



Introduction to Venture Capital

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Will Price
Hummer Winblad Venture Partners

Introduction

- Will Price, Principal
 - Harvard College, AB
 - Northwestern University, MBA
 - Investment banking, product mgt, start-up CEO
 - wprice@humwin.com
 - <http://willprice.blogspot.com>
- Hummer Winblad Venture Partners
 - \$1bn AUM early-stage software firm

What Is Venture Capital?

- Venture capitalists:
 - **Raise** pools of capital from institutional and individual investors
 - **Finance** new and rapidly growing companies;
 - **Purchase** preferred equity securities and **take board positions**;
 - **Add value** to the company through active participation;
 - **Take** higher *risks* with the expectation of higher rewards;
 - Have a **long-term** orientation
 - **Make \$\$\$** by via M&A or IPO liquidity events

A Long History!



"I call my invention 'The Wheel,' but so far I've been unable to attract any venture capital."

Impact on Economy

- Infrastructure
 - Intel, Cisco, 3Com, Juniper, Apple, EMC, Sun, Wind River
- Software
 - ORCL, MSFT, SEBL, EA, Lotus, Kana, Omniture, Sybase
- Internet
 - GOOG, YHOO, Ebay, AOL, Skype, Netscape, AMZN, Youtube...
- Healthcare
 - Genentech, Amgen, Alza, Affymetrix
- Services
 - Fedex, Staples
- VCs partner with entrepreneurs to build the companies of tomorrow

Snapshot

- 2006 US Deal Stats
 - \$25.8bn invested
 - 2,454 deals
 - \$10.5m per deal
- By Sector
 - 57% IT
 - 26% HC
- By Geography
 - Bay Area 33%
 - CA 47%
 - New England 11%
- Players
 - 600 Active Firms
 - 8,000 professionals
- Huge Growth in Asset Class (LP commitments)
 - 1980 \$2.1 bn
 - 1990 \$3.4 bn
 - 1999 \$106 bn
 - 2005 ~\$20 bn
- Internationalization Ongoing
 - India, China, EU, Israel

Private Equity Returns Over 20-Year Horizon

(by investor type; as of 3/31/05)

Thomson Financial's US Private Equity Performance Index (PEPI)

Investment Horizon Performance through 12/31/2005

Fund Type	1 Yr	3 Yr	5 Yr	10 Yr	20 Yr
Early/Seed VC	8.3	3.1	-10.9	41.5	20.4
Balanced VC	24.3	11.7	-3.5	18.9	14.6
Later Stage VC	6.9	8.6	-4.1	11.3	13.5
All Venture	15.6	7.5	-6.8	23.7	16.5
Small Buyouts	11.5	7.8	2.1	7.9	25.4
Med Buyouts	33.8	10.0	2.9	10.9	16.5
Large Buyouts	18.2	16.0	4.0	10.2	12.7
Mega Buyouts	35.7	17.8	6.0	8.8	11.4
All Buyouts	31.3	16.3	5.2	9.2	13.3
Mezzanine	12.2	4.8	2.2	6.4	8.9
All Private Equity	22.6	13.1	1.5	12.3	14.2
NASDAQ	5.2	14.2	-2.2	7.7	12.4
S & P 500	6.3	10.1	-1.1	7.3	11.0

Source: Thomson Financial/National Venture Capital Association

The 20 year early stage risk premium is 9.4%
versus S&P 500

Economics of VC Firm

- **Management Fees (typically 2-2.5% of AUM)**
 - Charge a management fee to cover the costs of managing the committed capital.
- **Carried Interest (typically 20-25%)**
 - "Carried interest" is the term used to denote the profit split of proceeds to the general partner.
- **Example \$100m fund**
 - 4x return and 2 and 20%
 - \$2m per year in management fee
 - $((\$100m \times 4) - \$100m) * 20\% = \$60m$ in carried interest

Flavors of VCs

- VC's segment in a number of ways
 - Sector
 - Healthcare versus IT versus clean energy
 - Size
 - Small fund (<\$100M) to large fund (>\$1B+)
 - Geography
 - US, EU, India, Israel
 - Stage
 - Seed/early – two guys and an idea/demo
 - Mid-Stage – initial revenue traction
 - Late-Stage – near breakeven – expansion/mezzanine capital

