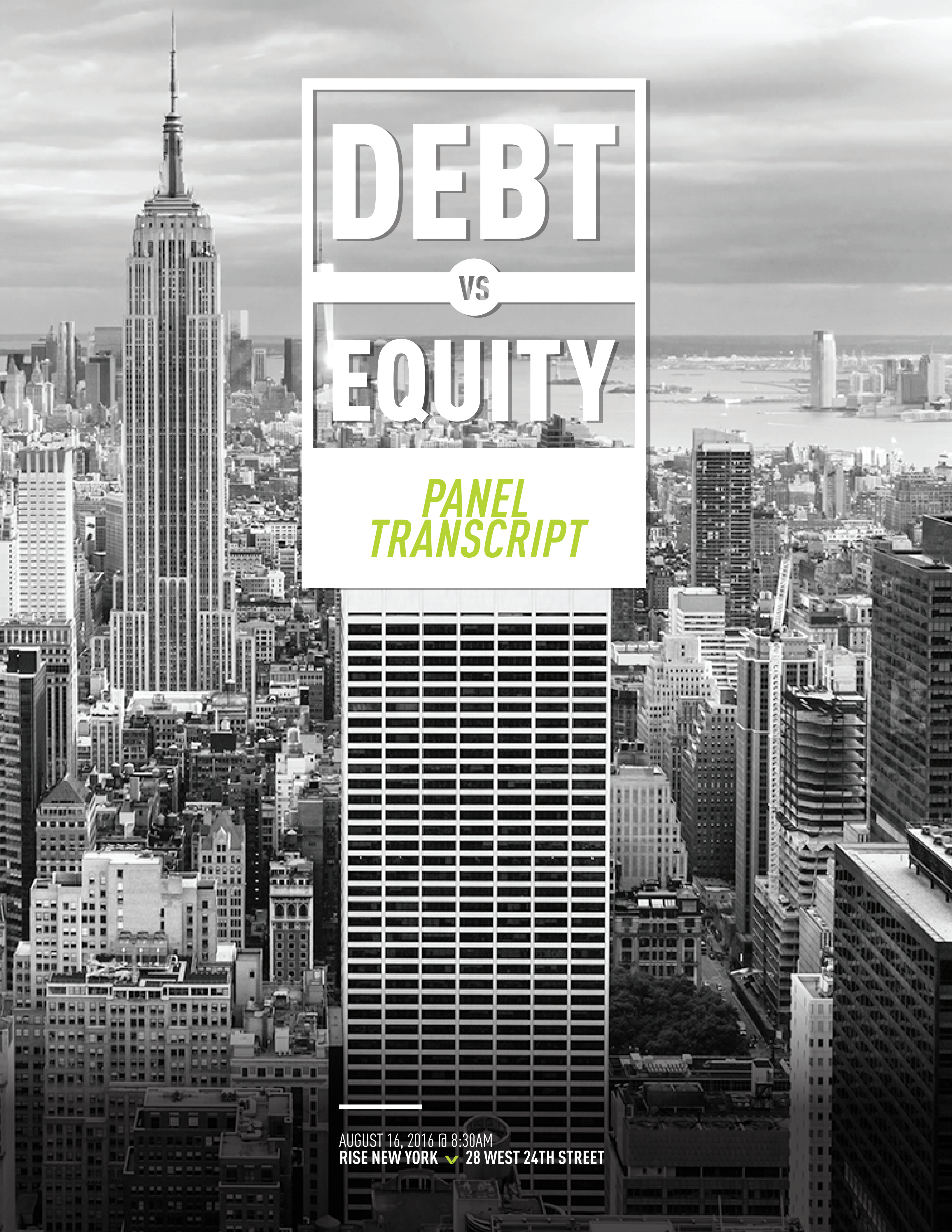

DEBT VS EQUITY

PANEL TRANSCRIPT

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RISE NEW YORK ✓ 28 WEST 24TH STREET

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Jon Zanoff is a FinTech product management guru and founder of Empire Startups. Currently, Jon is an Entrepreneur In Residence at Techstars, lowering barriers to entry to accelerate FinTech innovation. Prior to joining Techstars, Jon worked in product strategy at Blackrock. Jon has held a variety of roles driving technology product development in financial services, including at Goldman Sachs/ REDI Technologies, Instinet LLC, and E*TRADE Financial.

Ian is a Partner and Co-Founder of Greycroft LLC. Over the past ten years Ian has led numerous investments for Greycroft, including the firm's investments in Buddy Media (acquired by Salesforce.com), Braintree (acquired by eBay), Venmo (acquired by Braintree), and Vizu (acquired by Nielsen).

Prior to joining Greycroft, Ian founded StrongData Corporation, a pioneer in payment encryption, and spent several years as a venture capitalist with Boston Millennia Partners, where he focused on the software, wireless, and Internet sectors.

Ian's past experience also includes investment banking in the technology group at Donaldson, Lufkin, and Jenrette and strategy consulting with the Arnold Business Strategy Group.

Urs is the Managing Partner of BDMI. He is also a founding member who joined BDMI as Chief Financial Officer in 2006 from the Corporate Controlling and Strategy group at Bertelsmann where he was "chief of staff" to the CEO and worked on strategic projects for all of the media company's divisions. Urs has led investments in CrowdTwist, Mojiva (acquired by Pubmatic), Skimlinks, StyleHaul (acquired by RTL) and Zergnet. Urs was a Ph.D. Candidate at the Handelshochschule Leipzig and holds a Dlpl.Kfm degree in finance and strategy from the HHL Leipzig Graduate School of Management. He also earned an M.B.A. in finance from Tulane University.

Urs was named a 2014 Power Player in Digital Media by AlwaysOn and was on the Global Corporate Venturing Powerlist in 2012, 2013 and 2014.

PANELIST:

SUTIAN DONG

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Sutian Dong is a Partner at Female Founders Fund. Most recently, Sutian was a Senior Associate at FirstMark Capital, an early stage venture capital firm based in New York City. She focused investments in the healthcare IT, fintech, e-commerce, and consumer application space.

Previously, she was Director of Marketing for Norisol Ferrari, a New York based couture and luxury outerwear brand. She also held Sales and Marketing positions at MarketFactory, a FirstMark portfolio company developing software applications for high-speed trading platforms.

Sutian holds a B.S. in Finance and Marketing from the Stern School of Business at New York University.

