Securing Your Investment

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Howitt & Co

The Opportunity

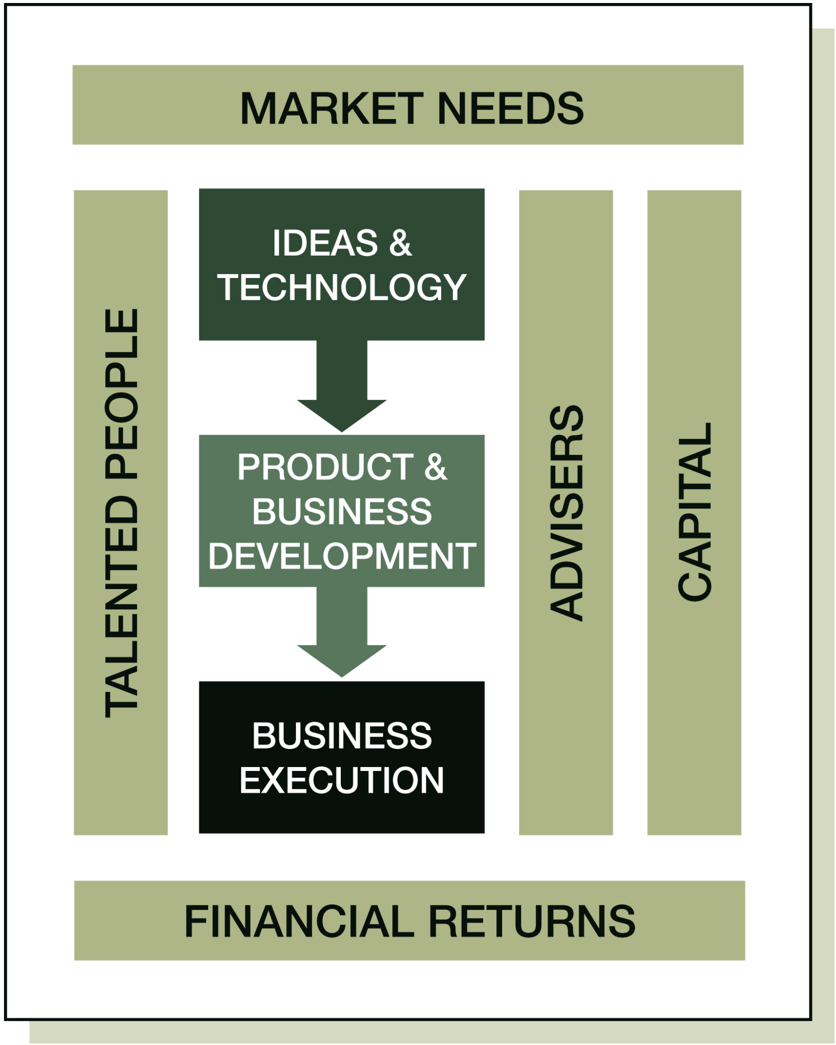
"*Thus we witness technology time compression. It took Hewlett Packard 47 years to gain a billion dollars worth of market capitalisation; it took Microsoft about 15 years, Yahoo about two years and Net Zero about nine months. When time is the competitive weapon,* ***a small, nimble company can out-manoeuvre a large company every time.***"

