

From Seed to Series B

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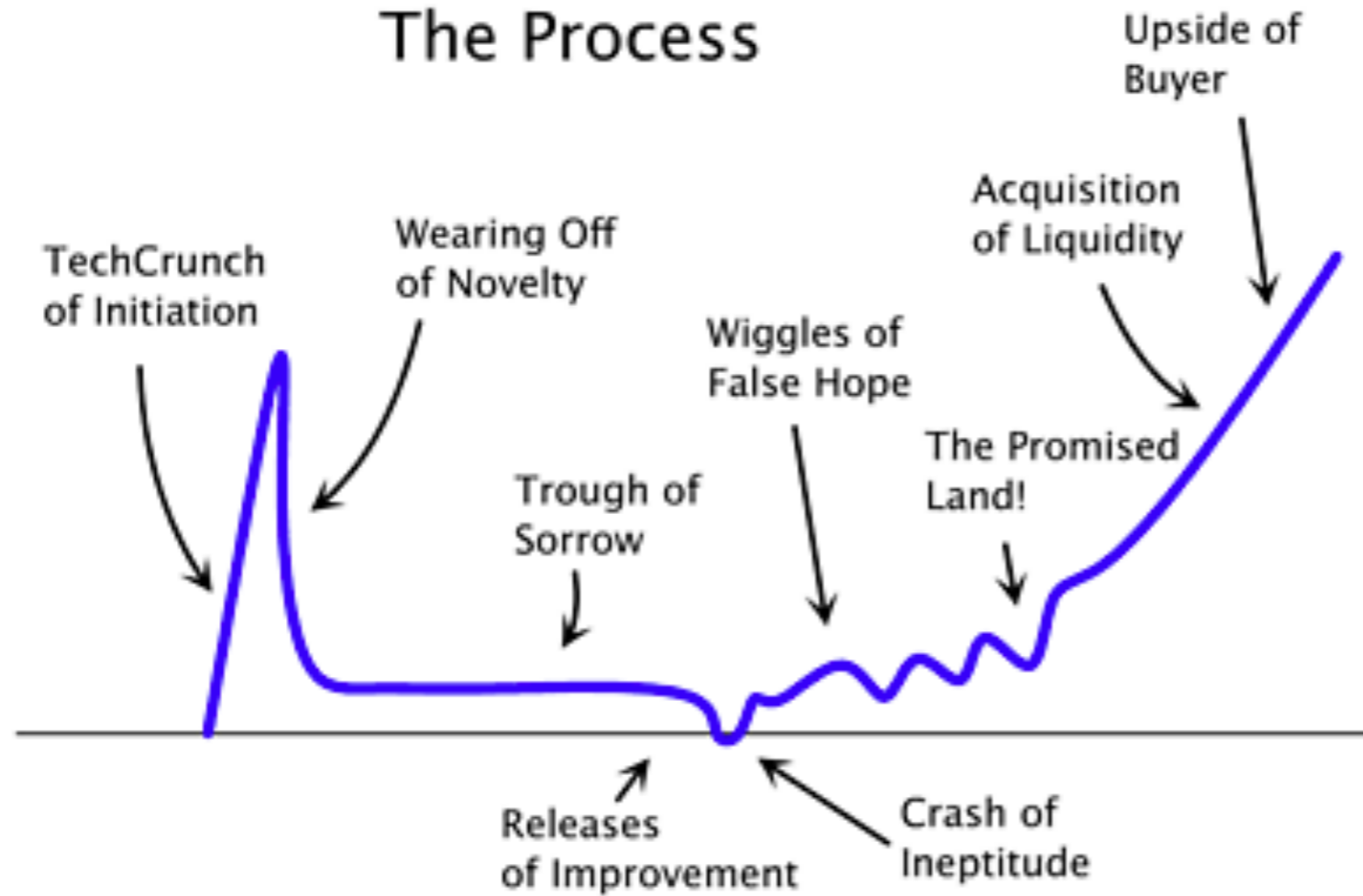
My Background

- Particle Physics
- Y Combinator (S08), Cloudant, IBM
- Liquid 2 Ventures



“Universal” startup trajectory?

