South Bank WORKS

Pitching for Investment

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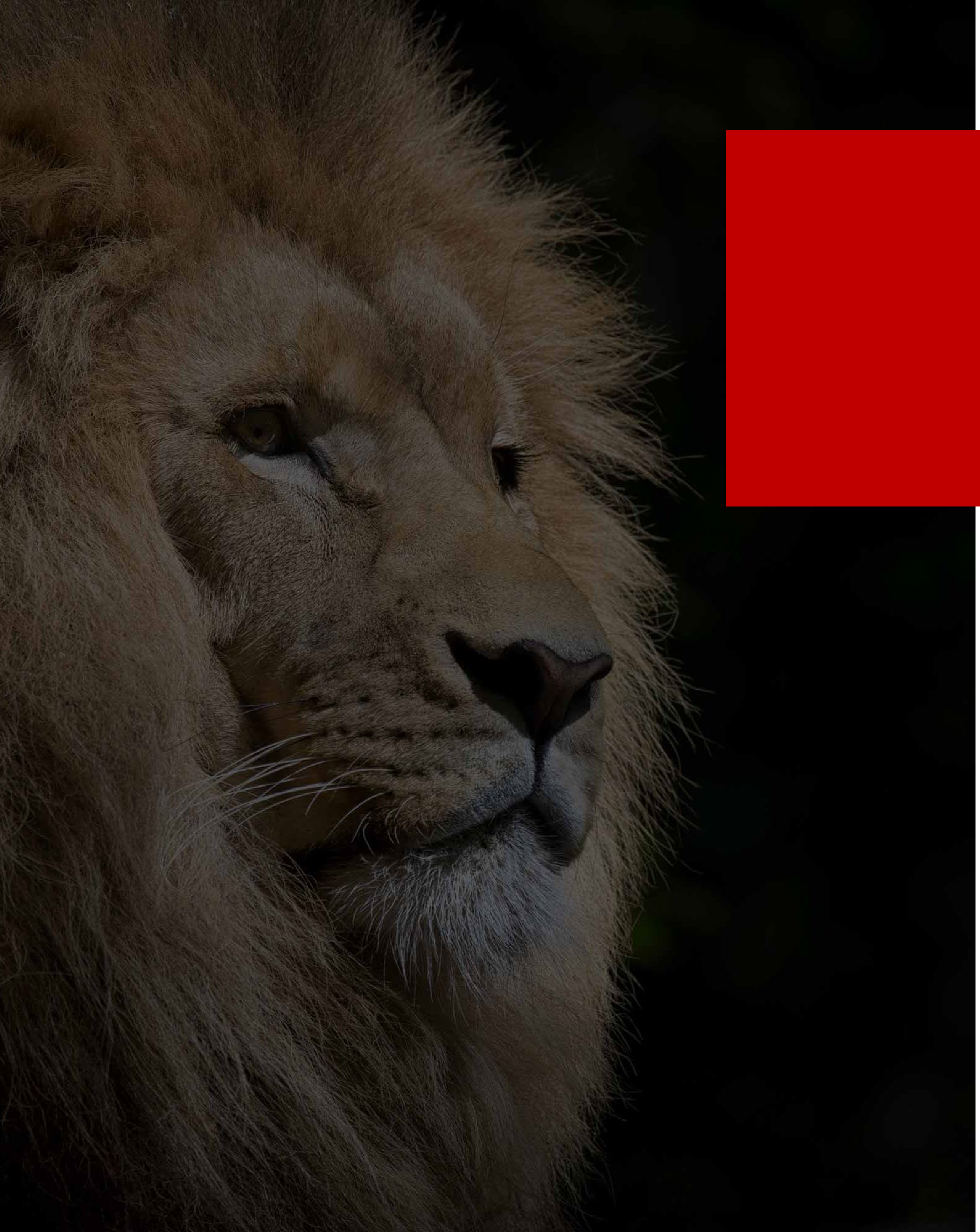
Enterprising Futures at LSBU



Michael Buckworth

- Founder of Buckworths, the only law firm in the UK working exclusively with start-ups
- Author of Built on Rock, the busy entrepreneur's legal guide to start-up success
- Entrepreneur in residence at UCL, LSE, LSBU and City universities
- Advisor to and investor in several start-ups

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What are we covering?

