

**CAPITAL
ACCESS**
PARTNERS

A Business Unit Of Investors Diligence, Inc.
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EARLY STAGE FINANCING

George C. McKinnis

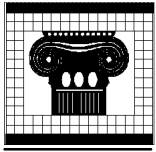
McKinnis Law Offices

and Chairman, Capital Access Partners

and

John Hammer

President, Capital Access Partners

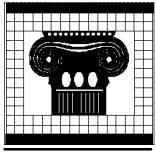


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AGENDA

- **Who is Capital Access Partners?**
- **How do I cut a deal?**
- **What financial alternatives can I use?**
- **What are the comparative benefits and risks?**
- **How do I decide which one to rely on?**



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Capital Access Partners Mission & Objectives

- Secure capital for early stage technology companies
- Provide entrepreneurial services to early stage companies

CONTACTS

John Hammer

Finance Planning
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George McKinnis

Intellectual Property
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Legal Auditing

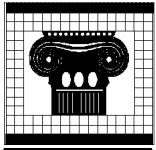
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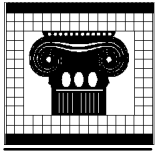
CONCENTRATION IN HIGH-TECHNOLOGY

- **Represented technology companies from startup through exit**
- **Helped technology companies be acquired and go public**
- **Outside General Counsel & Director of multiple technology firms**

COUNSELOR AT LAW - NEW YORK AND CONNECTICUT BARS

BACKGROUND ALSO INCLUDES:

- **Co-founder, Chairman and General Counsel of Capital Access Partners**
- **corporate and financial practice in Wall Street law firm**
- **General Counsel overseas merchant bank**
- **Lawyer for international telecom at ITT headquarters**
- **General Counsel of ITT's research labs**



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JOHN HAMMER

CORPORATE FINANCE SPECIALIST

- **Venture Capital**
- **Leverage Buy Outs**
- **Financial advisory**

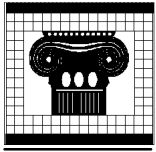
INTERIM CHIEF FINANCIAL OFFICER

TECHNOLOGY FOCUS

- **Internet**
- **Commercial software**

BACKGROUND ALSO INCLUDES:

- **Co-founder, President of Capital Access Partners**
- **Vice President at merchant bank**
- **Vice President at Leverage Buy Out firm**

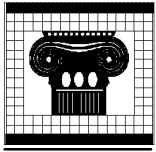


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THE ART OF THE DEAL

- **Chronology of a Financial Deal**
- **Valuation Techniques**
- **Use of Professionals and Cost Control**
- **Integrity, Integrity and More Integrity**



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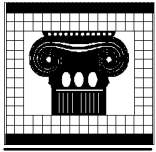
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CHRONOLOGY OF A FINANCING

- First** **Enter a Mutual Nondisclosure Agreement**

- Second** **Establish a Term Sheet agreement or
Memorandum of Understanding covering basic
points of deal**

- Third** **Negotiate and enter a final contract using
professional help and Win/Win negotiation
technique**



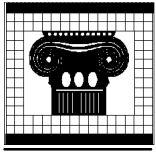
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VALUATION OF YOUR COMPANY

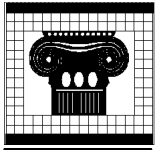
ACCEPTED METHODS

- **Recent Comparable Transactions**
- **Asset Value**
- **Discounted Cash Flow [DCF]**



DISCOUNTED CASH FLOW

- **Create plausible projections**
- **Calculate the sale or IPO valuation 3-5 years in the future and discount it to a present value.**
 - ◆ **Calculate “exit value” — multiple of earnings, cash flow, sometimes revenue**
 - ◆ **Select discount factor based upon risk — stage of development, market, management experience, competition, etc.**
 - ◆ **Use the discount factor and “exit value” to obtain the post financing**



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USE OF PROFESSIONALS

Legal Team

General Entrepreneurial Lawyer - knows your industry, has your work habits and understands intellectual property

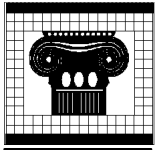
Patent Lawyer - knows your product and industry

Securities Lawyer - experienced in small and large financings

Financial Team

Financial Professional - experienced in startups and exits; knows your industry

CPA - worked with startups, knows your industry

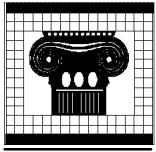


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WHEN YOU FIND A GOOD PROFESSIONAL

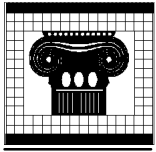
- **Do not be shy about discussing fee arrangements**
- **Consider creative alternatives such as stock options - step up fee schedule**
- **Seek to form a long term relationship**
- **Work with friends who care about you**



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INTEGRITY

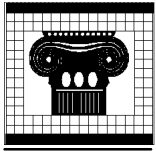


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FINANCING ALTERNATIVES

- ◆ **Private Placements**
- ◆ **Angels**
- ◆ **Blind Pools**
- ◆ **Merger into Listed Shell**
- ◆ **Rollups**
- ◆ **Strategic Associations**
- ◆ **Venture Capital**
- ◆ **Bridge Loans**



AMATEUR “PRIVATE PLACEMENTS”

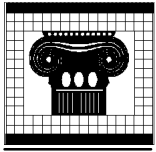
- **Requires careful legal controls and documentation by securities lawyer.**

Pros:

- ◆ **No substantial investment banking fees**
- ◆ **You control the list of investors**

Cons:

- ◆ **Almost never obtains amount needed**
- ◆ **You do the hustling**
- ◆ **Securities risk**



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PROFESSIONAL “PRIVATE PLACEMENTS”

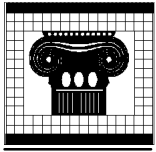
(Works best for later stage startup)

Pros:

- ◆ **Done properly and professionally**
- ◆ **Investors picked by professionals**

Cons:

- ◆ **High cost of Placement**
- ◆ **Not likely for bare bones R&D startup**



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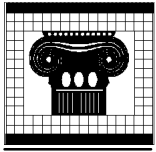
ANGEL INVESTORS

(\$20 Billion a year in Fundings)

Definition:

AN ANGEL INVESTOR IS A WEALTHY INDIVIDUAL WITH EXPERIENCE IN YOUR INDUSTRY WHO AS A SECOND CAREER AND WILL HELP START YOUR COMPANY WITH MONEY AND WORK.