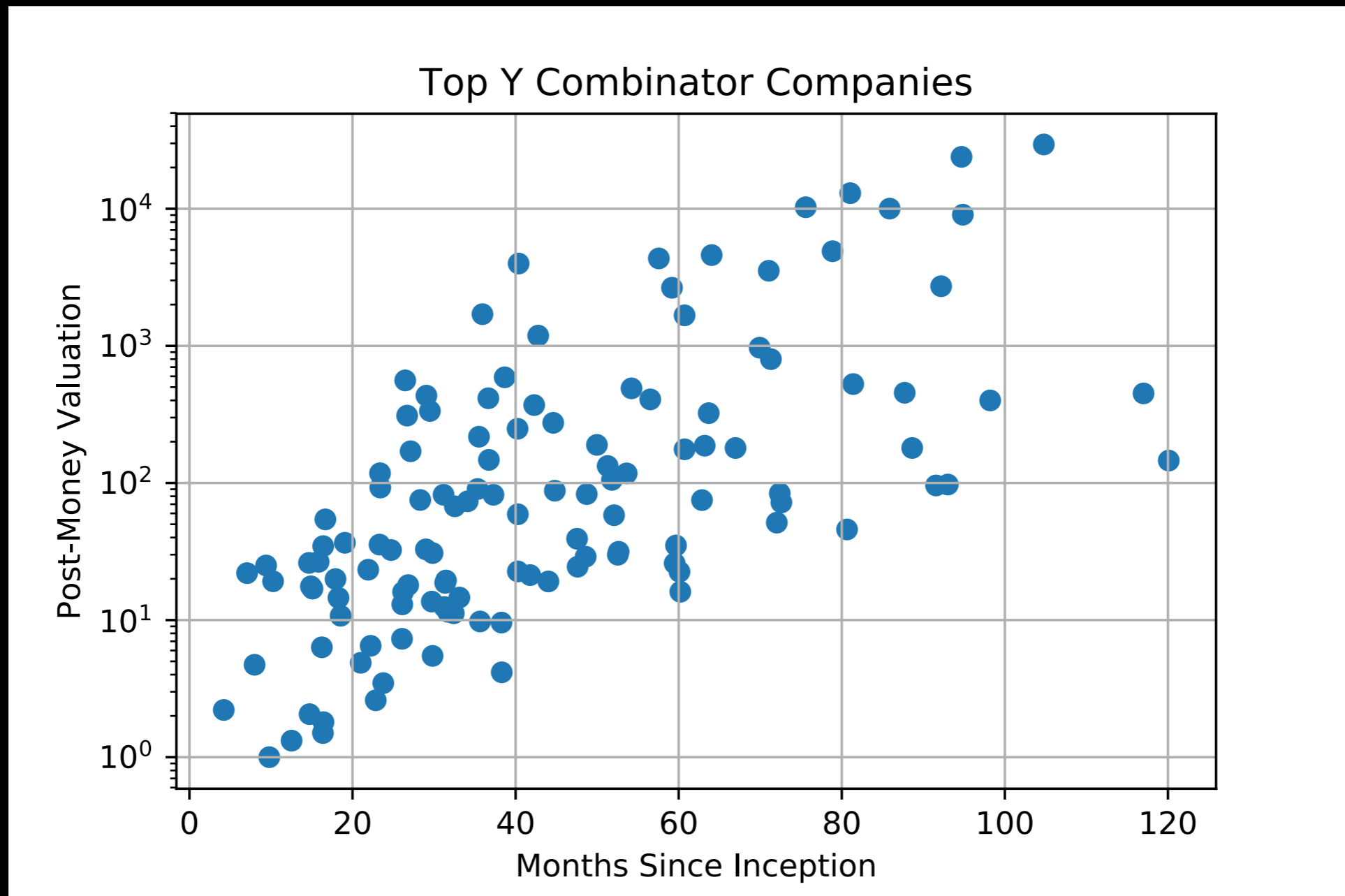
The Process



“Our job is to help you keep your startup alive
long enough to realize its potential”

