at the point of disclosure and then what are the implications of that and we were talking and I don't know if anybody's on the line from Minnesota or not but they have a real problem, they're not allowed to do any deal until the conflict is fully cleared. That was one of the most stringent conflicts of interest policies I heard because that can take up 12 months. Most are kind of a parallel process. We're starting a company and we're evaluating the conflicts.

Again, at the University of Utah, we allow what we call double dipping so most inventors at a university get an inventor share of the equity and the royalties and they're allowed to take an inventor share in the company so they can get equity on both sides of the table and you want to understand how those play off each other but I guess that's rare because I was at Texas before this and you have to make a decision early on and that's not always an easy decision to make, of what's going to pay off more. Should I take more equity? Should I participate in the equity that the university had because maybe it's got preferential treatment? But these are just

considerations, these are factors you want to consider while you're getting into the company. I believe more universities than the University of Utah actually make the inventor decide, you know, which side you're going to participate on, the university side or the company side and make that decision early on and then you want to also consider the inventor, what your role's going to be. So, are you going to be a board, you're going to take a board seat? Are you going to be – maybe you are going to be an employee in the company, maybe you're going to – some of our inventors reduce their time. We've heard companies, I mean, universities more and more allow employees to go on sabbatical, maybe one year or two years sabbatical to get the company going and then come back to their original position. They might be considered a founder, a scientific advisory, they might serve on that board, they might get equity for their consulting.

So there's many different areas you can participate in, actually get a piece of equity in the company but again, so the point of everybody was, so how much is that actually worth. It's probably not as worth as much as you think. It's a small percentage of the company because you're not actually involved in those day-to-day operations. You're going to see that the venture group and the executive team is probably looking at a greater stake in that company because they're taking a much greater risk in that company. So I think the point was made many times, make sure you're aligned with it, make sure you understand all the implications of all the sides that you're involved with and then really try not to be too greedy in this process because you're part of a bigger team and it's the faster you get to market and the less inhibition you can bring to the table, the greater the company's going to be and it really is about speed to market.

Adam Klotz: Yeah, I see people have, inventors having the greatest success where they think of it, not as entitlement but again, about incentives and making sure that every, you know, that everyone who is contributing something is getting the proper incentives and reward for doing so. It is almost fatal to a company and it's a total turnoff to an investor to look across the table at the inventor who feels a sense of entitlement to kind of the salary in perpetuity for having invented something. Next slide.

Adam Klotz: I thought it would be informative and helpful to kind of take a sample venture capital term sheet and walk through what is really involved and so as all new companies are

called, this company is Newco and what the hypothesis here is that there is a new company which really is very early stage, products not yet marketed. It might be that going out has a beta version of software or a simple kind of home shop, creative prototype of something and now it needs a substantial amount of money, a million and a half dollars from a, either a VC or an angel group that is established and experienced and commands the types of terms you'd typically see from a VC for a series they invest in. So what we have here – and I would like to just – I'll assume for the purpose of the conversation that people do not have a lot of experience with capital structure cause it's easier to hear what you already known than it is to miss on something you don't. In the ownership of a company, in venture companies, it's just typically divided between common stock and preferred stock and what preferred stock is, it's a separate class of ownership that has special economic and/or voting rights, typically the economic are the more focused on, (2) the common stock and in particular, it could have dividend rights and liquidation rights so if the business, in this example, if someone, if a million and a half dollars is being paid for preferred stock and the founder owns common stock, if the business sells a year later for a total of a million and a half dollars, the investor gets all of the money cause they have preferred stock and they get it first.

So here, we've just – I posited, it's angels, there're two angels and there's going to be, you know, one who puts in a lot of money and another who puts in a small amount of money. If you could scroll down a little bit so we can see all of terms of Series A Preferred Stock. So here, what happens if - preferred stock is really often a hybrid between debt and equity. In the sense of it's going to have features that make it feel almost more like debt in the sense of it's senior to the common stock and it often has a dividend feature. So dividends, this provision is – there's basically an 8% coupon on the money. There's a million and a half dollars that comes in and there, and often there is an argument as to whether that 8% is just gonna be accruing over time and so the preference that the investor gets on the million and a half dollars, does that have a time value of money associated to it? So it's always just growing and the more time it takes for an exit, the more there is a hurdle that you have to give the investor first before you, the founder get your percentage of the value.