Steve Jurvetson
Draper Fisher Jurvetson
September 2000

Summary

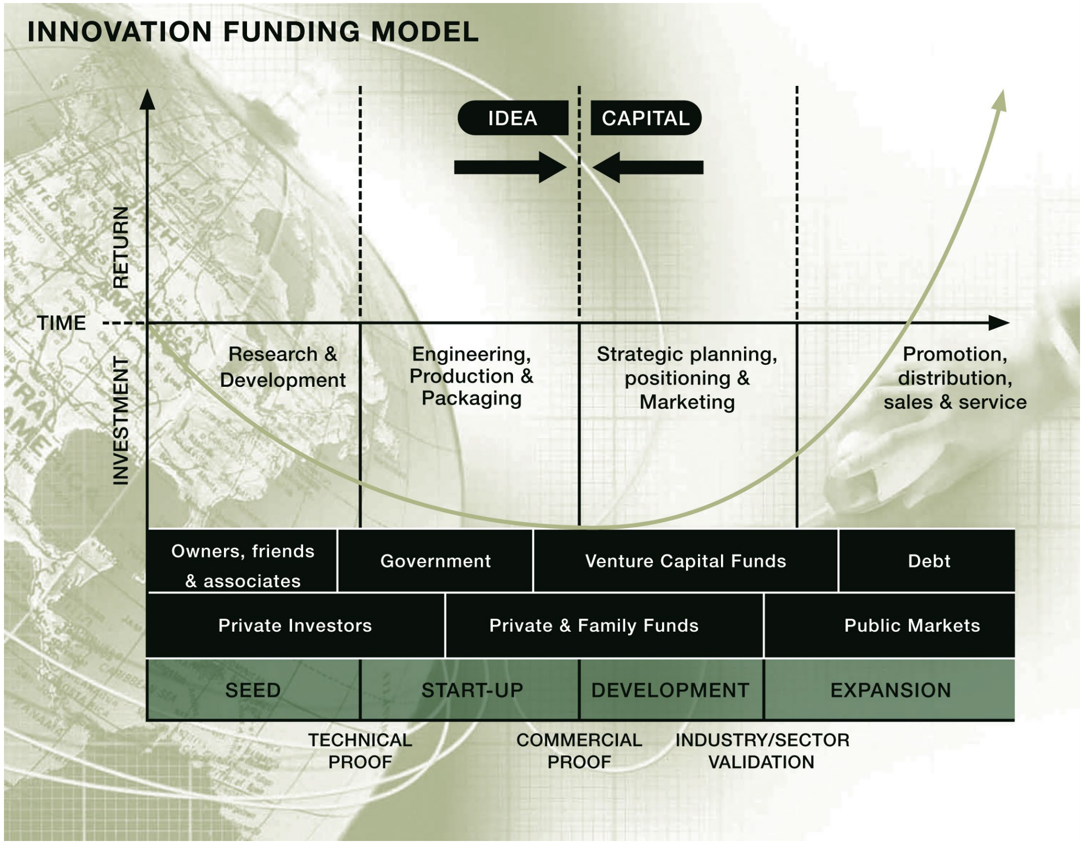
Enterprise Development

New enterprises need to bring together the right mix of people, skills, technology, resources and capital to build a successful business



Stepped Value Creation

Value is crystallised at critical development points and funding should be matched to ensure sufficient capital to reach the next point, with a minimum of risk but without excessive dilution



Availability of Capital

1. Risk funding through IPO’s is focussed on resources
2. Private equity as a % of GDP in is low
3. Allocation to venture investments is minimal
4. Competition for available funds is fierce
5. Enterprises seeking funds must stand out
6. Alternatively move to the USA

Sources of Funds

- Friends & Family
- Debt (credit cards, mortgage, personal loans)
- Government
- Angel Investors
- Family Funds
- Venture Capital
- Private Equity
- On-line Investment Boards
- Strategic Investors
- Public Offerings

Investor Requirements

1. Return on investment
2. Open market
3. Clear competitive advantage
4. Succinct rationale
5. Proven performance
6. Minimal risk
7. Business understanding/synergy
8. Confidence in the people
9. Global scale

Private Equity Issues

1. Funding timing
2. Structure of the transaction
3. Board & Management – value add
4. Valuation
5. Follow on funding
6. Strategic value

Determining Funding Required

1. Net cash flow requirements plus 25%+
2. Sufficient funds to achieve the next point of value creation (plus a safety net period)
3. Investors will always seek a substantial enough stake to justify taking the time to assess and execute the investment
4. This is typically 25-45% regardless of funds required and perceived valuation
5. If the business has global reach then 2nd & 3rd round funding may come in the targeted markets or through strategic partners

Valuation Approaches

a) Net Assets/Replacement Value

b) Price Earnings Ratio (PE)

   a) Typically 3-4 EBIT for private companies

   b) Leverage into public companies at av. 10-12 PE

c) Revenue Multiples

   a) Often 1 x for early stage companies

d) Discounted Cash Flow

   a) Values future cash flow i.e. the business potential

   b) May include a terminal value based on PE

Investment Instruments

- ✓ Simple share equity
- ✓ Shares and options
- ✓ Varying classes of shares
- ✓ Convertible notes
- ✓ Converting preference shares

