Investment Evaluation:

Company___________________________________

Criteria	Weight	Score	Wtd. Score	Notes: (see below for more explanation)
1. Current Sales	1.0			Startup=0, $1-2M=5
2. Profitability	1.25			>10%=5, BE=3, Next yr=2, later=1
3. Gross Margin	1.0			>60%=5, 50%=3, 40%=1
4. Industry Risk	1.0			High=1, low=5
5. Competitive Advantage	1.0			Patent, know-how, Market share Strong=5, weak=1
6. Competition Intensity	0.5			High=1, low=5
7. Projected Growth Rate	1.0			>200%=5, 100%=3, 40%=2, 20%=1
8. Investment Opportunity	1.0			IRR: 100%=5, 60%=4, 40%=1
9. Barriers to entry	0.5			High =5, low=1
10. Product or Service Differentiation	1.25			High=5, low=1
11. Management	2.0			Experienced=3-5, Professional=1-2
12. Working Business Model	2.0			Yes=5, prototype=2, Demo=1
13 Fatal flaws	(1.0)			See list. Count checked boxes
Total Score				

Assign a rating for each category. Multiply by the weighting, and sum the column. Score:

- <40: Drop it
- 40-45: Examine Further
- 45-50 Probably a good candidate, go to next step in process
- >50 Do the deal

Investment Evaluation: Notes and explanation

(This evaluation format is typical for an "Early Revenue Stage Venture Fund". Every fund is different here. Know your customer before you go in.)

These criteria are similar to the class notes (lesson 5). The Attribute Assessment Analysis (MAAA) outlined here is unique to their target investments. However, all of these investor screens will give about the same result. Different investors will have different criteria, based on the size of a Venture fund to "get buy-in" from the partners, take the "gut" out of the equation, and document their decisions so they can learn from their successes and mistakes.

1. **Current Sales: (Have you been able to do something already?)**
    - ❑ Startup=0,
    - ❑ >$0.2M=1,
    - ❑ $0.2-0.5M=2-3,
    - ❑ $0.5-2.0M=4-5

2. **Profitability: (How deep is the black hole before cash flow is positive?)**
    - ❑ Profitable for a while and EBITDA>10% =5,
    - ❑ Profitable now =4,
    - ❑ Breakeven =3,
    - ❑ Maybe profitable next year =2,
    - ❑ After next year =1

3. **Gross Margins: (According to GAAP) (at profitability)**
    - ❑ >60% =5,
    - ❑ 50% =3,
    - ❑ <40% =1

4. **Industry Risk: (Is this a good industry to be investing in?)**
   (check the boxes that apply, and make an "average assessment" between 5 and 1)

Good =5	score		Not so good =1
Very high growth market (>100%/year)			Low growth or declining market
Changes peoples lives (for the better)			Incremental improvement
Reasonable sized niche portion of the market, ($0.2-3.0B)			Potential broad market (>$3B), of interest to big competitors
Imperfect emerging market			Hot today, but could be cold tomorrow
Long life cycle			Short window of opportunity
Customers reachable			Customers loyal to others (Any B-C)
Long lead time required, but you are ready to go			Long time still needed to get to market

E.g. Cancer Cure = high risk: Long time, FDA risk, Big potential competitors

5. Competitive Advantage: (Can you effectively compete in the market?)

High CA =5	score		Low CA=1
Low cost provider			Expensive product or service. Possible for competition from 3rd world.
Control over distribution			Distribute through others. No forced loyalty of the channel
No (little) pricing pressure			Commoditization forces in the market
Proprietary know-how, or strong IP			IP Protection: None or weak
Lead time advantage			Aggressive competition can jump in
Cornerstone customers in place Exclusive supply contracts			No legal or contractual agreements
Well developed contacts and networks			New field for key team members
Your advantage is clear, documented, and measurable			Customers can't differentiate easily, prior to buying
Hard to detect the know-how, or "special sauce"			Easily copied by Bill or Larry (Gates or Ellison)

e.g. The "next web hosting business". Why not use India?

6. Competition Intensity: (Does everyone want to compete with you?)

Low CI =5	score		High CI=1
Sleepy market. Old technology. Not too exciting			Lots of smart or big players in the space, cool technology
Reasonable sized market, won't attract sharks			Hot market. Everyone is trying to get in
Have unique "ease of access" to market			Everyone looks the same to the customer
Niche defined and defendable			Easy to expand into market from another business base
Tough business for anyone except it's a slam dunk for this team			Opportunity is attractive to very smart people

e.g. The next "Customer Relationship Management" software. (e.g. Salesforce.com with Larry Elison on your BOD, who then went and competed directly, without telling them he was doing it.)

