

Evaluation of Case Studies, Class Exercise

Jack's Deal:

Jack has decided to simply sell the carts, and supply the necklaces. His initial customers include "beach bums", looking for a way to support their lifestyles, as well as dive shops and beachfront tourist shops. His customers put up \$20,000 for the cart, and \$30,000 for an initial supply of 10,000 necklaces. From this initial purchase, they should gross over \$100,000 in a 4 month period. Jack figures that if they are successful, they will continue to re-order necklaces from him (at a margin for him of \$2 each). Thus every cart he sells, has an immediate profit of \$15K on the cart, and \$20K on the necklaces. Every 10,000 reorder is worth \$20K net to him.

Jack's approach is to sell as many carts as possible, and avoid any attempts to control what his customers do with the carts. As part of the purchase, he does tell his customers where other buyers are located, gives them a catalogue for re-order, and makes them sign a "non-compete" agreement, where they agree to buy necklaces only from him for a 2-year period.

Jack needs \$100,000. He has asked you to put up the money, in return for a simple 4x return from cash flow. (You will be repaid \$400,000, with no further ownership in the venture.) If he doesn't return your 4x within 2 years, you will have warrants which will allow you to take a controlling interest (51%) in the ongoing business.

George's Deal:

George has decided to license. This way, he can stay in the US, keep his job at PU, try to keep his family situation stable, and still make some money. He has cut a sweet deal with PU where he will take charge of the licensing activity, including the costs of acquiring the licenses, and give the University 30% of the net licensing proceeds (after recovery of these costs). The licensing group at PU estimates that a "reasonable" license would be \$75,000 per ship that uses the technology, (<2% of the cost of the propulsion plant). If all the worlds' ships adopted the system, total revenues from licensing could be over \$35M per year!

George has a proposal from a consulting firm which specializes in licensing technology, whereby they will shop the technology for him. This firm has

asked for a retainer of \$100,000 to cover the costs of these efforts, plus 10% of the net licensing proceeds.

George has asked you to put up the \$100K. In return, he is offering one third of the remaining "net proceeds", i.e. a 20% share. (He gets to keep a 40% share).

Pete's Deal:

Pete has decided to go after the commercial market. He has negotiated a deal with one of the cable-laying companies where they will agree to purchase 3 systems minimum over a 5 year period (a \$50M contract), as long as the prototype works to specifications, including a reliability rider, not in the original contract. He has a letter of intent from their president on this contract, which his lawyers say is binding.

As part of this agreement, he has agreed to give this customer company an "option" to acquire his company for a price of \$50M. This option may be exercised anytime within the next 5 years. After 5 years, the option expires. The company insisted on this provision, so they would be able to keep any breakthrough technology from falling into the hands of a competitor.

The first prototype has been delivered to the customer by Sea Grant, which worked well enough to get Sea Grant paid, but the reliability problems are an issue. Pete needs \$100K to debug the vessel reliability problems in order to get the contract. He has asked you to put up the \$100K to get this done.

In return, he has agreed to give you 2% of the company's stock, plus options to purchase 3% of the company at a "pre-money" valuation of \$10M. You can exercise these at any time over the next 5 years.

Sam's Deal:

Sam managed to find out that not only has this been done, but there is an "Association of Marine Internet Companies" with over 200 members, and at least 5 existing companies with precisely this business plan of "disintermediating" marine purchases.

However, one part of the plan seems to have no competition. The reselling of "difficult to get proprietary undersea information" appears to be a real opportunity. He sees an "e-bay for information", where holders of the

information could list it for sale, and the site would take care of all the paperwork, in return for a 20% commission.

Basically, if you held data on a slice of the ocean, which might have cost \$100K to acquire, and another company wanted this data, you could potentially resell the data for let's say \$20K, split the revenue with the appropriate parties, and everyone would benefit. A real win-win. The internet would allow a marketplace to exist, where it was impossible in the past.

Sam has approached some of the government agencies who sponsor this research, who have been very receptive to the idea. He has been asked for a proposal from NOAA (Pete's sponsor), the Office of Naval Research (ONR), the Naval Research Lab (NRL). These agencies have told him that if he could build a demonstration prototype which worked, with the appropriate documentation and money splits, they would give him an initial contract for \$1.0M to deliver a site to cover their specific ocean-related needs. Sam figures this will effectively cover his further development costs until he was fundable by venture sources. (The benefit to these agencies is that they own a wealth of data which Sam's Internet marketplace may be able to mine. These agencies are under intense pressure to show a return on their research investment).

Sam also sees the possibility of using this model for other "hard-to-get" data. Pete's contact at NOAA has offered to pass this idea on to his counterparts at both NASA and NIH (Nat'l Institute of Health).

The idea has also been favorably received by several professors at MIT, who see the possibility of making additional revenue from their research efforts.

Sam has asked you to fund the \$100K he needs to prepare the demonstration, business plan, and proposal. He has signed up to help him the Sloan MBA students. They are offering you a 3% stake in their new venture in return for your investment.

Evaluation Sheet: Opportunity

Exercise: Compare the four cases in the notes

Opportunity Assessment

| Criteria | <u>Weight</u> | <u>1. Jack</u> | <u>2. George</u> | <u>3. Pete</u> | <u>4. Sam</u> |
|---|----------------------|-----------------------|-------------------------|-----------------------|----------------------|
| 1. Industry and Market | 1.0 | | | | |
| 2. Economics | 1.0 | | | | |
| 3. Harvest | 1.0 | | | | |
| 4. Competitive Advantage | 1.0 | | | | |
| 5. Management Team | 1.0 | | | | |
| 6. Fatal Flaws | 1.0 | | | | |
| <u>Total Score</u> (Add the ratings) | | | | | |

Give each opportunity a rating, (1-10) for each attribute. Make sure the relative scores are appropriate. Multiply the ratings times the weightings, and **Add the results** to assess the relative opportunities.

(in this case, the weightings have been set at 1.0, so you can just add the ratings)

Evaluation Sheet: Risk

Exercise: Compare the four cases in the notes

Risk Assessment

| Criteria | <u>1. Jack</u> | <u>2. George</u> | <u>3. Pete</u> | <u>4. Sam</u> |
|---|-----------------------|-------------------------|-----------------------|----------------------|
| 1. Having a competitive product | | | | |
| 2. Able to reach the customers | | | | |
| 3. Beat the competition | | | | |
| 4. Find enough Capital | | | | |
| 5. Attract top talent | | | | |
| 6. Viable goal and plan | | | | |
| 7. Strong Leadership | | | | |
| 8. Meeting the development schedules | | | | |
| <u>Total Score:</u> (Multiply the ratings) | | | | |

Give each opportunity a rating, (1.0 - 0) for each risk. Make sure the relative scores are appropriate. Multiply the ratings to find the relative risk.

(1.0 = no risk; 0 = very high risk)