Structure of Firm

- General Partners
 - 6-8 active deals at a time
- Principals/Associate
 - Drive deal flow, deal process, and portfolio company development
- Finance, Marketing, and HR Staff
- Decision Making
 - Typically unanimous
 - Individual partners champion deals to group
 - Deal team diligences prospect and builds investment case
 - Partnership acts as a check and balance to ensure careful decision making

What do VC's want

- This depends on stage – let's focus on early stage since that is what we do.
 - Team
 - Domain expertise with core technical strength and knowledge of given market opportunity
 - History of collaboration and success
 - A willingness to allow VC's to help build the team
 - Market
 - Emerging and fast growing market
 - Bad markets make for bad companies
 - Business model
 - How will you make money, how will you sell
 - Technology
 - Defensible technology/IP that can be protected to form competitive barriers over time

What Should Founders Expect: Reduce Prob. of Failure

- Codified best practices
 - FP&A/budgeting, KPI, templates, back office infra
- Acceleration
 - Shorten cycle time for hiring, partnering, selling, PR, capital raising
- Objectivity and Insight
 - Sanity check, check and balance

Suggested Playbook

- Be committed....
- Hire a great Valley lawyer
- Figure out what stage and sector you are
- Identify 4-5 firms that focus on this stage
- Identify which partner you think is most relevant
- Get an introduction to that partner
- Prepare a 1-2 page overview to send him/her
- Prepare a 10-15 slide presentation to give in a 30-45 minute timeframe if they ask you to present
- Only goal of the first meeting is to get a second meeting.

Your Pitch: 10 Slides

- **What we do**
- **Who we are**
- **How we plan to make money**
- **What we are asking for (how much money)**
- **Demo**
- **Secret Sauce/Technology**
- **Market Analysis**
- **Competitive Assessment**
- **Go to Market**
- **Business Model/Financials/Targeted Milestones**

The audience must know in first minute what you do
or they will tune out

Pat your head and rub your tummy...Hard to Do!

- Pat your head
 - Spec out 1.0 and focus on a customer need
 - Narrow the focus to broaden the appeal
- Rub your tummy
 - Paint a picture and product roadmap that is a company not a feature

What to Expect

- 12-16 week process
 - First meeting to close
 - 1st mtg → diligence → partner meeting → TS negotiation → close
- Prepare Investor Package
 - Presentation
 - Financial Plan
 - Personal references
 - Customer references
 - Market references
 - Cap Table
 - Market research
 - Product documentation
 - Competitive Analysis
- Investors will seek:
 - 20-50% of the company
 - Valuation function of targeted raise, ownership, and stage,
 - Preferred Equity securities, with key terms:
 - BoD seat
 - Liquidation Preference
 - Anti-dilution Protection
 - Participation
 - Pro Rata rights
 - Protective Provisions
 - Vesting terms for founders and employees

What to Consider

- Is the idea sufficiently baked?
 - Optimal time is 6 months of iteration
- Pick your co-founders very carefully
- Test fit with VC
 - Personality, values, knowledge of market
- Optimize for best deal not best price
- Consider the downstream effects of the financing
 - High-post moneys can be Pyrrhic victories if company misfires
 - Angel financing can be a mixed blessing – be careful

Approaching VC's

- Investing is a people business, and getting a meeting is all about “who you know”
- Best way to approach a VC is some form of introduction
 - If you don’t know a VC, find someone who knows you who does and get them to introduce you
 - Entrepreneur, professor, attorney...
 - Sending a plan to info@vcfirmname.com is a waste of time

Tips

- Don't take rejection personally, the odds are against you.
- Every VC is "interested" – force them to do work to test their level of interest.
- Don't waste time trying to change the mind of someone who says "no".
- Don't shop to multiple partners in a firm if the first rejects you.
- Don't ignore the junior partners – they can really help.
- There are lots of VC firms, focus on a firm that has some connection to you.

