Funding Options and What They Mean: From Angels to Venture

UNIVERSITY STARTUP DEVELOPMENT WEBINAR SERIES
SPEAKERS

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NCET2 Startup Development Officer
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BACKGROUND ON THE STARTUP DEVELOPMENT PROGRAM
Commercialization Model Timeline

Congress seeks to understand commercialization of SB137 annual R&D in Fed Labs / Universities

NCET2 Congressional Commercialization Summit – Corporate Sub-committee Formed

First Model Proposed

Model Vetting Roadshows: CA; PA; NY

Congressional Briefs

(Pilot) First Demo Day

Second Demo Day

2015

2016

2017

Startup Development Officers Pgm Announced

IP2 Startup Pgm Announced

STARTUP DEVELOPMENT PROGRAM
“Building Market-Aligned Startups for Corporates”
Startup Development Program

• Congress funds $137 billion in federal funded research at universities and federal labs

• Excellent opportunity for researchers and entrepreneurs to build a university startup around that IP
  – Universities have programs to help you

• NCET2 Fortune 500 members and SDOs who will partner with university startups to help develop and fund those startups
Startup Development Program

• NCET2 Startup Development Officer will also help university entrepreneurs, faculty, researchers, and students create, develop and fund market aligned university startups (http://ncet2.org/sdo)
SDO SERVICES

• Early management teams of university entrepreneurs, graduating students, faculty, and researchers
  • Business plan
  • proof-of-concept
  • prototyping
  • early product development
  • SBIR, Angel, and VC funding

– “Commercialization Experiments”
  • Get to work with Fortune 500 companies, angels, VCs, and serial entrepreneurs to help commercialize university and Federal Lab technologies
Benefits

• Startups/Entrepreneurs/Faculty/Researchers/Students
  – Access to professional SDO talent to help create, develop, and fund your startup

• Universities
  – Moving IP to market for significant market impacts
  – Graduating students into startups and working with Fortune 500 and SDOs
Engage with NCET2 and the SDOs

1. Submit your IP or startups to NCET2
   • The SDOs and Corporates review your IP and startups to determine if you are a good candidate for the Startup Development Program
   • Now accepting applications for IP and startups, visit: http://ncet2.org

2. Become an NCET2 SDO
   • Open to: Ex-Corporates in Open Innovation/Venture Capital, Serial Entrepreneurs, Active Angel Investors
   • Send your CV and with a short note about wanting to know more about being an SDO to startupdevelopment@ncet2.org
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Instructor: Andy Tucker
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What is needed?

- First job of the CEO is to not run out of money
  - Nothing happens without the ability to pay salaries, research, marketing
- Second job is to plan for the future
How money is raised?

- Debt
  - Bank Loans
  - Convertible Bridge Loans
- Equity
  - Common Stock
  - Preferred Stock
- Grants
How much money to raise?

- Achieve balance between stage of Company and capital raise
- Milestones for business
  - You want to be raising the next round after meeting planned milestones
- Always takes longer than you think to raise capital - Plan accordingly and remember first job
Types of Investors/Offerings

1. VCs (institutional investors)
2. Strategics (companies)
3. Angels / Angel networks
4. Friends & Family ([hopefully] high net worth individuals)
5. Bootstrapping
6. Crowdfunding
What do Angels Expect?

- Angels purchase from 20-40% of a company’s equity.
- Angels seek a return of 20x-30x over five years.
- More flexible investment structures
  1. Convertible Bridge Loans
  2. Common Stock
  3. Preferred Stock
- Want “discount” and/or protections if subsequent round possible/probable, especially if VCs to be sought
Inadequate early stage structuring and poor recordkeeping (especially equity)

Failure to protect intellectual property assets

Investment by too many (or the wrong) friends, family and angel investors (administrative and management burden)

Previous violations of state securities laws

Unrealistic expectations of inexperienced early investors

Previous unsupportable valuations

Unique or non-standard terms in earlier financing agreements requiring significant revisions

Too many board members and advisors (“hangers on”)

Brokers and finders
Seed and Angel Financing Alternatives

BRIEF SUMMARY OF ANGEL/SEED FINANCING ALTERNATIVES

1. **Bootstrap** (E.g., internally fund through revenues, government grants, consulting services, funded development contracts, etc.)

**Pros:** Minimizes dilution / distraction from financing

**Cons:**
- Pursuit of near-term revenue may divert attention from pursuit of core, strategic business, reducing long-term value prospects
- May hinder rapid development which may permit other firms to gain competitive advantage
Seed and Angel Financing Alternatives

BRIEF SUMMARY OF ANGEL/SEED FINANCING ALTERNATIVES (cont)

2. Bank Loan (no coverage, no warrants)

Pros: Very simple, no valuation set

Cons:
  • Unrealistic to request
  • Unlikely to be acceptable to investors who want equity upside for their risk
3. Convertible Bridge Loans – The Basics

- Debt Security
- Convertible into equity at a future point in time, generally equity raise
- Very common structure
- Discount on conversion
- Cap on conversion value
Convertible Bridge Loans – The Basics

Pros:
- Simple and standard forms
- No need to determine valuation
- Minimizes dilution

Cons:
- Short term maturity needs to balance against business milestones
- Not good for raising large amounts of capital
Seed and Angel Financing Alternatives

BRIEF SUMMARY OF ANGEL/SEED FINANCING ALTERNATIVES (cont.)

4. Common Stock – The Basics
   • The basic equity security of every corporation
   • Plain vanilla security
   • It is what management, founders get
   • Comes last in liquidation on sale or dissolution, behind debt and preferred stock
Common Stock – The Basics

Pros: Simple (which generally translates into lower transactional costs)

Cons:

• Must establish a valuation
• "taints" option pool -- i.e., sets a fair market value of common stock which has implications for options
• Will need to discuss what stockholder agreements look like
• No “downside” protection for investor
Seed and Angel Financing Alternatives

BRIEF SUMMARY OF ANGEL/SEED FINANCING ALTERNATIVES (cont.)

5. Preferred Stock – The Basics
   • Very flexible security
   • Generally comes with special rights compared to common

1. Voting
2. Liquidation
3. Anti-dilution
4. Contractual Rights
Seed and Angel Financing Alternatives

BRIEF SUMMARY OF ANGEL/SEED FINANCING ALTERNATIVES (cont.)

5A. “Seed” Preferred Stock (very simple “Seed” Preferred Stock with little or no negotiation with investors)

Pros:
- Fairly simple (relatively low transactional costs)
- Allows you to "discount" options due to preferred liquidation preferences
- Modest investor protection

Cons:
- Requires that a valuation be established, which is difficult at the early stage
- The terms of the preferred stock may invite further negotiation
BRIEF SUMMARY OF ANGEL/SEED FINANCING ALTERNATIVES (cont.)

5B. Standard “Venture” Preferred Stock (a more comprehensive version of the Seed Preferred Stock)

Pros:
- Can use as a template for the next round (puts entire framework in place)
- May be more palatable to experienced investors
- Allows option discounting and more investor protection

Cons:
- Must establish valuation (a common theme)
- Higher transaction expenses
- Invites more negotiation
- Generally only viable with larger investment ($2-3 million +)