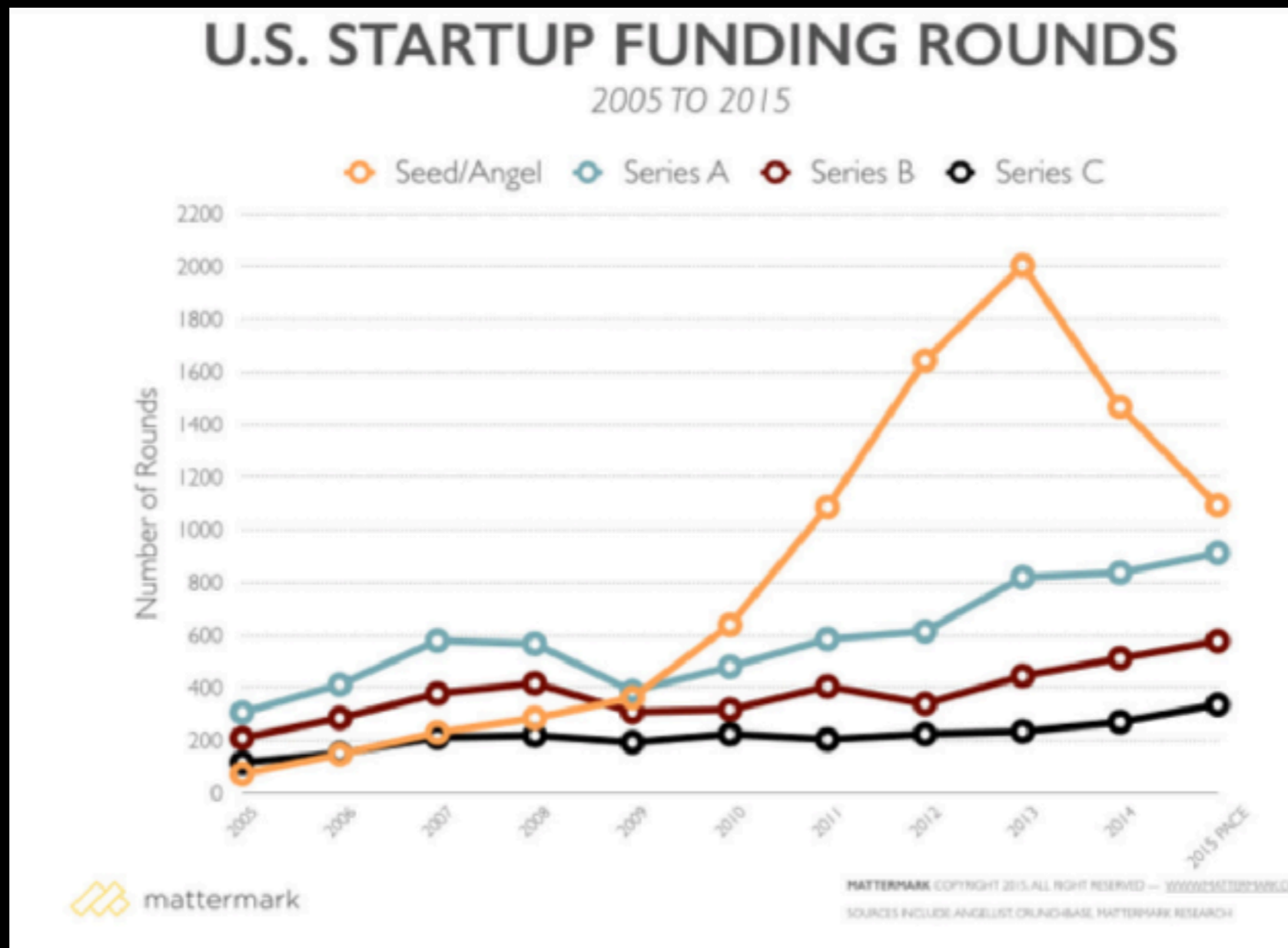
–Graham from Cendana Capital

“Universal” startup trajectory?