PANELIST:

MICHAEL MORRETTI

MANAGING DIRECTOR
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Michael Moretti runs Silicon Valley Bank's New York office. He is responsible for managing all relationship and business development activities with technology companies in the tri-state region. Prior to joining SVB in October 2003, Michael worked at LCconnect Inc., an online financial services company he co-founded in January 2000. Previously, Michael had been involved in the international, corporate and investment banking markets since 1982. Prior to starting LCconnect, Michael was co-head of Credit Lyonnais Securities' Corporate Advisory Group, which he started in 1995.

Before joining Credit Lyonnais in 1991, Michael served nine years at the Irving Trust Company, which was subsequently acquired by the Bank of New York. Michael received a B.A. from St. Lawrence University and an M.B.A. from the Thunderbird School of Global Management.

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JAKE SKINNER

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Jake leads strategic projects at FastPay and is responsible for corporate and business development initiatives. Originally from Boise, Idaho, Jake began his career in New York working at Goldman Sachs. He holds a Bachelor's degree in Politics from Princeton University.

FastPay is a funding platform providing a flexible cash flow solution for long payment term invoices for the digital media industry. FastPay's sole focus on digital media provides a significant advantage in evaluating credit and collateral performance of borrowers.

Jon Zanoff: [04:15] Alright, I think — Can everyone hear me okay? — Fantastic, a little bit louder. I'm good at only a few things, one is being loud. Ask my mom, torturous upbringing. Well, thanks everyone for being here, a special thanks to FastPay Evolution and Nomad Financial for putting this on.

I am Jon [Inaudible][04:41]. I'm EIR at Tech Stars upstairs. I also run Empire Startups. It's the largest community of fintech entrepreneurs. Under Tech Stars we've invested in 800 companies and seen 1 million — not sure if it's public — applications [Phonetic][04:57] adjoined.

I've seeing a lot of companies that are really looking to scale. Ultimately that's what today is about. It's about being able to run instead of walk by raising capital. There are lots of different ways.

There's a lot of good information and a lot of bad information on the internet. We have a pretty amazing panel put together to help provide some wisdom and insight into funding options and best practices. With that I'm going to let the panel introduce themselves with a brief "Who they are and why they're here."

Maybe we'll start with Jake on the end.

Jake Skinner: [05:30] Hi, I'm Jake Skinner. I'm the VP of Strategy. I'm also the GM of the New York office for FastPay. Prior to this I was at Goldman Sachs here in New York. I went out to LA about 3 years ago.

I just came back about 3 months ago. I'm running the office here with a couple other people in the audience today.

Mike Moretti: [05:48] I'm Mike Moretti. I'm with Silicon Valley Bank here in New York, full service commercial banks to startups. I've been there for about 12 years. For about 4 years before that I was a co-founder at a fintech startup. I can relate a little bit.

Sutian Dong: [06:04] Hi everyone, I'm [Inaudible][06:04]. I'm a partner at Female Founders' Fund. We're a New York-based early stage internet and tech startup. The difference between us and most other venture funds is that we, as the name suggests, invest in female founders only.

The fund was founded in 2014. I joined quite recently in 2016.You're looking at 7 1/2 to eight months if we round up in. We are always on the lookout for interesting female entrepreneurs, ideally before they even start that business to develop relationships over time, New York, LA and San Francisco for the most part.

Urs Cete: [06:37] Hello, I'm Urs Cete [06:38]. I work for BDMI Ventures[06:39], a big media company, [Phonetic][06:40] 120,000 employees. Think of it like a Time Warner or something like that.

I run the venture fund. It's a corporate VC. It's a little over 300 million under management investing out of our latest fund which was vintage 2015, which is 150 million. We do early-stage investments in media-related startups.

We do North America, Europe and Israel.

Ian Sigalow: [07:04] I'm Ian Sigalow[07:03] Sigalo. I'm a partner and co-founder at Greycroft. We're a VC fund based between New York and LA. Today we manage about 800 million. We're investing out of our most recent venture fund which is [Inaudible][07:15] started this January.

We have a lot of dry pattern.

Jon: [07:19] Fantastic. How this is going to work is we're going to do about 30 minutes of questions. For the 30 minutes after that and even for these 30 minutes we work for everyone in this room. You've got some high-powered individuals, some fund-raising experts on this stage.

We want your questions. If there are questions that we're not answering please, please raise your hand. I'm going to start it off. A lot of what I hear is just fundraising is getting harder. Are things changing?

Maybe we'll start on this side with Ian. The space that you're in — obviously you're the one writing the checks. Are wallets tightening up in your space?

Ian: [08:00] Do you guys hear me by the way? Speak louder? Okay, I'll speak a little louder. I had to write our semi-annual letter which went out yesterday.

Urs: [08:12] I got it.
Ian: [08:12] You got it, good.

[Laughter][08:14]

Ian: [08:14] When you've got corporate investors it's great. The series B and latter-stage market in particular has been hit very, very hard over the course of the past year. They track valuations year over year.

It's been down about 47 percent over the last 12 months. It's not apples to apples to a public market because different companies raised capital in Q2 of 2015 than the companies that raised capital in Q2 of 2016.

However that type of a step-down would be equivalent to the second-worst performance over a 12-month period of the US stock market in history. It's really awful for growth-stage companies trying to raise [09:01] capital.

The market is reset dramatically. I think that people in San Francisco probably won't like this comparison. There was a humongous bubble in venture-backed asset class in general. Growth0stage companies were trading at multiples that were in excess of public multiples.

We've seen that reset. That's what's made it so hard for a lot of companies to raise capital. That translates all the way down the stack. If your latter-stage companies are in workout situations it's very hard to put capital to work in early stage opportunities because you're too busy.

You're trying to basically harvest capital to make sure you can support your bigger companies.

Jon: [09:47] That's great. Well, Sutian [09:47] maybe I'll put you on the spot early and often. Is it getting easier for female founders to raise money? What part do you play in that?

Sutian: [09:56] Sure. As a fund we're early-stage investors. What I mean by early stage is that we are mostly seed stage investors [Inaudible][10:02] 500K and typically the first round of institutional financing that a company raises.

I will say that fund-raising has always been hard. No matter what it's never going to get easy. For most people it will never be easy and a walk in the park. That being said, as a fund we track the number of series A financings that female-led companies raise on a quarter over quarter basis.