Resources

- [http://
feeds.feedburner.com/venturecapital](http://feeds.feedburner.com/venturecapital)
- www.feld.com
- www.askavc.com
- <http://www.venturebeat.com>

Hummer Winblad Venture Partners

- First Fund Exclusively for Software Investing
 - Founded September 1989
 - 8 investment professionals
 - Fund V: \$420M (raised 2001)
- All Stages, focus on early stage including seed
 - Usually Part of First Round of Venture Funding
 - Usually Lead or Co-Lead

Hummer Winblad Highlights

- 104 investments in 17 years
- 51 liquidity events in 17 years
 - 17 IPOs, 34 acquisitions
 - 10 were 10X or more returns
- 4 liquidity events in 2006
 - Acquisitions: Marketwire, Akimbi, Employease
 - IPO: Omniture (OMTR) \$670M Market cap (1/3/07)
- Currently - 30 active boards

Q&A

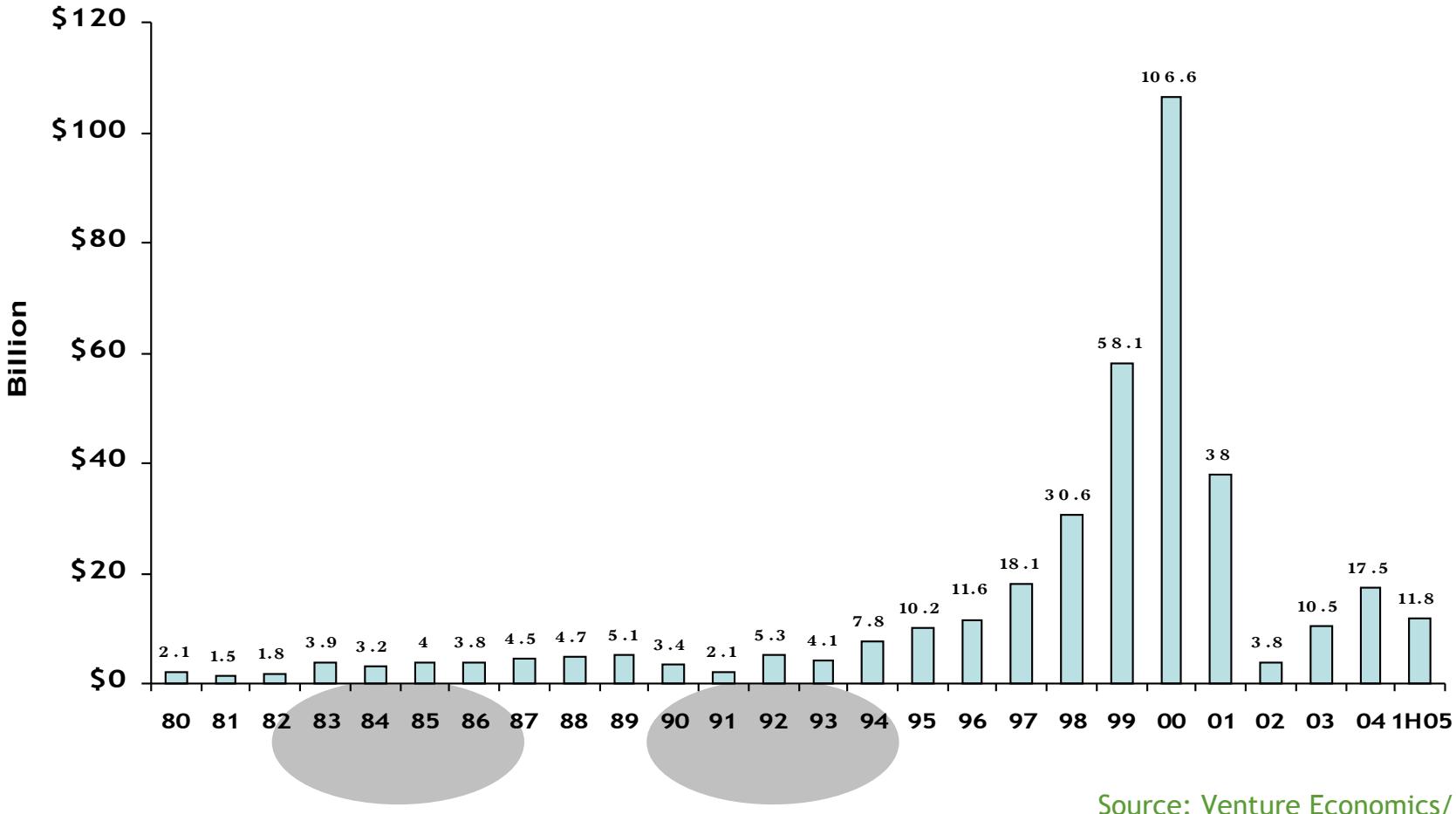
History

- **General Georges Doriot** is considered to be the father of venture capital industry.
- In **1946 he founded American Research and Development (ARD)** Corporation, whose biggest success was Digital Equipment Corporation.
 - When Digital Equipment went public in 1968 it provided ARD with **101% IRR**.
 - ARD's US\$70,000 investment in Digital Corporation in 1959 had a market value of US\$37mn in 1968. **528x!!**
- The first Bay Area venture-backed startup is generally considered to be **Fairchild Semiconductor**, funded in **1959** by Venrock Associates (Rockefeller)
- The 1979 Employee Retirement Income Security Act (**ERISA**) allowed pension funds to invest in private equity for the first time

