

"The Capital Challenge"

University of California, Santa Barbara
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What are the key ingredients for raising capital for early stage companies and how does a financing deal come together?



C. Thomas Hopkins

- Partner in the Corporate Practice Group
- Leader of the firm's Mergers and Acquisitions Team.

Areas of Specialization:

- Corporate
- Mergers & Acquisitions
- Technology
- Emerging Growth/Venture Capital

Representative Matters:

- Represented The Boeing Company (NYSE: BA) in its \$1.7 billion acquisition of Aviall, Inc (NYSE: AVL).
- Represented Primedex Health Systems, Inc. (OTCBB: PMDX) in its \$221 million acquisition of Radiologix, Inc. (AMEX: RGX)
- Represented Summa Industries (Nasdaq: SUMX) in its acquisition by Habasit Holding AG, and Habasit Holding USA, Inc.
- Represented JAMDAT Mobile (Nasdaq: JMDT) in its \$680 million merger with Electronic Arts Inc. (Nasdaq: ERTS).
- Represented JAMDAT Mobile Inc. in its initial public offering.
- Represented JAMDAT Mobile Inc. in its \$137 million acquisition of Blue Lava Wireless.
- Represented Fastclick Inc. (Nasdaq: FSTC) in its initial public offering.
- Represented Fastclick Inc. in its \$75 million recapitalization.
- Represented La Brea Bakery in its sale to IAWS Group plc.

Highlights:

- Named as a leading M&A lawyer by The Legal 500 United States 2007, a guide to America's leading business lawyers
- Named a "Dealmaker of the Year" by the Pacific Coast Business Times.

Sheppard, Mullin, Richter & Hampton

- Founded in Los Angeles in 1927
- Full-Service, Am Law 100 Firm
- Nearly 500 Lawyers
- Ten Offices
 - Los Angeles
 - Century City
 - New York
 - San Francisco
 - Washington, D.C.
 - Orange County
 - Santa Barbara
 - San Diego
 - Del Mar Heights
 - Shanghai, China
- Our clients include 55 of the Fortune 100 companies
- Strong focus on middle-market and emerging growth clients
- Responsive attorneys
- 24/7 Access

Rusty Reed

- Co-Founder and Managing Partner of Great Pacific Capital
- Southwest Securities
 - Investment Banking
 - Middle market technology capital raising in Texas
- ValueClick
 - Supported management team through IPO
- Homestore.com
 - Mergers and Acquisitions team
 - \$180MM in acquisitions
- Fastclick
 - Corporate Development
 - \$75MM Recapitalization
 - \$63MM IPO
 - \$220MM Acquisition by ValueClick
- ValueClick
 - Corporate Development
 - Finance at Commission Junction

Great Pacific Capital

Identify value. Grow value. Realize value.

- Early Stage Venture Fund
 - SLO to Agoura (101 technology corridor)
 - Focus on Santa Barbara
 - Start-up to exit experience in Santa Barbara

- Investment Model
 - Applied technology companies
 - Strong Management teams

- High touch
 - Accessible
 - “Been there” assistance

Overview of Program

- Types of capital
- Sources of capital
- What venture capitalists look for
- How to find capital
- How a venture capital deal comes together



**Raising capital is extremely
difficult and time-consuming!**



Types of Capital

- **Debt** – borrowing money – must be repaid. Difficult for an early stage company with few assets and little or no cash to borrow
- **Equity** – investment in the future profit of a business. “Repaid” through liquidity events (eq., sale of business recapitalization) and/or dividends

Sources of Capital

- Bootstrapping/Self-Funding
- Friends and Family
- Government Grants & Programs
- Angels
- Commercial Banks & Other Lenders
- Strategic Investors
- Venture Capitalists

Bootstrapping/Self-Funding

- Pinching pennies, selling to bring \$ into business (can be an advantage)
- All about making a product and/or delivering a service and selling that product or service
- Acid test for the business if you cannot generate cash from product/service sales you are done

Friends and Family

- Blood and money do not mix well
- Business failures are difficult enough; worse when coupled with loss of your friends!
- Little value-add to business
- Often unsophisticated
- Can be a good option though...