We see that trending up generally and more so in New York and LA than in San Francisco, which is a little bit interesting. I do think that the diversity of industry that female entrepreneurs are starting companies in is widening so that you have many people starting companies in fintech, in health care, IT and enterprise [Inaudible][10:58] and infrastructure.

It widens the pool of capital that would be looking at those startups by function of the industries that those funds invested in. It's a non-answer to your question. Fundraising has always been hard. We do see more and more female companies getting started and more of those getting started.

Jon: [11:20] That's fantastic.

Urs: [11:20] If I can interject, there was a time when we had I think twenty to 30 percent female-led startups, which is quite high for a fund. It's now much lower because we sold them all. They're all so successful. [Laughter][11:31]

We have Style Hall, Hello Giggles. We had a couple of exits which were female led. If there are more female founders here just talk to me.

Audience: [11:38] Okay.

Jon: [11:42] I sort of preface. It's about scaling a company. Ultimately we're going to dig into equity versus depth. It's ultimately about scaling a company to run. Michael and Jake, how does the role that FastPay plays and SVB plays in helping companies scale?

Jake: [11:57] Yeah, no, I think it's a good example. For SVB they're really focused on — [Phonetic][12:04] do you call it? — venture-backed, high growth, great group of investors, great group of executives that are there.

I think for us how we look at ourselves is really call it a minor league or a kind of preparatory for bank financing or even VC money as well. We have a lot of companies ni our portfolio that have equity investments.

We have companies that have been at banks before and come back. It's a variety of cases. I think how we see ourselves is call it — Maybe you're not quite a fit for bank financing yet where you're waiting for your numbers and metric to change.

I think to Ian's point what we've seen over the last few years is not necessarily a lack of venture capital but almost a difference in terms of how they look at the metrics. It's not just all about pure revenue growth.

Now they're starting to think about being profitable. Even the companies that we talked to in our portfolio, all of them are saying — I'm sure [Inaudible] [12:56] will be profitable by the end of 2016.

That's kind of the march that everyone is on right now. I think for us we look at businesses that have maybe not been in business for very long or have just started to really ramp up their growth and are not quite fit for bank financing.

We think SVB is a great place to kind of either graduate some of our bigger clients or be a soft no for some of the banks in the space so that these companies can grow, kind of find their groove, understand their market and then once they're ready for profitability, covenants and some of the bigger kind of types of financing we kind of graduate them to a bank.

At the end of the day cost of capital is lower. They need that in order to be able to grow their business.

Urs: [13:37] Yeah. I think you should tell him what FastPay does. I'm not 100 percent sure everyone knows exactly.

Jake: [13:44] FastPay, we are a, call it, accounts receivable lender to digital media companies. A majority of our clients are publishers, ad tech companies, some [Inaudible][13:54], really anything that's in the value chain for advertising in general.

How the business was started is [14:00] really on the premise of delayed payment terms in the space. You've got the major advertisers at the top like Anheuser Busch, [Inaudible][14:08] and these kind of big premium advertisers that everyone gets excited to work with.
Their payment terms are ninety, 120 and sometimes 150 days. What that does is it puts the burden of cash down on some of the lower guys that don't have tons of cash, that don't have big, cheap facilities from a Wells Fargo, an SVB or these other guys.

What we do is [14:30] we actually help them take care of those cash flow problems by financing invoices that they submit to our platform. You have an invoice that gets paid in 90 days by PNG. You can, if you're a client of us, submit that invoice to us.

We underwrite it, price it and then from there we advance that money to you and collect directly from the advertiser. It's a pretty seamless product. It works well. It's an interesting financial instrument for companies that are high growth and are trying to get cash in their business.

If they're [15:00] trying to spend their equities smartly, it's a great way to kind of stretch that runway for cash. That's what we do.

Mike: [15:08] I appreciate the background. That's why FastPay's a good [15:10] complement of Silicon Valley Bank. Typically we'll start with some venture debt financing. Company could be even potentially pre-revenue.

If they're [Phonetic][15:19] ventured backed there's the potential for some terminal financing. As they continue to grow and generate a significant amount of receivables, maybe there's a working capital line that can come in, and they can be profitable not at that stage.

If they continue the trend and become [Phonetic][15:32] cash flow positive then term loans become an option, cash flow, term loans, large revolving credit facilities, those kinds of things. It depends on the stage.

We just customize the facilities as needed — [Phonetic][15:45] One quick comment, I meant to add on to what Ian was saying, which we absolutely see, is when companies want to continue to grow the majority of our clients are still losing money.

They do need more capital. If there's a little less equity capital we're seeing more and more looking at that capital's an option. It has been particularly busy and not just for SVB. We have a number of competitors out there.

Everybody is busy in the capital market at least looking at opportunities so the companies can continue to grow.

Jon: [16:16] Great. For so many investors on the panel, do you have a preference with your fund, debt versus equity? Does it depend on the case?

Urs: [16:27] Since we only do equity, do I like it as my portfolio companies add debt to the mix? I think a big chunk of our portfolio has it now. I think a third or even more than a third have some debt facilities in the startups.

For me it depends on the stage. At the end of the day it's still debt — Nothing against your guys. It's debt. They want their money back. They're patient, much more patient than a Citibank or someone like that would be.

They're not a VC, not exactly. I think once it's a little later stage you've found product market [17:00] fit, I think for that scaling part I love it if you can kind of leverage [Phonetic] [17:06] or round up a little bit and add some non-diluted funds to the company.

Jon: [17:13] Okay. Ian or Sutian, [17:13], anything?

Ian: [17:15] The short answer is yes. Almost all of our companies have some debt facility. The longer more nuanced answer is about the cost of that. I think most entrepreneurs don't really understand the difference between debt and equity.

It's worth noting — I won't pick on SVB. Let's take a bank [Crosstalk][17:37] like [Inaudible][17:38].

Jon: [17:37] I'm going to [Phonetic][17:38] answer everyone. We want to get in the weeds [Inaudible][17:42]. Everyone in their head just said, "Please tell us more about the long-winded answer on what entrepreneurs need to know about debt."

Ian: [17:49] Okay. A bank like Comerica for instance has a rate of return on their debt of something like twelve to 13 percent. If you look at this asset class they're lending to the startups at [Inaudible][18:05] plus or Wall Street Journal prime plus a couple points.