Sources of funding

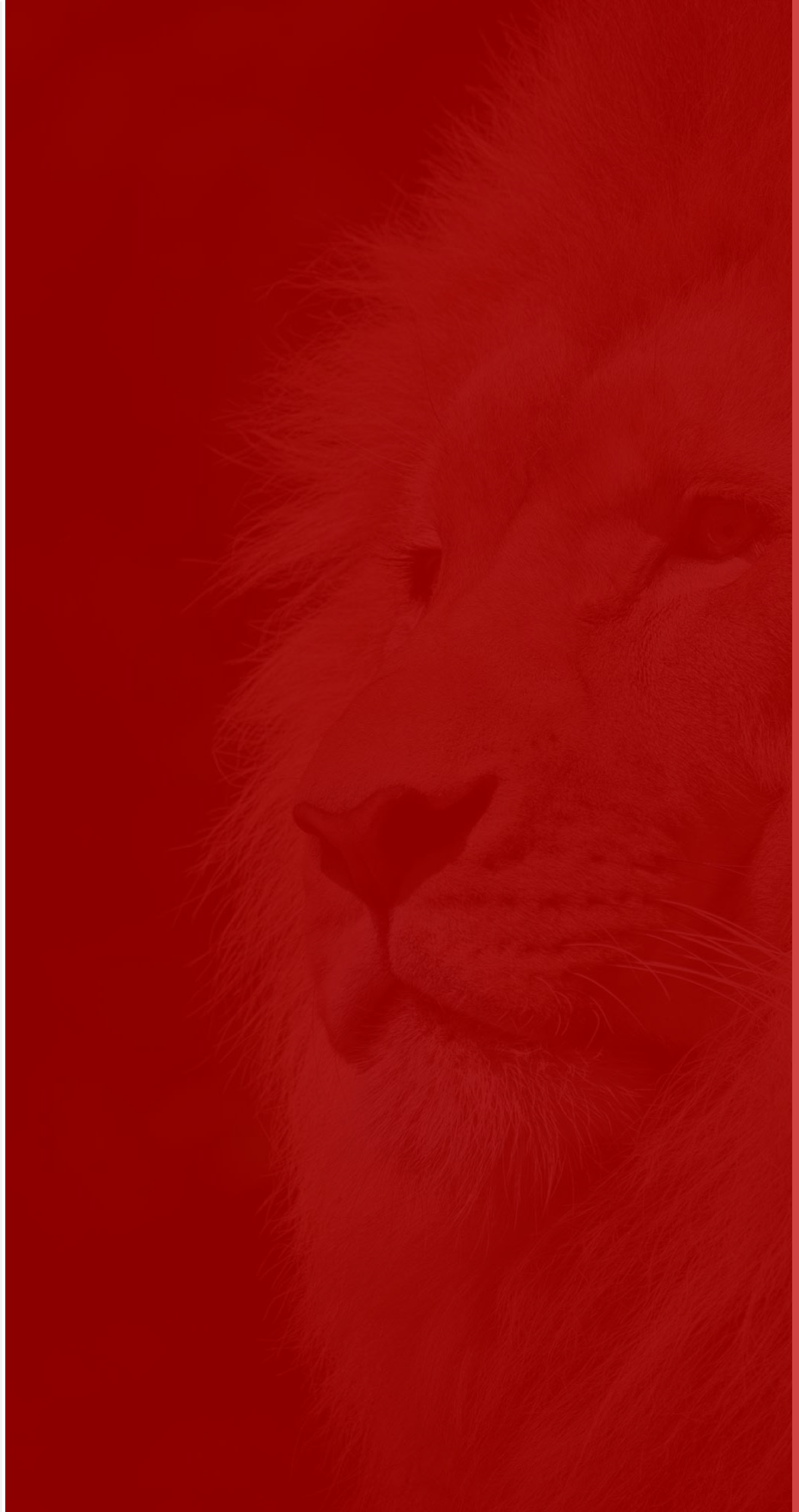
Getting the maths right & valuation

SEIS & EIS

Documentation

Due diligence

Pitching



INVESTMENT

Sources of investment

Grant funding

Equity Investment – angels and VCs

Self-funding, debt

Pre-sale of goods

Crowdfunding – debt and equity

Royalty Finance

Grant funding

- Check out Innovate UK, UK government's grant funding body
- Free cash (grants) and longer term project loans
- Some require "matched funding" i.e. you raise investment in parallel to release the grant
- Primarily for innovative R&D activities
  - Tech
  - Fin-tech
  - Pharma / bio-tech
  - Clean-tech
- Only apply for grants wholly within scope of your business
  - Grants are competitive
  - Time-consuming to apply for