Overview

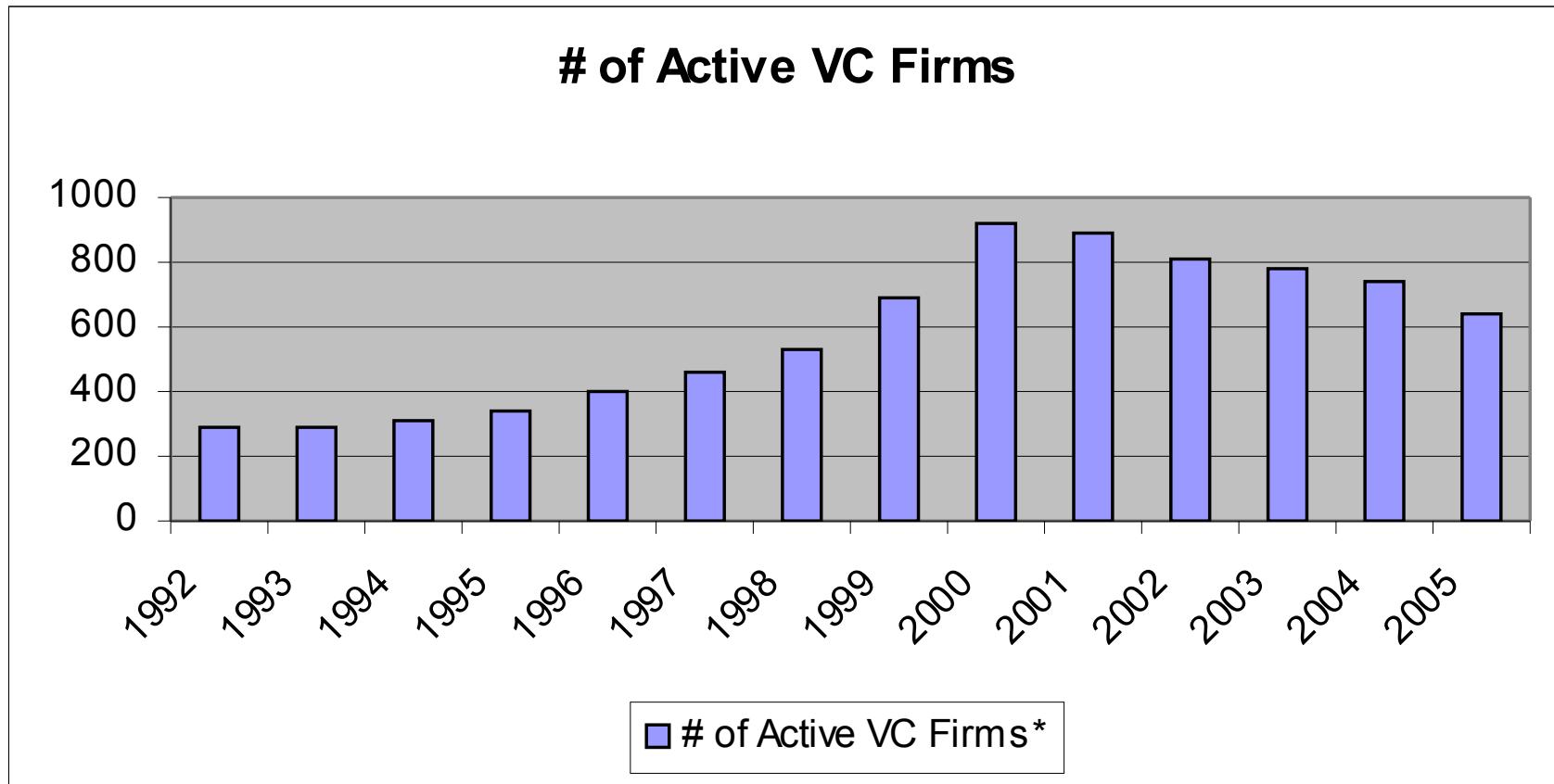
- Institutional investor will allocate ~ **2% to 3% of their institutional portfolio** to alternative assets
 - such as private equity or venture capital
- 50% of VC capital comes from institutional public and private pension funds
- 50% comes from endowments, foundations, insurance companies, banks, individuals
- Venture firms come in various sizes
 - From small seed specialist firms of only a few million dollars under management...
 - To firms with over a billion dollars in invested capital around the world
 - Specialization is a function of market size!!
- The common denominator in that the venture capitalist is
 - Wants to make\$\$\$\$\$\$\$\$\$ for their LPs
 - Has an active and vested interest in guiding and growing the companies they invest in