It ends up being — I don't know — 6 percentish interest rate. You wonder how that math works. How do they make the money that they make? There's a couple answers to that. One is there are all sorts of facility fees and unused capital fees and upfront fees and pay-down fees.

Then there are warrants which generate some incremental return. The last piece, which most entrepreneurs don't really appreciate unless times are tough, is that the loss rates on this debt need to be very, very close to zero.

There are some banks — SVB is particularly good in this regard. Others like Comerica are particularly bad. I hope they're here [Laughter][18:53] — where they get the wind of something not being great. You have a bad quarter and they sweep your cash.

That can be awfully painful if you thought you had a debt line and all of a sudden it disappears and you have to make payroll in a week. You get a call if you're the equity guy that says "Hey, we just got our cash swept by Comerica because we missed our bookings target for Q2," which is the exact hardest time it is to raise equity capital.

Sometimes those decisions have real ramifications for entrepreneurs that are not appreciated at the time that they take the money.

Urs: [19:32] Maybe [19:33] they don't like to talk about — I think in our history we're only ten to 11 years old. I think there was one case where at the end of the day we have to relinquish the keys to the bank.

I know they don't like to take control of assets because if we were not able to sell it — Are they really better at it? Let's see. It does happen. At the end of the day it's a bank. If you don't fulfill your requirements they can take your company.

It does happen but not often.

Mike: [19:57] A couple main takeaways from my standpoint — The first thing is that Ian our next lunch is definitely on me, no problem. [Laughter][20:03] One of the key things, and that is the whole topic, [Inaudible][20:08] equity.

Everybody is going to raise equity and absolutely should in every instance. Debt is case by case. One of the big things that we do at SVB is educate the entrepreneurs we talk to about debt. There are pluses to it.

There are absolutely minuses or at least potential minuses to it that everybody needs to know about before they go into it. Yes, it can extend a runway. Yes, it can be cheaper capital — yes, dramatically less dilutive capital, but it's debt.

Any lender will tell you they want to see it repaid. Equity investors are looking for as big a return as they can on their equity. Debt lenders want a 1X on their principal. They really want a 1X, not a 0.9X, a 1X.

That's the general mindset. Yes, different lenders have different mindsets in terms of what happens if a company trips a covenant, hits a bump in the road. Some of them are more flexible than others.

I'd like you to do your homework on which investor you bring in. You should do your homework on which lender you bring in.

Jon: [21:13] Let's flesh that out a little bit. We've talked about some scary aspects of the repo department coming for your assets. Let's talk about when it makes sense to raise debt. What situation or maybe an anecdote of companies that you work with has it really made sense?

Talk about it at what point in their sort of maturity or life cycle it's really made sense [Inaudible][21:37].

Ian: [21:37] If you are a high-margin subscription business, so most software companies now, or consumer business with really good retention and you can see that I borrow here and will get to here —

If I need to my payback period looks like such and such and I can stretch it or the multiple on my business [22:00] between here and here is so much greater than the value and cost of taking the debt and you run that analysis then it makes sense.

Two is if you are an IO-based business and someone is willing to factor your receivables which is a type of debt — I don't really think of that as debt. Candidly you've got a lot of assets that underpin it.

It's not the same as taking a credit line. That AR line, most companies should have an AR line of some scale. Everybody is going to want payment terms if you move into the enterprise or if you're working with bigger receivables.

It doesn't make sense to fund accounts receivables with equities. That's kind of a no-brainer. It's the corporate debt that credit facilities that really require more kind of consistent logic about where I'm going to go with that incremental capital.

Mike: [22:54] This is generally for earlier-stage companies doing the analysis. If you're latter-stage or especially profitable at that stage you definitely want some debt to complement it. At that stage you should be able to support it —

Working capital, cash flow lending, acquisition financing and things like that. At that stage then it's less of a discussion debt versus equity and more debt and equity.

Sutian: [23:15] I'll also add that as an early stage investor many of our companies raise debt later on. Typically post [Inaudible][23:21] you're not going to SVB and get a line. It's just too early.

It's not de-risked enough. Typically it's post-series A that you will talk to your series A investors and lean on their relationships with the various bank providers.

Jon: [23:39] Let's talk a little bit about crowdfunding. I'm not sure it's an alternative. Perhaps it can provide companies with additional liquidity. What's everyone's take on crowdfunding?

Can it be perceived as a detriment in any way? Are you seeing any acceleration or deceleration in terms of companies raising money via crowdfunding? Are those enough questions wrapped into one? [Laughter] [24:08] — Seven to one.

Ian: [24:12] It's coming to all aspects of venture and private investments. On the very early-stage side you've got AngelList. I would guess that AngelList is in like ten percent to maybe 15 percent of our companies.

Somebody somewhere has a syndicate that they've cobbled together. They'll say [24:30] "Hey, we'll do a quarter-million dollars." I look at the cap table and they only did 25 grand and syndicated $225,000 to their friends.

I don't love that by the way, but it happens. I think in the mid-market I don't see it a whole lot in series A and series B. Occasionally there's some aspect. Then we have a couple companies talking about doing a Reg A IPO which would be —

Crowdfunded is not really the right word, but it's potentially [24:58] crowdfunded for a component of that. It's essentially — Reg A+ is an IPO where you can raise $50 million and on less stringent terms go public.

That's going to be an interesting avenue I think over the course of the next 2 years if the later-stage formal IPO market continues to be so elusive for companies.

Urs: [25:21] I'm a little skeptical when it comes to crowdfunding. I don't know. Maybe that's the German in me that I can [25:26] always be skeptical about stuff. [Laughter][25:30] I've seen actually a number of cases where top VCs have kind of decided "Oh, I'm not funding this any further.

Let's put it on a crowdfunding platform. There are a lot of people that would love to invest with [Inaudible][25:41] A investor from Sandal Road or something like that."

Ian: [25:44] That doesn't work.

Urs: [25:45] I've seen it work. I've seen it work.

Ian: [25:47] No way. [Laughter]

Urs: [25:47] It does.

Jon: [25:48] This is what you pay the big bucks for guys, right here.

Urs: [25:52] I'll not name the company now because now it would be very easy. I've seen it. Generally I think what we do is very hard.

Jon: [25:58] How did that deal work out?

Urs: [26:01] At dinner on Friday I'll tell you. I'll tell you. [Laughter][26:02]

Ian: [26:03] The answer is clearly not good.