- **Good Angels live up to their name**
- **Watch out for time burners and flakes**
- **Do a careful Shareholders Agreement**

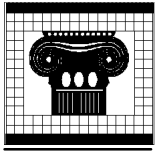


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BLIND POOLS

- **Investors form or acquire shell company**
- **Put cash into Pool**
- **Then look for companies to acquire**
- **You are acquired with stock; the cash in the blind pool becomes your working capital**

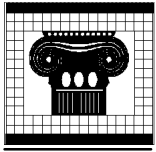


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REVERSE MERGER INTO LISTED SHELL

- **Canadian (Vancouver/Toronto) and US (NASDAQ)**
- **Canadian reverse mergers are complicated, highly regulated, and put you onto an exchange that has limited liquidity**
- **NASDAQ reverse mergers are not as complicated, put you onto a far more liquid exchange**
- **High failure rate**



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ROLL-UPS

- **Industry or market segment consolidation**
- **Not typical for early stage firms**

Used for:

Exit strategy -IPO or acquisition

Bring management expertise not present in smaller firms

Quickly achieve large size to dominate or compete

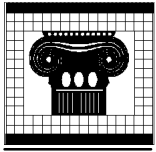
Economies of scale

Risks:

Compounds risk through combining operations

Conflicting cultures

Harder to obtain financing



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VENTURE CAPITAL

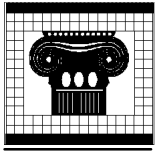
- **Mostly second and third stage companies**

Pros:

- ◆ **Highly professional advice and Board memberships**
- ◆ **Access to VC's contacts**

Cons:

- ◆ **Hard to close**
- ◆ **Risk of low valuation**
- ◆ **High transaction cost**
- ◆ **Investor protective documentation**

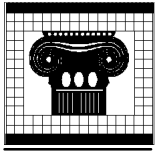


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WATCH OUT FOR #1

Watch out for your own personal interests! The financial people will look out for the interests of their shareholders. Worry about how much you can be diluted. Worry about whether financial directors will terminate you and cut off your stock options. Worry about how much control the insider startup team ends up with after dilution and after new Board members are elected.



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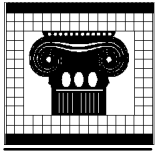
STRATEGIC ASSOCIATIONS

Definition:

A CONTRACTUAL RELATIONSHIP WITH ANOTHER COMPANY THAT GIVES YOU AN INSIDE TRACK TO CASH OR ORDERS, OR SHORTENS TIME TO MARKET.

EXAMPLES

- **A telecom parts manufacturing start-up enters into product sponsorship with a volume buyer/user which includes prepayment for a large order.**
- **A software applications house gets cash minority investment from a computer platform manufacturer that desires a close association.**



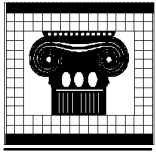
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STRATEGIC ASSOCIATIONS

Joint Venture

- **Supply**
- **Product Development**
- **OEM/VAR**
- **Technology Development**
- **Distribution**
- **Stock Purchase**
- **License**
- **R&D**
- **Loan**
- **Sales Representation**

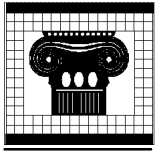


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RISKS OF STRATEGIC ASSOCIATION

- **Loss of flexibility and future opportunity**
- **May limit your attractiveness to competitors of associate**
- **Deal does not realize promised benefits to your vulnerable company**
- **Deal is hard for you to get out of without serious harm**
- **Dominant, large partner could pull out**
- **Impact on public perception if deal is unsuccessful**

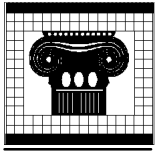


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NEGOTIATING A STRATEGIC ASSOCIATION

- **Consider corporate and personal culture differences**
- **Be prepared to structure the association as a separate company**
- **Be prepared to do business differently from your standard**
- **Lead or be led**
- **Manage the time and cost of completion**
- **Worry a lot about association structure – get it right**
- **Look for positive attitudes and compatible objectives**
- **Determine how to resolve disputes and unwind**

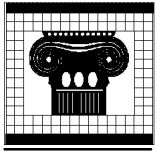


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WHICH FINANCING METHOD DO YOU CHOOSE?

- **KNOW THYSELF**
- **TAKE LEGAL COUNSEL**
- **TAKE FINANCIAL COUNSEL**
- **DON'T SHOP**
- **WATCH OUT FOR #1**
- **GIVE THE DEVIL HIS DUE**



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WRAP-UP

- **Know how to structure a financing**
- **Choose a financing technique with the care that you pick a spouse**
- **Make financial and legal advisors part of your inner team**
- **Use an accepted formula for valuing your company**
- **Be flexible in dealing with investors**
- **Don't under or over negotiate**
- **Use the highest integrity**
- **Watch out for the long term interests of the founders**
- **Honor the interests of your investors**