Troy D'Ambrosio: From a negotiation standpoint, this would be a standpoint that, a point of negotiations and I work out really hard, cause, you know, the giving a participation liquidation premium like that would be something I'd really work hard to negotiate on.

Adam Klotz: Yeah, this one is drafted as kind of a middle ground or even quite sound or favored.

Troy D'Ambrosio: Yeah, I thought so too, yeah.

Adam Klotz: This is a dividend that says it's non-cumulative and it's when and as declared by the board of directors.

Troy D'Ambrosio: Exactly.

Adam Klotz: In this market, you're going to find an investor says no, I need to have, you know, that the cumulative aspect is, does it automatically just accrue so every year, 8% or a million and a half dollars is added to what the investor gets first and the reason the large majority of investors, in particular VCs are going to insist on that, is the way they're constructed as a fund. They take the million and a half dollars from their investors and then, they have to pay their investors a preferred return, in their entity. The managers of the venture capital fund pay Princeton endowment or Harvard endowment or CALPERS, you know, retirement fund or large institutions or just wealthy individuals. They are paying time value of money to the investors before they share in the upside of managing this investment. So venture capital managers are very reluctant to sign up to something that doesn't have kind of a mirroring return.

Troy D'Ambrosio: Yeah and as you said, Adam, this is a founder friendly clause of the way this dividend is written.

Adam Klotz: Yeah, more times than not, it's going to be cumulative. Then, on the liquidation preference, you will see this, you will see that so in a liquidation or winding up of the company, the investor gets their money back plus declared but unpaid dividends. Here it's declared means the board said hey, we're paying a dividend. Most of the time you will see this say plus accrued but unpaid dividends meaning dividends that have just added up over time and then after that,

this one here, it really – I shouldn't have included it this way, typically what happens, the Series A will be treated, will get to participate as well. This is non-participating preferred stock which you will almost never see. Participating preferred stock means you get your liquidation preference, you get your million and a half dollars plus accrued dividends and then, you get your full percentage of the company. So if you own 50% of the company, you get a million and a half dollars plus your dividend plus you get 50% of what's left and that is by far the norm and in some cases in this market you'll see that you get two times your investment or three times your investment. I should say you, the investor does before anyone participates.

Troy D'Ambrosio: Yeah, I think if you got to this level or this is just done on the liquidation preference out of – this is Troy, this is something you should run to the bank with as you're raising capital one to one liquidation preference with a non-cumulative dividend.

Adam Klotz: Yeah, this would be an extraordinary opportunity. So the whole idea of conversion is really going to come up in the case of a company going public and really the reason you have separate classes of stock is to keep separate rights and separate economics for the investor and to create a special class of protections as well and one of those main class of protection is here, under anti dilution provisions. Basically what there're all different types of anti dilution protections, the kind that you would never say yes to and should just automatically know that it should be a non-starter, it's kind of share based anti dilution protection, meaning the investor puts up their million and a half dollars and they always get to own 20% of the company, no matter what happens in the future.

Troy D'Ambrosio: Or a fuller ratchet anti dilution provision.

Adam Klotz: So that next on the kind of continuum would be the fundamental issue that the investor is concerned about is that they're investing at a valuation now and okay, we accept your valuation, we're going to get X percent of the company for our money. What if you're wrong and in terms of how much money you need or in terms of what the company's worth and six months from now, you go out and raise a bunch more money at a lower valuation.