Urs: [26:06] No, the company is still alive. I think they raised $1.5 million via crowdfunding on top of after all insiders passed on not keeping it alive anymore. It does happen, but maybe not often.

It's very hard what we do. I think on AngelList you see a lot of sophisticated angels. I think then it's totally fine. The time where —

Ian: [26:25] Who wants to see dentists and people who don't know anything —

Urs: [26:29] That's what scares me a little bit more. I'm not sure they really understand how hard it is and what the odds are of something working out. Once you have a bunch of people in the middle of the country lose a bunch of their savings because they invested in some sexy startups I think then there'll be some backlash.

I'm a little bit skeptical. It's just because maybe I've done this now for 11 years. I just think it's very hard. I know it doesn't sound like that to the entrepreneur. What you do is definitely harder, but it's not —

Being consistently good as a VC is also not that easy. I'm a little skeptical with [27:00] crowdfunding.

Mike: [27:02] Just a couple of comments to add to that — One is that it's even more important who you take your equity from. Yes, you want to raise some money. That should only be one component of it.

Maybe if you're doing a little bit of seed funding then crowdfunding can be good. If you're doing anything later stage you really want to know who's going to be sitting around the table with you. They can potentially provide a lot more value than just giving you a check.

That can make a huge difference to your company. If you get the right person [27:30] on the table the benefit there is very significant. You have to do your homework on that. Once you go later stage especially fundraising — it's not just raising money.

It's not just getting the right person around the table with you. It's also marketing event, especially if you're talking about an IPO. That's a very important component of it too. Crowdfunding may not bring all the additional value that a more traditional type of funding can bring you.

Jake: [27:58] I think what we see all the time is, and we tell our clients this all the time, messy cap tables are a big burden later down the line. It might sound like a good idea upfront like "Hey, they gave me the best evaluation.

I love these guys. It's someone I trust. They are not directly involved with my sector, but he's willing to pay $5 million more than the guy over here. Do you know what? I'm just going to do it."

We always say is that the best idea? I think it's always really important to think about how you're thinking about your investors, what you are going [28:30] to need from them down the road and also when things go bad and you have to, say, call up your equity investor and tell them something.

If they've been around and have seen companies like this in the past they're going to be a lot more understanding. They're going to help you get an action plan to get back on track. I think the biggest problem I see with companies that are crowdfunded or have 50 Angels is they have a battle or something down the road that ends up being way messier than it needs to be.

That can make up your debt. It can mess up your equity. Ultimately your company might end because [29:00] you brought on these investors that seemed good at the time but later on they brought nothing of value to your company.

Jon: [29:06] I think a lot of entrepreneurs in the room may not be ready to raise today but six, twelve, 18 months down the road they will be. Michael touched on the research entrepreneurs can do to understand who their investors are.

Maybe we can talk a little bit more about that but other advice — if they're not ready to raise today but maybe in six to 12 months they are.

Sutian: [29:30] I think that's a great place to be if you're not ready to raise today, to develop relationships now before you're going out to ask for money. If you think about the process of an equity financing, it can happen very quickly, four weeks from first meeting to money in the bank.

When you think about that and also think about raising money from investors like entering in a marriage with each of your investors, a seven- to 10-year cycle and you can't get divorced with these people, you [30:00] want to make sure that you like them and that you want to work with them for the long term.

What that means is that if you can develop relationships over time and connect the dots and say "Oh this person offers valuable advice in addition to money that they can help me along the way, that they have a background or investment history that lends itself to my business," that's a much better —

You're going in with a lot more education than if you were just to go out to market and say "Hey guys, I'm out raising money." The process for developing those [30:30] relationships whether you're six to twelve to 18 months out is varied.

The best entrepreneurs that we've invested in have come from introductions from either our existing portfolio companies, our LP base or people we trust in the industry who say "Hey, we're investing in this person, or we already invested in their company. You should take a look."

With that being said, if you have the luxury of time you can work on developing relationships with people you think could be great fits for your next [31:00] round without having that time crunch, without saying "Hey I need to get to know you really well in 3 weeks.

Will you invest in my company?" That's a really hard ask.

Jon: [31:09] [Inaudible][31:10], Michael?

Mike: [31:12] [Inaudible][31:12] comments. The only thing I'd say is it's hard to network too much. You want to know as many people as you can because then you're one degree. If you're two degrees of separation away from somebody it's totally fine —

Good referrals that come in to you. Maybe they don't know you. They know somebody who does. That's a good referral.

Jake: [31:30] Yeah, I mean from our own experience — I did our equity raise with our founder in 2014. We actually met the investors we met with over a year before casually. We talked about the business.

It was a really nice conversation. A lot of times if you start those relationships early you can actually have a better conversation about your company and what you're trying to do. They can give you great feedback.

If it's a more formal meeting and you're coming in to say "Hey, I want to raise $10 million on a [Phonetic][31:55] hundred pre, the questions are a lot harder." You have to have things really buttoned up.

You have to know that your finances are ready. You have to have a team in place. I think it's really good to kind of start being warm [Inaudible][32:05] early, get them comfortable with your business, see them at places and then start to have those formal conversations when you're really ready with your business and not necessarily just set up 100 meetings and try to take the highest evaluation you get.

Urs: [32:17] [Inaudible][32:19] echo some of what was said earlier. I think meeting a year before is no problem. That's actually a good time to meet VCs. Then have something like an update email where you tell them in the first meeting "This is what I want to do."

Then you [32:30] prove with like two email updates that actually I told you I want to do this and actually did this. Of course then it gives the VC kind of feeling that "yeah, they actually do perform. They do execute on what they told me."

It's at least one further data point. I get a punch of these "investor and friends" updates from companies I haven't invested in. Keep some people that you think might be useful in the future in the loop of what you're doing.

Jon: [32:56] What's the best way to contact everyone on stage or contact your firms? It's always nice to say "form relationships early." I'm not suggesting you share your Gmail with anyone but best practices when people [Crosstalk][33:10][Inaudible].

Jake: [33:11] Snapchat.

[Laughter][33:12]

Jon: [33:16] What hashtag do you use, et cetera, [Laughter][33:18] best practices in contacting your firms to forge those relationships?

Jake: [33:23] I think the best way to do it in terms of reaching out to people is to find someone you're friendly with or that you know in the past and not just cold email — "Hey Ian, my name is Jake. I'd like to talk to you about investing in my business."