Key terms

- ✓ Period and conversion price
- ✓ Ratchet and valuation mechanisms
- ✓ Terms of next round of investment
- ✓ Interest rates
- ✓ Control of core assets
- ✓ Security to be provided
- ✓ Legal jurisdiction

Due Dilgence

1. Preliminary due diligence
2. DD files in an electronic folder
3. Confirmatory due diligence
4. Lawyers & accountants

Producing Documentation

- Business Planning Guide
  - For business plan or IM
- Pitch guide
  - A succinct “elevator pitch”
- Corporate Profile
  - Typically 2-3 pages, a précis of the investment proposition
- Investment Presentation
  - Typically 30-50 slides
- Integrated Financials
  - Assumptions, Valuation, Projections, Resourcing, Capital Expenditure, Cash Flow

Presentation Overview

- Introduction
- Mission Statement
- Background
- Market Drivers & Analysis
- Key Revenue Sources
- Products & Services
- Major Clients
- Market Opportunities
- Strategic Advantage
- IP & Trademarks
- Corporate Structure
- Management Structure
- Financial Projections
- Comparatives
- Valuation
- Investment & Returns
- Transaction Process
- Risks
- Timetable
- Summary

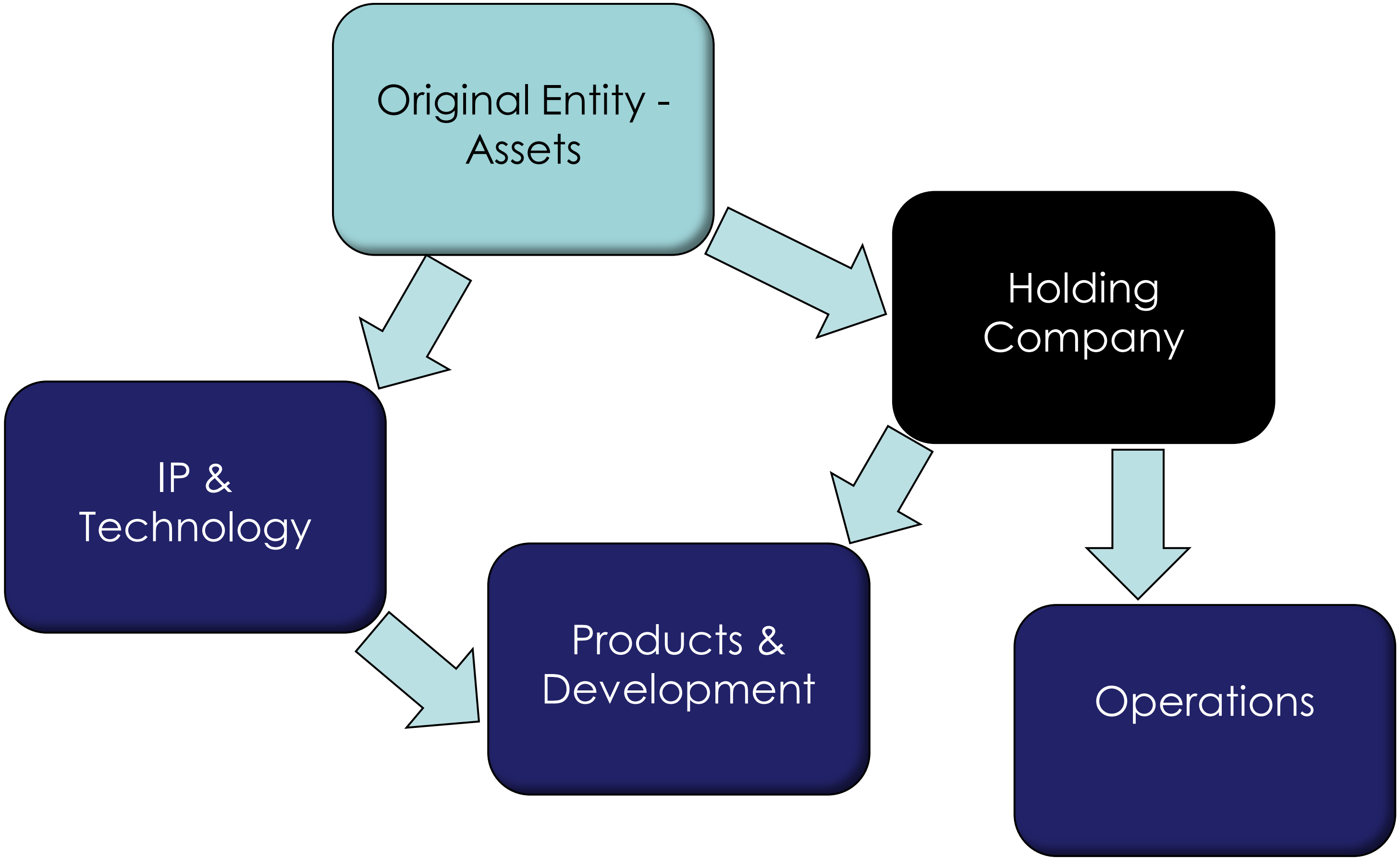
Selecting an Advisor

1. Arguably more important than your accountant or lawyer
2. Should have a demonstrable track record in similar sector and stage of development
3. Rewarded for deliverables and successful outcome
4. The selling team should be the delivering team
5. Rapport so you can keep talking over the tortuous journey

Company Structures

1. Simplicity versus protecting core assets and the Founders
2. Assets and operational liabilities should be separated
3. The jurisdiction should be where the funding occurs
4. Investors desire a clean structure without unknown liabilities
5. Investors want their funds/equity where the real assets are owned