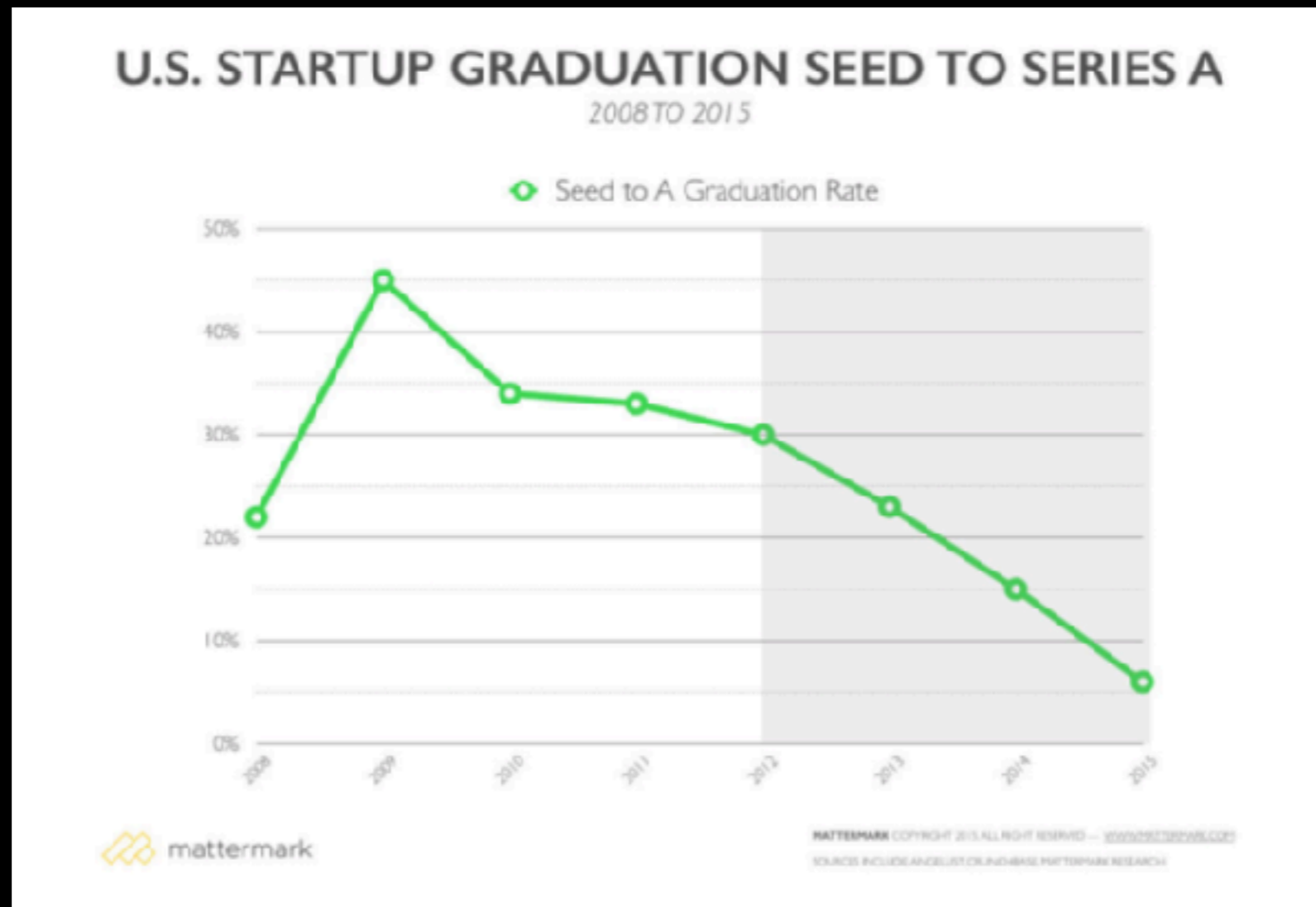


Data taken from Pitchbook

Industry Trends



Industry Trends

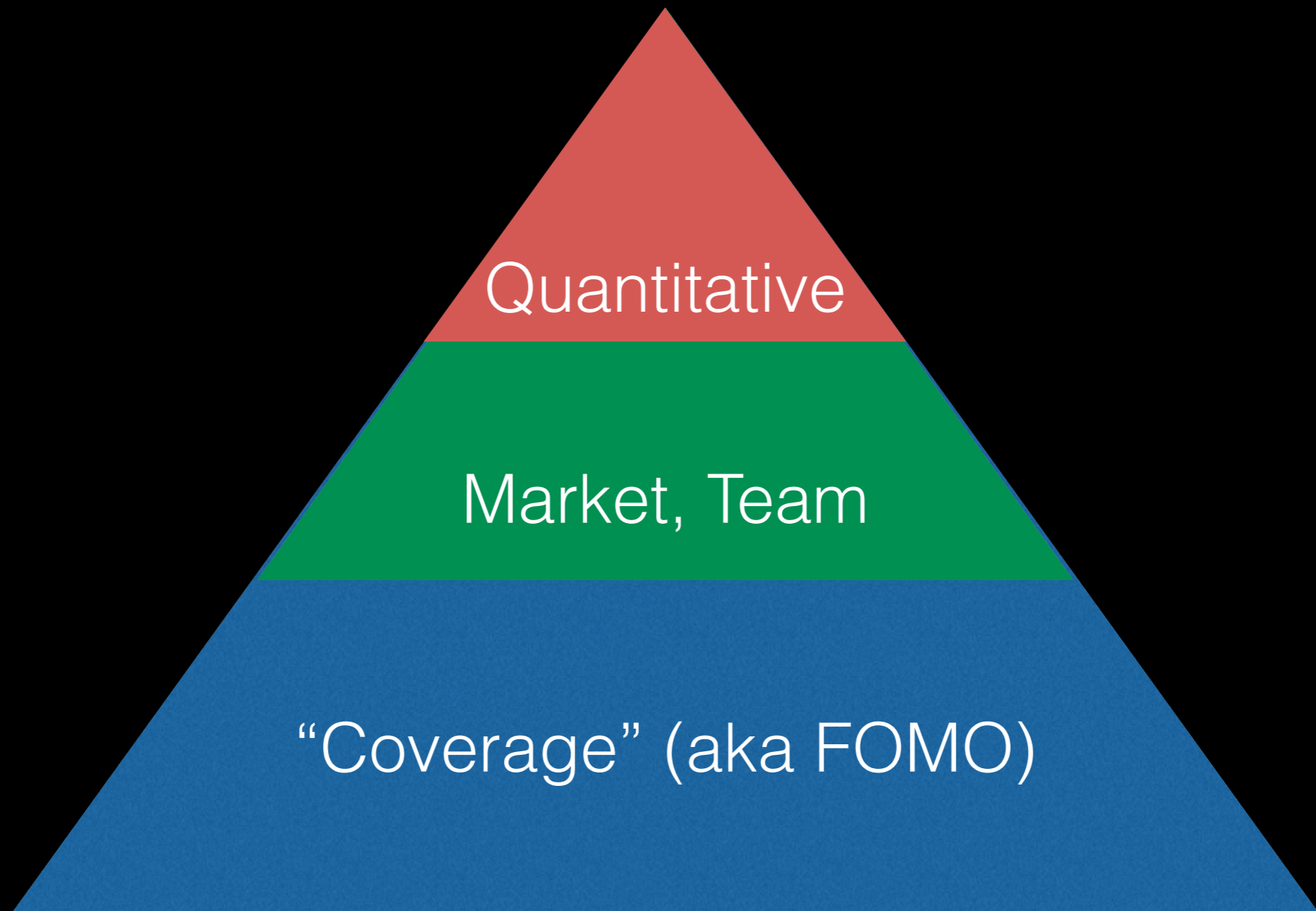


In truth, graduation rates vary wildly on starting population. Who did the seed, how big, when?

“We find 65-70% get Series A funding, 40-45% get to Series B.”

-Anon (Top 5 seed fund MD)

Why deals really get done



3 Types of Investors

“What do I have to do to get funded?”

