Developing a Financing Structure That Sells

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There once was a time….

- When rookie CEOs could raise $5 to 10 million.
- For brand new startups.
- Structures did not matter much.
- Even business plans weren't all that important.
- Virtually every company got financed.
- <u>They called that time 1999.</u>

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And it was bad

- Very, very bad.
- Alan Greenspan called it ‘irrational exuberance”.
- It was a temporary suspension of good investment practices and risk management,
- And rational thinking.
- Occurs regularly in our financial history.
- Created a distortion in the financial continuum that we are still suffering through.

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But we survived

- Today, those of us in the technology and biotech industries have just lived through
- A financial event reminiscent of the roaring 1920s,
- And recession of the early 1930's.
- Felt bad but was actually a good thing.
- All of us have survived.
- Now we can get back to building companies
- And making money for our investors and ourselves.

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What does that mean for you?

- Assuming you are here because you want to raise some money,
- New rules apply for:
  1. Structures
  2. Deals
  3. Corporate governance
- Return to solid fundamentals of business and investing.

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Structuring - KISS

- In the 1990's some investors developed ever more complicated preferred shares and definitive agreements.
- Created fundamentally flawed relationships between the entrepreneurs and investors.
- Today, there is an encouraging move back to common shares.
- And keeping it simple.
- Tough, but simple.

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Current Investor Thinking

- Instead of complicated preferred shares and hundred page definitive agreements,
- Today, investors are returning to fundamentals including:

1. Reasonable valuations
2. Common sense structures and vesting
3. Excellent corporate governance

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Structure Example - Vesting

- Many elements to structure – would take days to discuss.
- An important example is vesting.
- When I was a CEO in Silicon Valley in the mid 90s
- Everyone wanted to have 18 month vesting.
- Just did not make sense, because
- it still took as long to build the companies.

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Vesting Today

- Now vesting periods are back to what they were at the start of the 1990's.
- Median periods for linear vesting around four years, longer for founders shares.
- Optimum new vesting model is:
  - Half of the founders equity vest over 3 years
  - Half vests only on a sale of the company.
  - All vesting accelerates on a sale.
- Considered the best alignment between investors and team members.

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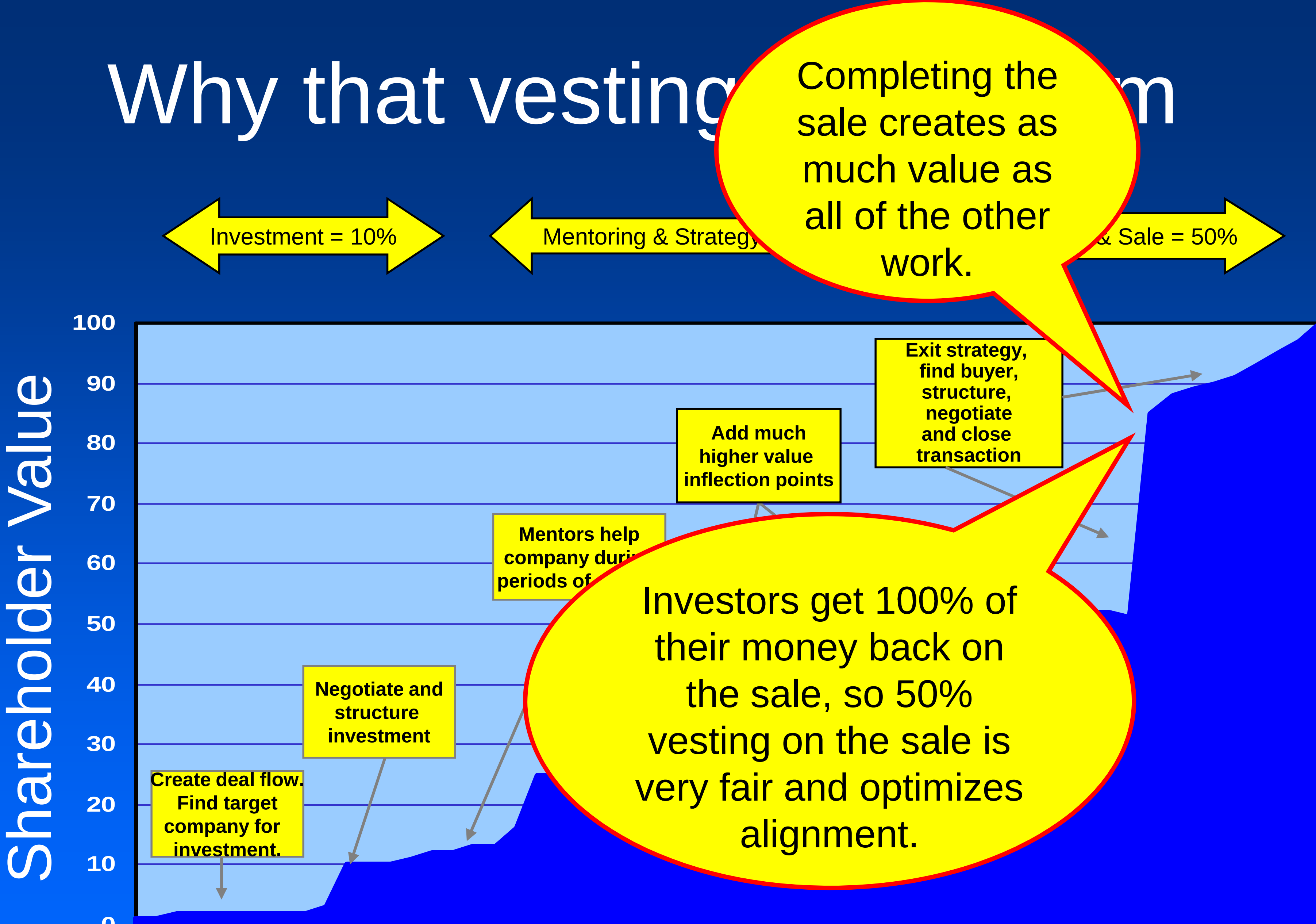
Why that vesting m