And so what anti dilution protection does is it adjusts the effective price that is paid by your prior investor. So if you're paying a dollar a share here and someone later buys it for 50 cents a share, a ratchet

is kind of a mechanical engineering analog, it's one for one if I paid a dollar and some else paid 50 cents, you adjust my price to 50 cents which effectively means I get twice as many shares as I would have gotten and you give me the full benefit of that prior valuation. What happens in that situation is the investor is completely protected from any dilution on that. It's as if they had bought at the same time as the new investor and the founders are the ones who get their shares completely – they are give – they're just reaching into their pocket and paying 100% of the cost of the change in value and that is a very difficult and it can really be something that destroys the incentive on the founder and should really be resisted, if at all possible, where you see those most often a ratchet most often happening is not in the first round of a company but in a situation where there have been multiple rounds. There's a disagreement about valuation and the fund says okay, we'll live with your valuation but if you're wrong, we have this hammer on you. That would be having a situation where I've seen it dealt with most and the other thing to do is if you're going to have a ratchet and you have to live with it, is to put a time limit on it because there could be a lot of reasons, overall market conditions could change, all different things could happen that cause down rounds that aren't just about not succeeding on your business model. So I've seen as a compromise that you say well, you can have a ratchet after, if there's another round in the first 6 or 12 months. What's in here is a much fairer analysis which is to say, if you invested at a dollar and the later a round is done at 50 cents, you calculate what is the average price per share paid and that's what the conversion adjust to. So effectively you are giving the investor some additional shares to account for that the valuation is being adjusted but it's in the middle, it's an average and a hot part of the negotiations is going to be what types of issuances don't affect the number of the percentage ownership of the investor. There're certain types of dilution that you want the company to have and you want, so, e.g., you're going to hire new officers, directors, employees, consultants. You're going to do an acquisition and use shares of the company or you're going to get some equipment financing or something and you're to give some warrant coverage to the lender. Those things again, if their pie expanding, then there isn't a basis – you're not really hurting the value of the company, you're hopefully increasing it. Those are situations where you do not want to be getting more shares to your investor.

Talk about voting for a moment. There are two things. Very often investors going to say that they, you know, they want representation on the board of directors. The director of a company has a fiduciary duty to defend and do what's in the best interest of the company. If they happen to also be the founder or happen to also be an employee, an executive or an investor, they have to be very careful that when they say yes, we should borrow this money or we should issue more shares or acquire this company, that they're doing it because – or no, that they're doing it because they believe it's what's in the best interest

of the company, not what's in the best interest of their personal investment. So an investor who is on the board looking at, should we raise more money at a lower valuation than I invested in, has to put to the side what their personal circumstance is and do what's right for the company at the time. On the other hand, protective provisions are basically veto rights, special veto rights given to the investor that they are being specifically told – please scroll back up – it's still actually on the page – little more, one more, almost there. Protective provisions. So what those are, those are flat out veto power- that you cannot, a company cannot do these things without the permission of the investor and those are very – that's a very important list because that's basically the investor can slam their foot on the brake and say no to things.

Troy D'Ambrosio: Adam, on both the provisions on the board; having the board and the protective provisions. Again, I think these are clause that are extremely founder friendly because of the makeup of the board and the protective provisions that I mean, a lot of times you'll see if there's any of the preferred stock outstanding, they still have the protected provisions in place. Here you only have half of the proverts so I think both of these clauses are very founder-friendly.

Adam Klotz: Yeah, I would say, you know, you should be able to get it to be 25% of the shares outstanding. What you do not want someone to be able to do is have just one share of preferred outstanding and still have a lot of control but 50% would be extraordinarily founder friendly, I agree.

Troy D'Ambrosio: And the board makeup of five members and you know, the founders being able to point a majority at the board. Usually you have five and the investors are two and the founders are two and then there's an independent person appointed by them collectively so that neither has control and there's kind of a third, neutral party arbiter and that they have agreed to, if you will.

Adam Klotz: I agree.

Troy D'Ambrosio: And that would be acceptable and that's something that you should put would be an acceptable board structure, I think.

Adam Klotz: I think that's- I agree with that, as well. I think I'm going to skip over the registration rights provisions.

Troy D'Ambrosio: Yeah, I agree with you, just – I got hung up on those. My initial first time I did this and you realize they're basically useless cause the underwriter determines any of the thing regarding that anyway so.