What you cannot control

- Your competitors
- Geopolitics and macro-trends
- VC dogma
- The outcome of any given deal (highly stochastic)

What you can control

- Product
- Team
- ***Revenue***
- NPS
- Messaging around raise (pre-seed, seed, seed', seed+...)
- Timing
- Optimizing the raise:
 - Establish the market
 - Who you pitch first, what feedback you get, etc

Aside: Why investors care so much about Marketing

- Measure twice, cut once
- Have you really identified the core business problem that you solve?
- How easy is your sale
- Is your sale repeatable
- Cloudfant example: it's not the tech, or scaling, its the time time market. => make it faster to build new revenue

Series A: SaaS

- Pre-A Funding: \$2.5MM-\$3.5MM
- MRR: \$100k - \$250k
- ARR: \$1.2MM-\$2MM
- 15-20% MoM,
- ***12 months in the market***
- Wide range, dependent on the actual GP

Series A: Infra

- Pre-A funding: \$4MM-\$5MM
- **“Prepare yourself for a seed prime/seed extension/seed plus/seed convertible raise...”**
- \$1MM - \$3MM ARR
- 3-5 “marquee” customers: “thought leaders associated with New IT, devops, digital transformation and the like”
- “Beefy ACV to demonstrate you’re solving an important problem”

Series B

- Estimates vary even more wildly.
- “5x your A numbers in <2 years”
- “Be like Gitlab!”
- MRR: \$500k - \$1.2MM
- ARR: \$6MM - \$9MM
- Quantify: churn, CAC, LTV
- Team size 40-60, significant non-eng
- 2-3X YoY strong B (*)
- 5-10% MoM rev growth

(*) Hmm, where does that come from?

IMHO: To achieve Series B, prove you are going to be a “meaningful exit” for your VCs.

<https://medium.com/jme-venture-capital/meaningful-vc-exits-2bb5702776e2#.usqs1a7h6>

A Typical Early Stage VC Fund

- 2/20 Fund Structure
- ~20 core investments per fund
- Goal: 3x gross returns
- Expected outcomes:
 - 7 zeros, 7 money backs, 6 wins
 - 5 “meaningful exits” and one “home run”

What's "meaningful"?

The diagram illustrates the calculation of a meaningful return. It features a central equation: $\frac{\text{Returns}}{\text{Company}} = \frac{3 - 1 - \frac{1}{3}}{5}$. Red arrows point from labels to parts of the equation: 'Return Goal' points to the '3', 'Homerun' points to the '1', 'Money Back' points to the '1/3', and 'Meaningful Exits' points to the '5' in the denominator.

$$\frac{\text{Returns}}{\text{Company}} = \frac{3 - 1 - \frac{1}{3}}{5}$$

Meaningful Return = 1/3 of Fund Size

What's "meaningful"?

Fund Size	Meaningful Exit	Home Run	VC ownership	Exit Size for Meaningful Exit	Exit Size for Home Run
50	17	50	20%	83	250
100	33	100	20%	167	500
350	117	350	20%	583	1750
1000	333	1000	20%	1667	5000

Your Goal



Assumes 20% ownership (Series A goal)
Larger funds do have more GPs, but this is LP math

Revenue Requirements

- A SaaS company with 75% gross margin can be sold for 5x ARR
- A marketplace company with 15% take rate can be sold for 1x the last twelve months (LTM) gross merchandise value (GMV)
- An e-commerce company with 30% gross margin can be sold for 2x the LTM revenues
- In all cases, Net Debt (debt minus cash) at the time of exit equals zero, so Enterprise Value (EV) = Equity Value
- In all cases, the same growth rate is assumed

Know your asymptote. I didn't.