Typical Structure



Capital Raising – Summary Process

Typical Timing

Strategy, Targets & Preliminary Pricing

Stage 1:
Develop Strategy & business plan

- Assess business using proprietary methodology
- Confirm strategy
- Produce detailed valuation
- Identify potential investors/ partners & conduct preliminary research

4-6 weeks

Documentation and Implementation

Stage 2:
Present Opportunity to targeted range of investors/ partners

- Create selling documentation
- Prepare due diligence materials
- Finalise target list of Investors/ partners
- Presentation road show and distribute selling documentation

6-8 weeks

Finalisation and Integration

Stage 3:
Execute transaction to maximize value For client

- Facilitate preliminary due diligence
- *Negotiate & Structure transaction*
- *Shortlist investors & sign terms sheet*
- *Confirmatory due diligence & process legal documents*
- *Close Transaction & Integration*

6-8 weeks

Pre-transaction Review, Planning & Structure

1. Review structure & shareholding and contractual relationships with all stakeholders.
2. Analyse financials & forecasts and validate financial assumptions.
3. Review management & board resources.
4. Re position key selling proposition.
5. Formulate minimum and desirable capital requirement.
6. Define a profile of the ideal investors
7. Consider structural/market implications .
8. Modify documentation to reflect new offer
9. Create a detailed project schedule.

Strategic Support & Documentation

1. Review structure & transaction approach.
2. Refine integrated pro forma financials & projections.
3. Develop a Corporate Profile (2-3 pages) and a company presentation targeted at investors.
4. Draft revised Information Memorandum.
5. Document comparatives & valuation justification.
6. Develop draft execution documentation.