Adam Klotz: One thing I do want to just point out because it might not necessarily be intuitive but, and I'm not anywhere in particular on the term sheet at the moment but the expenses of the financing itself, it someone's investing a million and a half dollars, an investor turns his last things, they expect their legal and accounting expenses to be paid out of that.

Troy D'Ambrosio: And you had a cap in here, Adam, of why $25,000, I think which is, you want to definitely cap the expenses that can be charged back against the invested amounts so.

Adam Klotz: Right and that's also a company friendly number. It really depends in what region you are, what's involved in the company, how much – if it's a pure startup versus if there's a lot of contracts to review and a lot to understand in terms of the existing capital structure but just so you'll understand, as a founder, as the university when the investor writes a check for a million and a half dollars, they expect the company to then pay their expenses out of that money. They're not – because again, how their fund is constructed, whatever they have to do to invest in the company is their investment and they do not want to reach into operating capital the little that they have in order to make an investment. It also, in terms of tracking an investment, they want to know every dollar it cost them to put into the company.

Troy D'Ambrosio: And exactly, if they have some third party due diligence expenses that they have to do, an expert that they have to hire or they have to travel or do something like that, they'll ask for reimbursement of those expenses generally too.

Adam Klotz: So, I would like to talk about pro rata rights on future financings. This is basically the ability to co-invest in future rounds and what that does is the best way to protect their position is to keep investing and you want an investor that wants to keep investing but by the same token, this is not an obligation of the investor to invest. This is under what circumstances do they have a right to invest and a key issue here is you need to carve out the situation where you're really not trying to raise money. If every time you, if you hire a new CEO and you give that CEO two, three, five percent of the company, you do not want the investor to be able to say, well, I get to buy a piece of that because the purpose is you're not raising money and you shouldn't be protecting from dilutions, the investor and a carefully negotiated part of this is going be how much equity can you give away to executives, to lenders, to other people before they can say well, hold on a second, that's too much, you know, stop and then, and a key one there is acquisitions. If you're now in a position where you're able to use equity the company to buy another company, that's a situation and the board thinks it's a really good idea for the business, having the investor say, well, I'm going to put in some money instead of the acquisition or to have further dilution,

really disrupts the business's ability to grow because you're not looking for money, you're looking for something different from money.

I think that's the next thing I'd like to talk about is, I'll get to the warrant option pool next, founder's stock vesting. Even if a founder and an inventor already owns all their shares, if there is a real dependence going forward on that person to be involved, very often investors will say, as insurance and incentive that you inventor are going to stick around and not quit, I want there to be vesting on your equity. So basically the company, if you leave the company, the company should be able to buy your equity from you because the valuation effectively was wrong or your, if not the right division, if you're not longer around. This is a hotly negotiated topic and it's just something that, you know, it can be appropriate but can also be a great shock to someone who already owns all of their shares to be told there's a chance that an investor's going to want to take them away.

Troy D'Ambrosio: And Adam, I think you're right in this term sheet. This is the most problematic, this section in this term sheet, in the way this is structured always one of the most difficult ones to negotiate, you know, if investors are focused on the founder being long term with the company.

Adam Klotz: Yep and this is one where and I just, I can't tell you, this, I took an actual one that I did a number of years ago with what I would say it was a very high sex appeal, dot com business with, that was very synergistic with a billionaire's existing public company and a bunch of very savvy inventor clients of mine, got him to understand that it could really help his company for a company like this to exist and this was the key issue. Was like I'm willing to invest and I don't want a lot of controls and I don't need huge economic teeth but you better be around and the reason I use one that was actually more founder friendly than some of the others is to show that these things really are living dynamic negotiable things and the situation very much thrive where the issues are going to be around the negotiations. This was the hot button. I'm investing in you, genius CEO and I'm willing to, you know, take a big risk. I think this company could be huge but if you're not there, I have very low appetite. Just a provision that founders might not be as familiar with but it does come up as a co-sale agreement or a tag along right. Very often there're going to be provisions around well, if one person is selling, you can't leave the others behind. So if the founder finds an ability to sell, that has to allow other people to sell in proportion. As a practical matter, it doesn't usually come up because as in here, there's a right of first refusal. If anyone wants to sell their shares, they have to come to give the investor the first right to buy those shares, which often effectively means that you will not be able to sell your shares because no one is going to make an offer

and do the diligence and learn what is involved in buying the shares if, when they finally do that, the investor could just say, oh, I like that deal, I'll just scoop it.