I always think that's, not rude, but it's not exactly the best manners. I think it's interesting if you know someone or have a relationship with someone in the past. You explain to them "Hey, this is what I'm looking to talk to them about.

Would you mind asking even before introing me or asking if they're comfortable?" and then getting more of a warm introduction. I think it sets you off on better terms. They are going to be happier to meet with you.

You have something to talk about in the beginning too, "Oh, how do you know so and so?" It just makes [34:00] it a little more natural as opposed to just "I've got an email list. I'm going to just email these people."

I always think that's a little bit of a harsh strategy.

Urs: [34:08] [Inaudible][34:09] if they're all still in in the 2. [Laughter][34:11] If you literally have —

Urs: [34:13] Nobody CC's.

Urs: [34:13] Forty funds and then "Hey, I have a great idea. Would you want to invest [Inaudible][34:16]" happens once a week now [Inaudible][34:19].

Ian: [34:21] To the point of the last question I was thinking about this. I think every investment I've made happened really fast. I meet a company and really like this company, or didn't happen at all or it happened much, much, much later.

They met me once. "I really like the entrepreneur but I don't like what they're doing, so I'm going to put it into a tracking thing." We follow up. I'm not interested in having that entrepreneur necessarily ping me every month.

I get enough email. The last —

Urs: [34:50] Every month is too much.

Ian: [34:52] Every one is 6,000 more emails a month. We have people on our staff who will follow up with these companies on a regular basis, or I'll do it if I'm interested in something. Either the company comes in and it's a first meeting and they check all of the boxes of what we're looking for.

They check enough that I will follow up with them every 6 months and get an update. It could take 3 years before we invest in the latter group. If you're not in either of these groups and we're not actively following up with you or the first meeting wasn't an immediate "Let's move to step two," it's probably not going to happen.

I think for [35:30] most entrepreneurs out there it's a pipeline management thing. it's enterprise sales. You have to have a huge pipe if you want to get one [phonetic] investor pipe to meet with a hundred.

It's just the way the math works. The good news is that there are like 1,200 VCs out there. There are plenty of people with capital.

Mike: [35:50] In the VC world you get so many people hitting you up for an investment —

Ian: [35:55] So so many.

Mike: [35:55] You have to prioritize. If it's somebody you know or somebody who came in with a good referral, that's higher up the priority list. If it's something that just comes over the [Inaudible][36:05].

Ian: [36:07] If you think about it I think the number of public companies is like 3,500 now, US domicile public companies. We meet with about 7,000 companies a year. It's like processing the entire public market every 6 months.

It's impossible. It's beyond the point where people can actually meet with all of the companies or even read all of the business plans. We have a team in the Philippines now that reads business plans because there are just so many business plans.

Jon: [36:35] Is that "Don't create a business plan?" [Laughter][36:37]

Ian: [36:40] Don't cold email business plan. The odds are zero if you cold email business plan.

Urs: [36:44] Info@Greg, yeah, that does well. [Laughter][36:46]

Urs: [36:45] Echoes to [Inaudible][36:46] actually. [Laughter][36:48]

Ian: [36:51] He lives in the Philippines. He — [Laughter][36:54]

Urs: [36:54] It's my second job.

Jon: [36:56] That's about the 30-minute mark. I want to open it up to questions. There were a number before. Let's start right here.

Audience: [37:03] [Inaudible][37:04] Is there anyway — That's my question. [Inaudible][37:09]

[Laughter][37:10]

Jon: [37:12] That's a great question. It's hot.

Jon: [37:15] I think over here it's doing the best it can. I can't speak for the [Inaudible][37:18] folks, but we definitely mentioned it. Are there other questions about the temperature of the venture community?

Audience: [37:25] I think you, by the way, everyone for being here early. I loved hearing from all of you. In terms of raising C capital, does it make a difference how you structure your business initially? We've gotten mixed information whether to be C corp or LLC or anything along those lines.

Any thoughts about that would be helpful.

Jon: [37:53] Yes and no. If your goal is to someday get venture money, we only invest in C corps. Maybe we've made one — You have to pick block or corporations for LLCs because there are tax issues with our partners.

It's a longer conversation than we have time for. When you're still a seed stage company it's less relevant. It may be the case that the people who want to invest in you as a seed stage company want the tax losses.

I don't know why that would be. Some of them might want it. I think ultimately you could do a [38:30] conversion later from whatever your seed structure is to a more formal structure. Right now your goal should be to raise the money and have the lowest cost possible for operating the company.

I wouldn't set up a Delaware C corporation unless the investors insisted on it.

Audience: [38:46] Conversely — I mean, I understand having a loss which might be a positive thing for someone who's wanting to write that off.

Ian: [38:52] Not a write-off necessarily. If there are operating losses in the company they can take a percentage of that against their taxes.

Audience: [38:58] Exactly. I understand that. This may sound like a stupid question. Is it a negative to have profit, to show profit? Would there be shareholders who might not want to [crosstalk][39:09] claim —

Audience: [39:10] Like 7 months after we launched.

Ian: [39:12] Yeah, it's highly unusual. The short answer is no. If I were an investor in a profitable company I would probably want, and the company wasn't distributing cash — Break this into two groups, services and businesses.

I invest in a restaurant. That restaurant has profits. LLC is fine because I'm going to take distributions out of the restaurant every year. On the flipside you're building a widget. You're going to eventually deficit finance it so you're not distributing the cash [Phonetic][39:48] then a C corporation because I want you to be able to retain all the cash.

I don't want to have to pay taxes on phantom income from your company.

Audience: [39:55] Got it. Okay, that [Phonetic][39:56] explains it. Thank you.

Audience: [39:57] [Inaudible][39:57] you mentioned AngelList and other folks who do crowdfunding. [Phonetic][40:01] Are you going to actually deal with one name on the cap table or [Inaudible][40:04].

Ian: [40:06] One name.

Audience: [40:06] Who's that one name? Is it the person who syndicated the deal [Inaudible][40:08]?

Ian: [40:10] Yeah, I'd have to look. I think they set up a separate LLC for every single one of these investments. There is some entity, AngelList, Jim Simon LLC, whatever.

Audience: [40:24] Somebody represents that LLC.

Jon: [40:24] Yes. That's a good question. I don't know —

Sutian: [40:29] [Inaudible][40:29] and Utah. They have a third-party fund administrator.