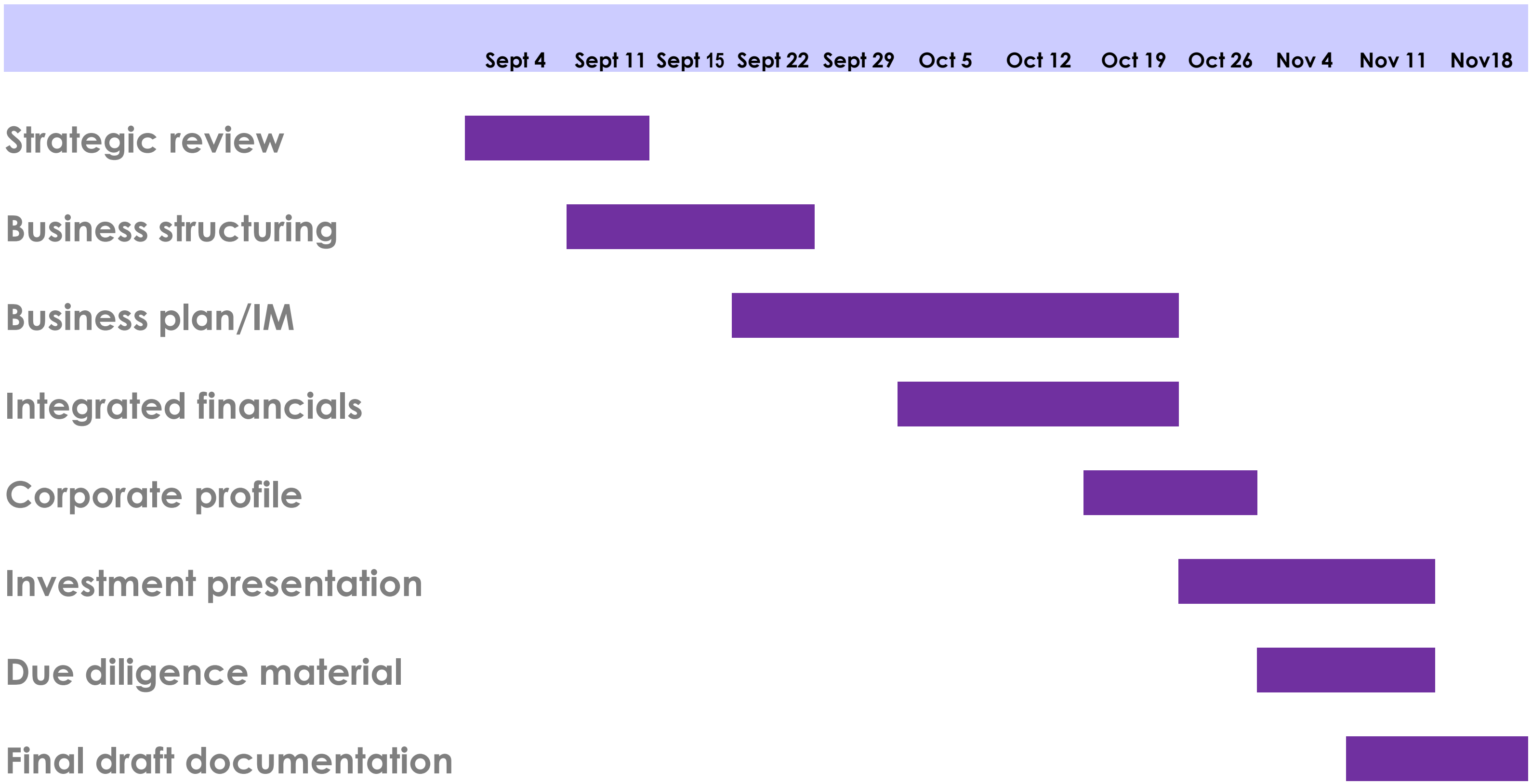
Transaction Execution

1. Determine the list of investors and make initial approaches.
2. Obtain NDA's & arrange presentations.
3. Follow up qualification & provision of information packs.
4. Support valuation & comparatives.
5. Assess roadblocks/risks.
6. Maintain transaction momentum.
7. Facilitate preliminary due diligence.
8. Manage project schedule.
9. Propose term sheet and seek agreement.