Troy D'Ambrosio: And Adam, you had – and a lot of times you wanted to see, you'll want to see drag along or tag along rights and just see complete lockups, you can't sell your shares at this point, right?

Adam Klotz: Right. I think I'd like to go to the sample cap table now unless there's anything anyone would like add. So this is the game I was talking about earlier. If you suppose that the founders, there are two inventors and together, they own 1.7 million shares and the investor says, I'll give you a million and a half dollars and the first example, the shares actually outstanding, give a million and a half dollars and I'll pay a dollar a share so the investor's getting 46.88 percent of the company and the implied pre money valuation there is $1.7 million because you put in the 1.5 and together, it's $3.2 million. If, on the other hand, on the next line down, the shares outstanding or reserve, if you say, well, we think we're going to need to issue another million and a half shares to employees and service providers and the, effectively the investors' going to look at that and say, well, I'm only getting 32% roughly of the company once all that stock is issued.

So the compromise that's here is to say that, okay, we're going to treat 800,000 of those shares that are reserved as actually having been issued and what the issue becomes is how many shares is the investor going to dilute for? If the investor doesn't dilute, then that means the founders are taking all of that dilution and I've seen it all over the board. I mean the ideal for the founders is that the investor just pays one and a half million dollars for one and a half million shares and any future issuances dilute everybody proportionally. In the, I guess I left out it here to make it clearer. In the other examples, in the four million, you would have the investor would actually pay a lower price per share in order to protect themselves from the dilution on the 800,000.

Troy D'Ambrosio: Yeah, cause they'd be looking, Adam, that's where they're looking at a percentage ownership post money so they target and buy in, instead of a dollar a share, they buy in at some lesser value so they'd still be at the 46% of the company or something like that so.

Adam Klotz: Exactly.

Troy D'Ambrosio: And one thing that this, Adam, is assuming that you don't need subsequent rounds of capital and if you do, if the million's just the first round you're looking at B or C or D rounds in addition, you almost have to extrapolate out beyond this and say, what is this A round investor going to own after

we do multiple rounds of investment because that's what they're going to be looking at what they're fully diluted, of ownership is based on the valuation to create their economic returns. So this is a straightforward one round investment that to give symphony with more complicated, if you're looking at raising more capital in this.

Adam Klotz: Yes, and in order really to, for a founder to, what I typically do with a founder, is, you know, you're building that, the three to five year plan that you are showing to your, the financial plan that you're showing to your investors. A lot of times, a lot of founders initially think it's just a big waste of time and they're just, you know, making stuff up in order to tell a story to bring in the money and that's the view at the beginning of the process. Going through the exercise of what you really think you need to do and what builds your operational plan. When are we going to need money? How are we going to spend it? How is this going to happen? It's never going to be accurate in the sense of you're not going to follow it exactly but it is a very good educational process to go through and you really can't predict what your Series C, your Series D round is going to be and what's it going to do but doing that is a very good exercises to seeing exactly how it, you know, it might play out and having the conversation and understanding from the investors' perspective what are they looking at in terms of really getting a return on their investment.

Troy D'Ambrosio: Yeah, and if you don't do that and can't say to how much additional money you'll need beyond this round, they're not going to, you're not going to be successful raising that round.

Adam Klotz: Well, I think we're at a point we could probably take some questions.

Cindy McManus: Absolutely, thanks, gentlemen. Ladies and gentlemen, I'm going to open the floor up to your questions and your comments and as promised, we'll be opening up the phone lines in addition to the chat. While we're waiting for folks to get organized in both those area, Gerard, I'm going to hand things back to you.