Jon: [40:33] I also don't know — On the flipside if you invest in an LLC you need a K1 for every single one of these investments. Personally I would never do a lot of crowdfunding. I can't imagine having to collect 50K ones every year to file my tax return.

Jon: [40:48] Which is an opportunity for entrepreneurs to work on that. Solve his problem. [Laughter][40:53]

Jon: [40:55] Back right.

Audience: [40:55] Can you talk about the process [Inaudible][40:57] from the moment you said yes [Inaudible][40:59]?

Urs: [41:04] I think it depends on — It depends a little bit on the stage and seed. I think the fastest would be two to 3 days because it's a small check. We do a little less.

If I'm the lead [Inaudible][41:14] I think normally between saying yes and paperwork done and cash in the bank is three weeks or something like that, three or 4 weeks I'd say on average. Sometimes it's faster if necessary, rarely longer.

I think that's just, I guess, normally what I see rounds take to paper.

Audience: [41:34] You speak about what diligence you do when you look at things [Inaudible][41:39].

Urs: [41:45] Do you have the right to buy out other people? Do you do due diligence on the rest of the cap table?

Sutian: [41:49] I'll speak as a seed investor. Typically we're, if not the first money in, then the first round of institutional financing in. A common thing that we see is that there's a convertible note that is outstanding that converts with the seed financing.

The cap table is pretty clean before. It's just the founder equity and an employee option pool. There's very little diligence to do. I think in terms of figuring out who the rest of the investor base is, that's absolutely important to us as we'll be working closely with those people as well.

At the seed stage we don't really look to buy people out or try to [Inaudible] [42:25].

Ian: [42:29] I'd say — a little bit of historical context on this one. I started in '01 in the venture business. That was the worst time in the history of venture but the best time to learn the business because you learn all of the things you shouldn't be doing.

People talk about the risk in a venture deal, operating risk, management team risk and tech risk. There's also financing risk. Financing risk is probably the reason that [43:00] 15 percentish of our companies that died died.

There just wasn't a strong syndicate. The follow-on money couldn't be raised. A partner who was our co-investor left the firm. It became an orphan deal. You go through all of these permutations of what happens to companies.

Some of them are pretty ugly. They can be avoided if you do your homework as an entrepreneur and a VC on who's in the deal with you. There are often times different [43:30] incentives for earlier stage investors than there are for later stage investors.

Some people will look to go liquid at the wrong time. They'll be shopping their shares on Share Post or something. You'll hear about it. That can taint a fund raise. I think as an entrepreneur — The entrepreneur is the one who's ultimately responsible for his or her cap table.

You pick everybody that invests in the company. Nobody can make you take their money. You've got to be [44:00] careful about that. You have to pick people who you like and who you trust.

You should diligence them the same way they're diligencing you. You should ask for references. "Who else have you worked with? How long have you been here? When's your most recent fund? How long are you going to stay?" All that adds risk.

Urs: [44:17] One advice there may be not only talk to the founders who are still in the portfolio, find those companies that died, didn't work out. Find out how they were in those cases.

I'm sure even in our portfolio you'll find some founders who will be so disgruntled and say "Oh, they didn't [44:31] keep us alive." At the end of the day if you get feedback from a founder, from a startup that didn't work, I think it's a good way of diligencing how a fund behaves when times are tough.

As an entrepreneur times will always be tough. It's never kind of a —

Jon: [44:43] [Inaudible][44:44] times are good, but yes.

Urs: [44:47] Overall they are, hopefully.

Audience: [44:48] Hi, first off thanks for getting up there [Inaudible][44:52]. It's really great [Inaudible][44:53] all this. Now this question [Inaudible][44:57] — Our company we deal with 30 global regulators [Inaudible][45:00] platform.

What is the propriety of asking an investor for a copy of the periodic AMLPYC affirmation to know who the investors are? If we go to your fund and regulator says "We want to make sure that no one in the fund is also investing in Iran, Iraq, one of the OPAC countries."

Jon: [45:23] If you are dealing with institutional equity partners you can rest assured that they are not dealing with people who are investing in Iraq, Iran, Syria, North Korea because, one, the other institutions who have invested with us wouldn't allow that to happen.

Two, we wouldn't take it. You would know because it would be released in the press. There would be a boycott on [Phonetic][45:48] Swarthmore's campus that Greycroft who's an investor took money from people that are propping up a regime —

You can't imagine what would happen. [Laughter][45:57] We've [Phonetic][45:59] got a lot of college endowment money. They're the most sensitive people on the planet when it comes to this sort of stuff.

Private partnerships, it depends on ultimately what your business does. If you're in a regulated industry I think you have the right to ask questions. If necessary you can have fund council just affidavit something that would say "Yes, this is the case."

I don't think any fund however is going to release to you the names of all of their investors to allow you to do your own diligence. They could [46:30] just sign the document that basically indemnifies the company and provides an affidavit to that effect.

Mike: [46:37] Just one quick general comment to that. This is across the board in terms of regulatory issues, specific at SVB. We're growing in a number of areas. The fastest-growing group at Silicon Valley Bank is our compliance team, for better or for worse.

Jon: [46:53] I'm not going to touch that one.

Ian: [46:54] That means you should raise money now from Silicon Valley.

Mike: [46:55] Hurry up, hurry up hurry up. [Laughter][46:56]

Ian: [46:56] Before the compliance team gets really big and then the terms get worse.

Mike: [47:01] Exactly.

Audience: [47:03] A lot of my clients — I work with the founders [Inaudible][47:07] accounting services. The founders invariably need a financial model. I've heard a variety [Inaudible][47:13] different investors who want to see things presented a different way.

I'd love to hear anybody who wants to comment's take on whether you're just looking for [Phonetic][47:22] accrual financials or if there are particular key metrics that you always like to see. I'm sure it varies by industry, but if you could comment generally it'd be of interest to [Inaudible][47:32] lot of my clients.

Ian: [47:35] A lot of companies will approach us with financials that don't' make sense because they don't know how to do financials. We will often times ask somebody to translate chicken scratch into a financial model that makes sense.

One is this thing between gap accounting and cash accounting, which if you deal with a subscription business is very important. You need to know not necessarily that I'm collecting this much cash — that's important — but [48:06] also what my revenue is.