7. **Projected Growth Rate: (Is this a reasonable business of sufficient size to survive?)**

The investor will usually discount your projections here. Typical discounts are to divide by 2. Growth applies to both the business AND the market. (If the market is growing also, your numbers receive less of a discount). If the investor gets a sweet deal, or can use leverage, they may take a lower rate. (Beware of presenting a "lifestyle business).

Your planned growth:

- ❑ >4x per year =5,
- ❑ 100% =3,
- ❑ 40% =2,
- ❑ 20% =1 (No exit strategy = -2 pts, iffy exit = -1 pt)

(Rule of thumb: If your required white collar headcount is growing >60%/yr (after about 30 or so), probably not believable and will be discounted. Use partnership or acquisitions to grow faster.)

8. **Investment Opportunity: (What is in it for me?)**

This is the investor's number, based on his assessment of valuation, investment and risk. You should not present a "valuation", but should have one that you would discuss, and be prepared to defend it with data.

- ❑ IRR: 100% = 5,
- ❑ 70% =4,
- ❑ 50% =3,
- ❑ 40% =1-2.
- ❑ No (or unbelievable) exit strategy =0 (regardless of IRR)

If risk is small (downside well covered), 40% =3. If you have a well developed deal presentation, nicely presented= big help. E.g. "we anticipate a pre-money valuation of $xx, based on these comparables, adjusted for the current market"; and when the investor checks, he agrees.

9. **Barriers to entry: (Can you slow down or keep out a competitor?)**

High Barriers=5	score		Low Barriers=1
Hard to get into the business			Easy to enter
Big prior investment of time and money (especially time)			Guy in garage
Good rolodex of contacts and networks			Outside your network of contacts
Great reputation in the industry			Who?
Strong patents or equal (with money to defend)			No IP, or **<u>no money to defend</u>**, or problems with IP, or customers want competition, etc.

e.g. web service firms today. (Sapient, Scient, Viant)

10. Product or Service Differentiation: (Is your advantage clear to the customer?)

High Diff =5	score		Low Diff =1
Sustainable.			You are working to establish the market, big guys can come in and clean up.
Very unique, Hard to copy or learn from you			Can learn all your stuff from looking at your product
Your advantage is clear, documented, and measurable			Can't detect the difference without trying it out first (e.g. consulting services)
No substitutes or replacements			Substitutes available
Good Brand			No brand

e.g. The next small DSL service company. (ATT is just waking up)

11. Management team: (Can they do it, will they do it)

- Hot young entrepreneurs = 1
- Professional experience = 2
- Experienced Management team = 3
- Team has done it once already, successfully = 4 (e.g. Mark Andreeson, Netscape)
- (Grey hair on the team = +1/2pt.)
- (Highly motivated leader – i.e. Strong Psychic Contract = +1pt.)
- (Solo Entrepreneur, no obvious strong team = -2pts)
- (Low sense of urgency = -1pt)

12. Working Business Model: (How large is the customer's pain, and are they involved?)

- Yes, for a few years, customers love it, solves a big pain = 4,
- Just got it working, a few key customers involved = 3,
- Prototype = 2,
- In development = 2
- Demo = 1
- (if revenue from a <u>strong recurring revenue stream</u> = +1pt);
- (if recurring revenue is not clearly there, -1 pt. Service businesses = -1pt.)

13. Fatal Flaws: (Any one is sufficient to kill a venture. Check number of obvious flaws, each one counts -1)

- ❑ No real customer
- ❑ Can't access the customer
- ❑ Wrong corporate culture
- ❑ Intellectual Property company (PhD syndrome)
- ❑ Ignorant of market
- ❑ Over engineering of product
- ❑ Failure to stress test properly, or recognize importance of stress testing
- ❑ Poor sub suppliers or partners
- ❑ More than one person from any "family".
- ❑ Trying to do too much
- ❑ Lifestyle business
- ❑ Wrong location
- ❑ Competition can drop their price and kill you
- ❑ Market window has closed
- ❑ Microsoft (or equal) in your space
- ❑ Leaders focused on technical issues, not business issues
- ❑ Green team, or no diversity
- ❑ Inappropriate team (Unmotivated, wrong skills)
- ❑ Lack of focus of leaders and management (toys, other interests)
- ❑ Team doesn't listen (or recognize good advice vs. bad advice)
- ❑ Monarch or King syndrome
- ❑ Arrogance
- ❑ Any key team member obsessed with his "position or title"
- ❑ Too many time conflicts on the leader
- ❑ Business violates “human nature” in some way
- ❑ No real sense of Urgency
- ❑ Single Product company (one trick pony)
- ❑ ________________________________
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