Yes, but my shares are vested

- Still a few entrepreneurs,
- Who think their shares have already vested.
- And still want the investors to think about investing.
- Darwin will take care of them.

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Corporate Governance

- Probably the biggest change for early-stage companies over the past few years.
- Corporate Governance will continue to increase in importance for many years.
- Enormous topic – would also take days to do justice to.

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Harder to attract good directors

Business in Vancouver February 18–24, 2003

Insurance hikes force lawyers off boards

Clark Wilson discourages appointments; partner off DataWave board

Tracy Tjaden

U.S. corporate governance scandals have pushed insurance rates sky-high, forcing one Vancouver law firm to discourage its lawyers from sitting as directors of public companies.

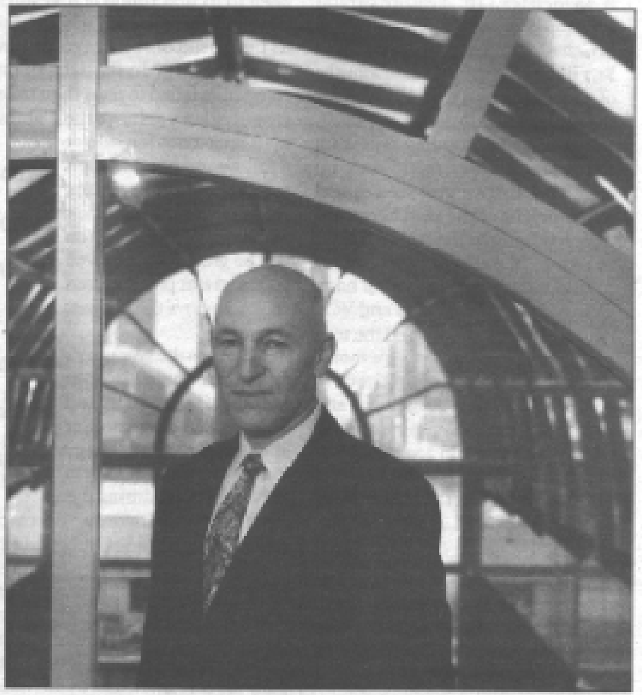
Bernard Pinsky, a partner of corporate law firm **Clark, Wilson**, resigned from Vancouver-based **DataWave Systems Inc.**'s board of directors February 7.

In total, Clark, Wilson lawyers have resigned from half a dozen boards in recent months.

Two years ago, its lawyers sat on about 25 boards of public companies, Pinsky said. The firm's lawyers are in the process of resigning from all public company boards.

The firm's insurance costs for directors' and officers' liability insurance shot up 150 per cent this year over last year. That's after a 75-per-cent increase last year over the year before.

"It's the big corporate governance failures in the U.S. that have driven rates up because [the insurance companies] are paying out billions," said Pinsky.



DOMINIC SCHAEFER

Resigned: Lawyer Bernard Pinsky left DataWave board due to insurance costs

Minimum Governance Guidelines

- Boards must:
- Have a majority of independents.
- Who are successful and experienced.
- Who should have a real financial interest in the company.
- Chairman cannot be CEO.
- Good D & O insurance almost impossible to get.
- Boards will cost companies more – in equity.

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Advisory board is not the same

- It's much harder to recruit a good board today.
- No, an advisory board won't do.
- If you can't get a good board committed,
- Do you really think its fair to ask someone to invest?
- Good news is that early-stage funds and angels will often help you build a good board.

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Practical suggestions

- Recruit a real board.
- Who have the experience and stature
- And the time and interest to be effective mentors.
- Listen to them.
- Be realistic,
- And encouraged – we have turned the corner.
- Its going to get really exciting again soon.

Questions?

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Shortage of early stage funding

- One of the results is a dramatic decrease in early-stage funding.
- Based on US data from 1996, Angels were investing about two to three times more money each year than venture capital funds.
- But after the crash, Angel investors dramatically decreased their new investments.
- Professional funds still had a job to do.
- Angels have no obligation or motivation to invest.

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Venture Capital in Canada

- Historically, Venture Capital in Canada has come from the institutions,
- Life Insurance Companies and Pension Funds
- A decade ago, Canada was ranked #11 in capital under management.
- Today we are #4.
- Due entirely to Labour Sponsored Funds.
- Individuals are the new driving force in Venture Capital fund formation.

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The Funding Gap