Government Programs

- SBA Loans
- NSF Grants
- Military Grants



Angels

- Will invest small amounts in very early-stage companies (as little as \$25,000)
- Most have some business experience savvy
- Desire to coach entrepreneurs
- Beware of doctors, dentists and courtroom lawyers!
- Lots of them – hard to find
- Less validation for business than institutional investors

Commercial Banks and Other Lenders

- Personal Guarantees
- Equipment leasing/financing
- Asset Based
- Cash Flow



Strategic Investors

- Not usually as tough to deal with as financial investors/VC's – often driven more by strategic issues than return on investment
- Co-development of technology; combined technology and services
- Co-marketing
- Big brother or 800 pound gorilla?
- Sometimes makes it difficult to branch out
- Competitive and confidentiality issues

Venture Capitalists

- Lots of Dollars to Invest
- Experienced in Growing Companies
- Well Connected
 - Investment Banks
 - Management Talent
 - Lawyers, CPAs and other Professionals
 - Strategic and Customer Relationships
 - Validation for Business
- Interests Aligned with the Shareholders
 - Higher Valuation
 - Exit Strategy
 - Want Highest Rate of Return in Shortest Period of Time

What Are Venture Capitalists Looking For?

- Product or service that is “disruptive” or fills an unmet need in a large and growing market
 - Games for mobile phones
 - Fastclick
- Healthy margins
 - not interested in commodity products/service
- Defensibility
 - Sustainable competitive advantage
- Well thought out and well articulated idea
 - Written business plan
- Management team with relevant experience and a track record of success
- Exit Strategy- begin with the end in mind

How Do I Find These Capital Sources?

- Diligent Effort
- Networking
- Professional Advisers (lawyers, CPAs)
- Research/Databases/Internet
- Events (TMP, TCA, Venture Capital and Industry Conferences)
- Other Entrepreneurs

How to Increase Your Odds of Success with a Venture Capitalist?

- Get an Introduction – unsolicited proposals receive little attention and often end up in circular file
- Know the venture capitalist's profile – many venture capitalists have highly defined profiles and investment criteria:
 - Early or late stage
 - Industry focus
 - Geographic footprint
 - Size of investment
 - Majority/Minority investors
- Preparation
 - Executive Summary
 - Written Business Plan
 - Financial Model/Projections
 - In-Person Presentation materials
- Be realistic about valuation

How A Venture Capital Deal Gets Done

▪ Valuation

- Dartboard Approach – it is all negotiation
- Multiples of trailing/forward revenues/earnings on an annualized basis
- Pre-Money Valuation – The value of the company before the equity investment is made
- Post-Money Valuation – The value of the company after the equity investment is made. Equal to the Pre-Money valuation plus the amount of the investment
- Fully diluted valuation is typically a value per share based on all outstanding shares of stock, all securities convertible into shares of stock and all options issuable under a company's stock option plan

How A Venture Capital Deal Gets Done

- Most Common Form of Venture Capital Investment is Convertible Preferred Stock
- Term Sheet
 - No-Shop/Exclusivity
 - Due Diligence

How A Venture Capital Deal Gets Done

- Key Issues
 - Liquidation Preference – who gets what if the company is sold or otherwise liquidated
 - Anti-dilution protection – protection against down rounds (Later sales of stock for less than the investor paid)
 - Registration Rights
 - Board Representation
 - Co-Sale; Rights of First Refusal; Drag-Along
 - Restrictions on Other Financings

How A Venture Capital Deal Gets Done

- Legal Documents
- Closing and Funding
- Quick Celebration then time to put that money to work!



Again, raising capital is extremely difficult and time-consuming -- Never give up if you hope to succeed!



Thanks for coming!

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Q&A