I can't recognize it all right now. Things are generally valued off a multiple of revenue not of cash collections. Figuring that out is a key piece. The more important piece is creating a model that shows where this business is going to go and how many people they're going to hire and what that burn looks like [48:30] to get there.

We spend a lot of time on that exercise before investing. I want an entrepreneur that's going to sign off on that plan that says "I'm taking in four or five million dollars. Here's my business today.

Here's where I think it could be in six months, in twelve months, ni 18 months." I don't need a 5-year crazy forecast that no one is ever going to hit. It's good to have pen to paper that says I'm hiring these people in this order.

Here's the productivity that I'm going to hold them accountable against in order to raise more [49:00] money. Yeah, it's really important. I would say that most of the companies were funding will bring that function in house within the first couple of months after we first.

The entrepreneurs will realize how important it is and want to manage it.

Mike: [49:17] I'm definitely glad you asked that question. That is critical as Ian is saying. Yes, you want to build out a product. Yes, you want to sell it. That's critical. You can't ignore the finance part of the business.

You do need to track it. It's important for any investor, [49:30] potential lender. We get financial statements all the time. It doesn't happen a lot. We do get balance sheets that don't balance.

Jake: [49:38] Negative equity, that's a good one. I like negative equity [Phonetic] [49:42] on them too. That's always fun to watch.

Jake : [49:44] Yes. You don't want to start out a dialogue that way. It's good too to put your best foot forward. We have clients too that come in and their financials are a mess. Their model is a mess.

It's not exactly the best look on you. It's like going to a date covered in trash.

[Laughter][50:00] They're not going to give you a great first impression —

Man: [50:01] I love that.

Jake: [50:04] When you're sending them to investors and lenders it's always a good thing to have like — We tell clients [Inaudible][50:09] all the time. Hire an outsourced CFO. Hire an outsourced account.

Make your books actually look somewhat like real books. It will help your terms. It will help your negotiations. They'll just have a better opinion of you as you go down the due diligence path because it's not a hard thing to do from the start.

It's better to just start off on the right foot. It makes you look better [50:30] in the eyes of equity, debt, no matter who's looking at your business.

Jon: [50:33] Two more questions and then let the team out from under the hot spotlight. One is right here.

Audience: [50:40] I started a company that [Inaudible][50:40] self-financed for 10 years [Inaudible][50:45]. Can you talk to me a little bit about the experience of [Inaudible][50:48] equity and like losing control [Inaudible][50:51] for the first time?

How do you manage [Inaudible][50:55]?

Ian: [50:57] I see that a lot. The hardest part is that companies that bootstrap have some bootstrapping debt. By that I mean not in the technical debt term. You've done things over 10 years that you wouldn't do if you had all the cash you needed.

You probably have people on your development teams spread across the US and not all in the same office for instance. Maybe you find them cheaper in certain places. Maybe you have contract terms that could [51:30] substitute the long-term tail of a contract for more upfront payment, which we wouldn't normally do.

We're interested in the long term not collecting cash up front. The hardest part when we invest in companies that have been bootstrapped is unwinding that bootstrapping debt to become more of a fast growth venture-backed company the way that we envision companies going forward which is assume that capital is not a constraint anymore.

Your goal is now to build the biggest and most valuable [52:01] company you possibly can. You might have to change offices and relocate people and rework contracts and do other things in other to build that type of business that a VC would want to fund.

There's a mindset of having a partner in your company now. Some people want to have a partner. Some people don't. There have been plenty of great companies built without ever raising venture money.

I think most of the biggest companies have [52:30] taken venture at some point along the way because they either needed it or just wanted that advice. It's really an entrepreneur's decision. Once you take venture your life changes because VCs are interested in growth.

We don't want to lose money either, but we're okay losing money as long as the company is accelerating at a fast pace.

Mike: [52:51] Just one quick comment to add to that. I remember when I was an entrepreneur if you're going to go out and raise some venture money do not automatically go with the one with the highest valuation.

That's a factor to take into account. In my opinion there are more important factors than just valuation.

Urs: [53:06] Think Silicon Valley Season 1 Episode 3 or 4. [Laughter][53:10]

Mike: [53:13] Exactly.

Urs: [53:14] It's a must-see episode for raising — Fortunately the whole series was pretty good.

Audience: [53:19] I like the one with the driverless car.

Jon: [53:22] Great, last question I think.

Audience: [53:25] I think [Inaudible][53:27]. I was going to ask from the equity perspective and then the debt perspective, what's more important [Inaudible][53:34]?

Jon: [53:40] If you're profitable the government owns 40 percent of your business, right? Every dollar of profit you make they sweep 40 percent of. If you're in a market that is mostly untapped — I don't know exactly what your company does.

Assume that you [54:00] just invented something new and have sold a little bit of it and no one else has it. You've got 98 percent of the market left to go. You don't want to be profitable.

The return on taking that incremental cash and investing it in more salespeople to grow faster will outweigh whatever bit you get for profitability. You're going to expose the market to other fast followers and new entrants.

If your market is an established market, you're going to be [54:31] judged on a different set of rules. You're going to want to be profitable. It really depends on the situation. In general the companies we're investing in have no desire to be profitable right now.

They're in brand new spaces. They want to grow as fast as they can.

Mike: [54:46] From one lender's perspective, the majority of our clients are still losing money. We know that. We're totally fine with that. It's the nature of the business. Generally the plan is to at some point get to profitability.

Again we'll just look at the numbers. It's in one year. It's in two years. It's [55:00] three years. That's fine. We'll keep a close eye on how close they come to those numbers. Hopefully they're tracking reasonably well to them.

Ian: [55:11] The way the analysis works in a board meeting is "I will look at how much cash a company is burning. I will have a formula that the entrepreneur and I agree upon about how much value they're creating through growth."

Generally speaking that is some multiple of [55:30] incremental revenue that you're adding every period for the cash you're burning. As long as that multiple outweighs the cash burn you're in good shape.

You will continue to be able to raise more capital at a higher valuation that reflects the muscle you've put on from adding all that incremental revenue. The problem is some companies don't add revenue fast enough to counteract the cash they're burning.

Those ones go out of business.

Jon: [55:56] Great. With that thanks a lot to FastPay, Evolution and Nomad Financial for hosting us and to Jake, Michael, [Phonetic][56:01] Satiyan, Urrs and Ian for being here.

[END]


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