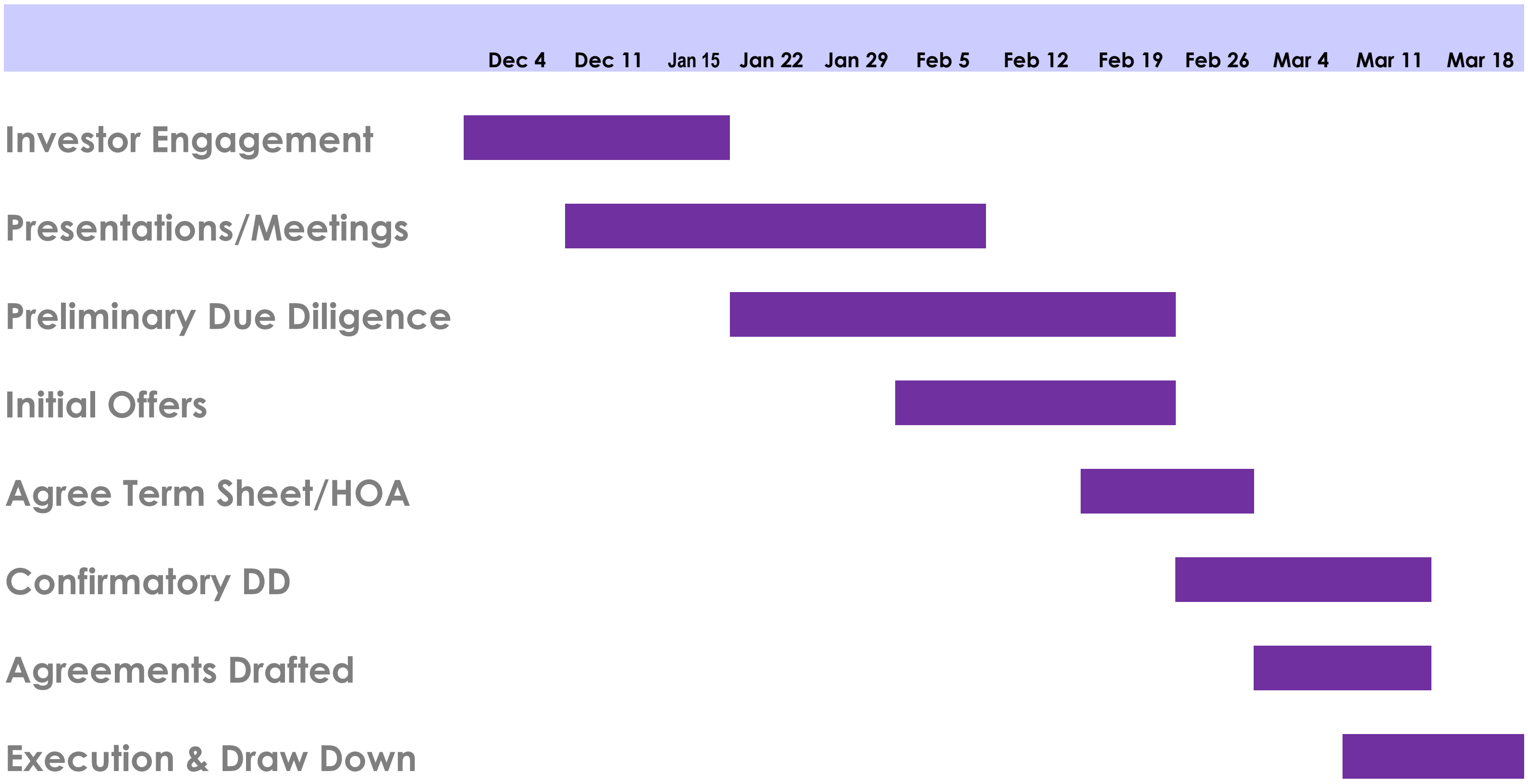
Completion

1. Facilitate investor confirmatory due diligence.
2. Assist analysis and support for financials.
3. Review, analyse & summarize offers/terms comparatively.
4. Co-ordinate external advisers as required (lawyers, accountants).
5. Facilitate negotiation of terms.
6. Provide independent but committed input to all parties to ensure execution.
7. Provide informed input to closing documentation.
8. Maintain momentum to successful conclusion.

Capital Raising Time Table - Preparation



Capital Raising Time Table - Marketing



Reminder: Key Areas of Focus

1. Ensure your business is consistent with the weight of capital
2. Research your market and competitors thoroughly
3. Focus on value creation and competitive advantage
4. Define an achievable business model and distribution strategy
5. Demonstrate that your Board and management have the capacity to execute
6. Establish a sensible company structure
7. Show clearly your application of funds and capital requirements

Why Pre IPO funding using Private Equity…

- Access to capital faster than public markets
- Ability to fund a specific transaction in timely manner
- Debt/Equity mix maximized
- Valuation has the potential to provide IPO benchmark
- Provides Management exposure to Financial Markets