Revenue Requirements

Fund Size	Exit Size for Meaningful Exit	SaaS Target ARR (5x)	Marketplace Target GMV (1x)	E-Commerce Target Revenues (2x)
50	83	17	83	42
100	167	33	167	83
350	583	117	583	292
1000	1667	333	1667	833

You've got 5-7 years to hit ~\$20MM ARR

Growth Requirements: t2d3

Year	0	1	2	3	4	5
ARR Growth Target		Triple	Triple	Double	Double	Double
ARR Target for Meaningful Exit	0,2	0,7	2,1	4,3	8,5	17
ARR Target for Home-Run	0,7	2,1	6,3	12,5	25,0	50

Triple: 10% MoM
Double: 6% MoM

What to do if your round isn't happening

- Be honest with yourself and investors
- Grow both revenue & margin
- Extend runway: (Burn <\$100k month)
- The dirty secret of the bridge round, and how to do it
- Venture debt (Banks & Funds)

How bridge rounds really work

- Almost everyone has to do a bridge rounds.
- Bridge rounds are always insider rounds.
- Try to secure 50% commitment from your anchor investors before picking up the phone.
- Don't expect much/any bump in terms.
- If you are executing extremely well, you may be able to do an uncapped note with 20% discount to the next round.

Venture Debt

	Hercules Technology Growth Capital, Inc.	Silicon Valley Bank - Term Loan	Silicon Valley Bank - WC Facility	Gold Hill Capital 2008, L.P.
Loan Amount	\$ 7,000,000	\$ 3,000,000	\$ 4,000,000	\$3,000,000, minimum advance of \$1,000,000.
Funds Availability	\$4M at Close, and \$3.0 M available Q1 2014 upon achievement of 85% of revenue in the Board approved 2013 Plan.	Up to \$3M available from closing through end of draw period, or 6/30/14.	300% of MRR x annualized Customer Retention Rate (CRR). CRR = (100% - lost customer percentage) x 12. MRR = monthly contractually obligated recurring revenue from SaaS customers, excluding license, advertising, and usage based processing.	\$3,000,000 available through March 31, 2014, minimum \$1,000,000 advance.
Maturity Date	42 months	48 months, or June 1, 2017	364 days from Closing	42 months
Interest only	12 months	12 months	12 months	6 months
Amortization	30 months	36 months	Principal due at Maturity. Outstanding Principal shall conform to Borrowing Base Formula, and any amounts exceeding Formula shall be paid immediately.	36 months
Prepayment Penalty	Prepayment fee of 3% of the advanced amount if prepaid prior to the first anniversary of the funding, reducing to 2% between the first and second anniversaries and 1% thereafter	None	None	Prepayment fee of 3% of the advanced amount if prepaid prior to the first anniversary of the funding, reducing to 2% between the first and second anniversaries and 1% thereafter
Interest Rate	9.5% + 1% PIK interest	WSJ Prime + 2.25%, floating (WSJ currently 3.25%)	WSJ Prime + 1.25% floating. WSJ Prime is currently 3.25%	11% fixed
Facility Fee/Other Fees	1%, or up to \$70k, and a due diligence fee of \$30k	\$5,000 paid at closing, \$5k good faith deposit at start of due diligence, refundable if not approved by Bank. If approved, applied to commitment fee, but retained by bank if transaction does not proceed.	\$10,000 paid at closing, \$10k good faith deposit at start of due diligence, refundable if not approved by Bank. If approved, applied to commitment fee, but retained by bank if transaction does not proceed.	Final payment of 2% of amount advanced at the end of the amortization period, or up to \$60k
Warrant Coverage	6%, or ~ 208,955 shares or >1% of fully diluted, priced on the lower of the Series B preferred stock price or the price of the next round of financing, includes registration and anti-dilution rights in parity with the series B investors.	3% of line, or \$90,000 worth of shares at the series B price (~45k shares or less than 1% of fully diluted).	2% of total line amount, or \$60,000 of shares of Series B, or approx. 29,850 shares or <1% of fully diluted.	Upon closing, 130,000 shares of common stock at \$0.32 per share, and 43,333 shares of common stock per each \$1.0 M advance at \$0.32 per share.
Collateral	Perfect first lien security interest in all assets with a negative IP pledge.	First lien in all corporate assets, excluding IP, with a negative pledge on IP.	First lien in all corporate assets, excluding IP, with a negative pledge on IP.	Blanket lien on all corporate assets excluding IP, with negative pledge on IP.
Covenants/Conditions of Closing:	Contingent upon closing at least a \$10 MM series B equity round.	No discovery of material facts that would change investment decision after due diligence, no reps, warranties or disclosures shall be false or misleading, signatures required, borrower pays legal costs.	All collections will flow through a cash collateral account or Lockbox. No discovery of material facts that would change investment decision after due diligence, no reps, warranties or disclosures shall be false or misleading, signatures required, borrower pays legal costs.	Transaction must be completed 45 days from execution of term sheet. Subject to satisfactory due diligence, calls with venture capital investors, satisfactory loan documentation and no material adverse changes prior to each advance.
Financial Covenants	None	None	Minimum TNW (Tangible Net Worth) plus deferred revenue of \$2,800,000.	None
Reporting Requirements	Monthly and quarterly financial statements, including bookings and billings reports, audited financials, BOD materials and other Lender requests.	Annual CPA audited financials, and Compliance certificate within 180 days of FYE. Monthly company financials and compliance certificate within 30 days. Annual approved projections and any material projection changes.	Annual CPA audited financials, and Compliance certificate within 180 days of FYE. Monthly AR aging, AP Aging, deferred revenue report, recurring revenue report, renewal rate report, and Borrowing Base Certificate within 30 days. Annual approved projections and any material projection changes.	Quarterly company financials and monthly compliance certificate, BOD slide deck within 30 days of meeting, annual audited consolidated financials within 180 days of FYE, operating budgets, updated cap tables as modified. Reporting requirements become quarterly upon repayment of loan and expire upon expiration of the warrant. 409a valuation report within 30 days of completion, management representation (audit) letter and CFO quarterly checklist.
Right to Invest in future financing	Up to \$500,000 in Subsequent Equity Financing under same terms as existing investors on future round.	None	None	Borrower shall grant right to a) invest the lesser of \$500,000 or 5% of each of Borrower's subsequent equity rounds on same terms, conditions and pricing, or b) convert up to \$500,000 in the Borrower's subsequent equity round on the same terms, conditions and pricing, conversion at Lenders sole discretion.
Breakup Charge:	In the event Borrower does not go through with Hercules financing, Borrower to pay all expenses, Due Diligence Charge and Loan Facility Fee.	None	None	None
Expiration:	April 15, 2013, loan closing May 31, 2013	6/21/13	6/21/13	6/23/13