Commitments to U.S. Venture Funds



Source: Venture Economics/NVCA

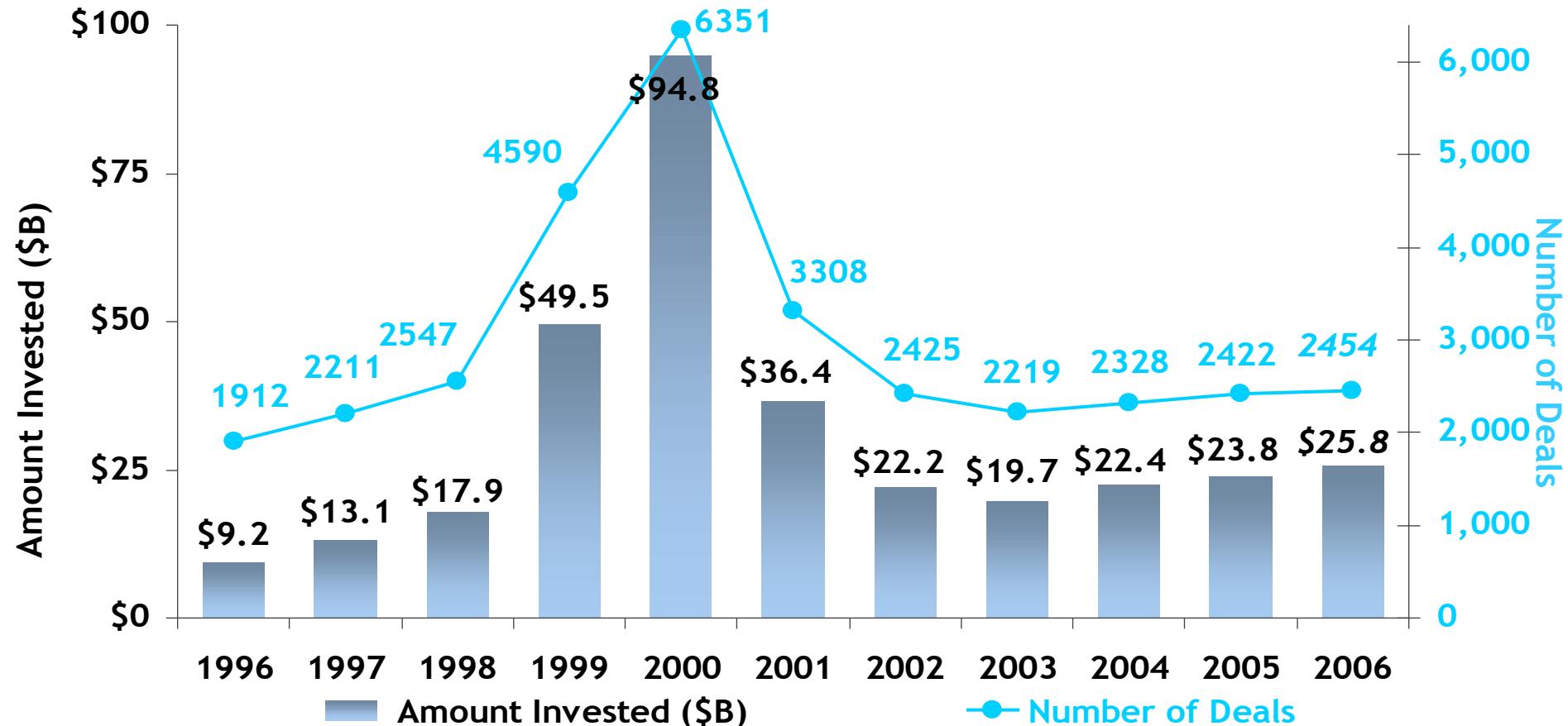
Growth of Active Firms



*Source: Venture Source

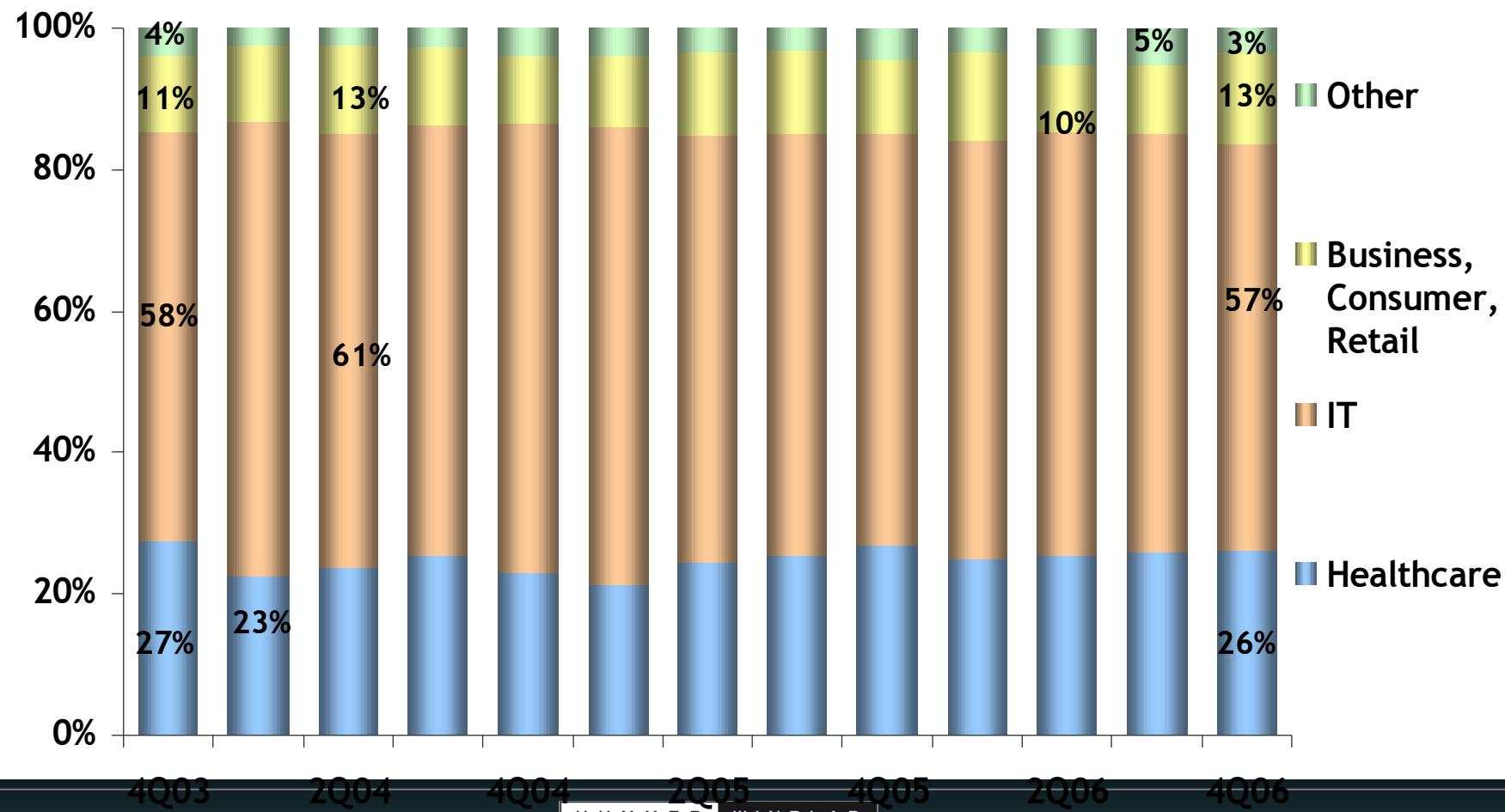
Investment Level Surpasses 2005

Deal Flow and Equity into Venture-Backed Companies



IT Leads Deal Allocation

Deal Flow Allocation by Industry Sector



Bay Area Draws Most Investment Dollars

Regional Investment in the United States 4Q'06