Gerard Eldering: Yep, great. Thanks, Cindy and panelists, I'm just going to ask a question while we wait to get something in from the audience. Can you guys talk a little bit more about opportunities to bootstrap and consult? We've all seen some companies where folks have gotten along with some consulting services, bootstrapping for a number of years until they got to the point where they had to raise capital or maybe didn't even have to do that and I'd like to hear from any of you. Troy, you might have some particular input on that.

Troy D'Ambrosio: Thanks, this is Troy, you know, in the company that I raised capital for, they were such capital intensive businesses that we weren't able to do that in those. So it was a full core press to raise the capital and we had capital of our own to kind of get us to that so but, and several of the university companies that we've spun out, we've been able to do that and people are both with the university's support and then, as Jack mentioned, the service providers round, you really can build a great deal of value without having to take capital and sometimes they'll provide you need and sophistication in that company you need just to get to where you can raise that outside capital, that includes, you know, legal work but accounting work but also in product development and software development or development. We've got a medical device that we've been able to do a lot of work here at the University and use consultants without bringing on a whole bunch of staff to get that into a prototype phase where we're able to actually now go ask for a first round of investment.

Brian Cummings: And this Brian. Bootstrapping is obviously, you know, to Troy's point, it's great if you can do it and operating lean and mean is obviously valuable and that, if you can really focus on the milestones that you're going affect the valuation, you're going to end up with value where you can affect the valuation from an equity standpoint and the university can obviously affect it from a licensing standpoint. You just don't want to – you want to make sure that you don't get too safe and secure and we see this a lot and you know, people use the term SBIR shops so if you bootstrapping with some of that free money and you rely a lot on SBIRs, people actually tend to get really good at writing those and they just keep writing another one and another one and they really lose track of focusing on product development and exits. It's a fine business but they're never going to get big exit or usually a big return on their equity so you never want to get too comfortable.

Troy D'Ambrosio: And Brian, this is Troy. If it's a technology, you really don't have time to – you don't have a significant amount of time where you can just bootstrap it because if your technology's new and cutting edge, the competition is right behind you probably.

Brian Cummings: That's right.

Gerard Eldering: Gentlemen, this is Gerard. Have you guys seen any cases where friends and family have been able to move a company along. I've seen a few situations where the family actually has, can make a significant investment.

Troy D'Ambrosio: This is Troy, I mean, that's how I did my first business is was primarily our first capital and there's been a couple cases at the university we've had people been able to reach into their own pockets, I think Brian, is that correct?

Brian Cummings: It is, I mean we don't see it a lot but we, I mean, we probably had three this past year that friends and family have been involved in and normally, again we're a little leery cause you want to make sure that you got the right money in, you got the right executive team but these have been fairly savvy people that have come out of the school of medicine, some of the family had some money that comes in from relatives and this one guy, his brother was overseas, it was a medical software appliance, it's worked really well actually in moving the technology along quickly.

Gerard Eldering: That's great, you just have to have the right family, right?

Brian Cummins: Right.

Troy D'Ambrosio: Rich relatives, they're a good thing to have.

Gerard Eldering: It's heart, mind. I know they're out there.

Paul Rauch: As I recall, Troy, your dad was always asking you why you weren't working on Sundays, sometimes that money's pretty costly money too.

Troy D'Ambrosio: Yeah, when you're at Sunday dinner, it has it's own cost to it so.

Gerard Eldering: Yeah, that's true. Well guys, with that we're going to have to wrap it up today. We're even a little bit over time. I want to thank all the panelists for their time and valuable insights. It's great discussion. I think going in to the cap tables and term sheets can be very, very valuable. I'd like to thank our audience members for participating today. We've got another great session planned next week. We're going to get down into the business plan which is really key component to a successful startup in helping you think through the plan and how you're going to move forward with it. We've got some terrific speakers for that as well so we hope that you'll be able to join us for that. Thanks so much, enjoy the rest of your day.