- Debt is complicated: CFO territory
- Banks: WSJ' + 1.25-2.25%
- Funds: ~11% fixed
- Interest, warrants, right of first refusal
- Amortization, prepayment, fees, collateral, covenants, breakup charge...

Venture Debt (Funds)

“Post Seed: Typically more conservative debt ratios, 25-40% of equity raised (so if company raises \$3mm, we do \$750k - \$1.25). In high end of range, we would use milestones to get there. At this stage, very dependent on team, product, market. Would want growth to unlock milestones.

A: Typically 35-45% of the equity raised. Key here is wanting to see the origins of standard SaaS metrics, that company has acquired customers in a process that can be replicated. That TCV supports CAC, and low churn. Product should be in a good place and ready to ramp, feedback from early customers is strong (possibly with renewals). Also want to understand the ROI as perceived by users, to ensure product is ripe for market and not just purpose built for POCs.

B: Typically 50-60% of equity raised. Want to see true SaaS metrics – LTV, CAC, Churn, Sales cycle, ASP, etc. Want to see that company has successfully built sales organization and has strong process for onboarding and ramping new salespersons.

In general, we are typically trying to buy companies 6-10 months, where we can be comfortable that our capital is adding value. Revenue growth rates are hard, because it will depend on the ASPs. But 100% y-o-y is good rule of thumb. Higher growth may give us comfort to do more debt, and vice versa.”

25-40%

-Top 5 venture debt partner

Venture Debt (Banks)

“A little all over the map, but if a company has raised a true series A or B VC round with a few VCs, they can probably get anywhere from \$2.0-\$5.0MM of debt from someone like us. What the revenue scale is, what the customer contracts look like, growth rate, margins, burn, and SaaS metrics all play into it.”

-Top 5 venture bank

Conclusion

- Focus on what you can control
- Revenue growth is your #1 measure of success
- If your round isn't happening, know your options
- Lean on your existing investors for advice