Self-funding; debt

- Only raise investment if you need it
  - By issuing shares to investors, you reduce your ownership of your business
  - Equity is more expensive than cash
- External money reduces your risk
  - Businesses fail – don't put all your savings into the business
  - Conviction – do you truly believe in your business?
- For smaller amounts of money, or where you need funds for a one-off project, debt may be better
  - Start-up loans – personal loans to founders
  - Entrepreneur loans from banks – guaranteed by British Business Bank
  - Traditional term loans and overdrafts

EQUITY & DEBT

Crowdfunding

- Equity – Crowdcube and Seedrs
- Debt – Funding Circle and Crowd2Fund

- What is it?
    - Platforms are FCA authorised
    - Start-up creates campaign video and platform promotes it to its network of investors
- When to do it?
    - Only once start-up has launched, built a network and probably raised a round
    - Marketing exercise – way to attract new customers
    - Start-up must bring 30% to 50% of round to the platform

Royalty finance

- A form of revenue/profit share

Advantages

- No disposal of equity
- Often time-limited
- Costs scale up as revenue/profit scales up

Disadvantages

- Unpopular with investors (as a part of revenue/profit is being paid as a preference)
- Protected by an effective anti-dilution
- Revenue share ignores costs
- Often IP ownership is retained by funder
- Must be capable of termination
- Impact on investor tax reliefs (UK)

Equity investment

- Issuing new shares in your company to third party investors for cash
  - You do not transfer any of your shares
  - The total number of shares in your company increases
- Types of investor
  - **Angel** – high net worth individual investors looking for:
    - A business that will grow and scale such that they can exit at a multiple of the price they paid for their shares
    - (UK angels) tax relief
  - **VC** – structured fund made up of angels, institutional money and government money. Looking for:
    - Specific multiple on exit
    - High degree of control

Getting the maths right

Pre-money valuation = value of company today pre-investment

Post-money valuation = pre-money valuation + amount invested

Percentage investor will receive = amount invested/**post**-money valuation

Price per share paid by investor = **pre**-money valuation/number of shares pre-investment*

*Generally, the number of shares used is the *fully diluted share capital* (i.e. including any option pool)

Getting the maths right

Worked Example

Pre-money valuation = £900,000

Investment amount = £100,000

What percentage will the investors hold on completion of the round?

Calculating your valuation

Discounted cashflow

- Estimate total market for product/service & market share
- Estimate how much you will grow your market share between launch and [24] months, and put together cashflow forecast
- Apply discount to forecasts based on stage you are at

[24] month P&L/revenue forecast

- Estimate P&L/revenue [24] months after the round and apply a multiple based on your sector and the stage of your business

Comparison with other start-ups

- What valuations/multiple did similar businesses raise?

Dilution

- You don’t want to be diluted more than 10 to 20%

SEIS & EIS

(Seed) Enterprise Investment Scheme

Tax rebate schemes giving investors:

- 50%/30% of their investment back as a credit from HMRC
- 0% capital gains tax on sale

High risk investments

- Start-up companies
- Investment for growth NOT maintenance
- No preferential treatment for investors

Apply to most trades (other than professions, property, asset rental, banks, crypto)

These schemes are used by 90% of UK angels

SEIS & EIS

SEIS

- the company lifetime allowance for SEIS investment is £250,000.
- the qualifying trading period for SEIS is three years from the date of commencement of trade.
- the upper limit of a company's gross assets is £350,000.
- the maximum amount that an angel investor is able to invest in start-ups using SEIS in any tax year is £200,000.

EIS

- Companies over 7 years old (standard) or 10 years old (knowledge intensive) will be treated as companies in distress and not eligible for EIS if they have spent more than half of their share premium account i.e. they have accumulated losses greater than half of their share premium account.

Term sheets

Standard terms

- Pre-emption on allotment/transfer
- Drag-along [& tag-along]
- Board observer rights for investors
- Information rights
- Founder vesting – 4 year; 1 year cliff; acceleration on exit
- [5]% option pool

Terms to consider

- Liquidation preference (x1)
- Anti-dilution (down-round only)
- Co-sale rights
- Director appointment rights (time/percentage limited)
- Consent rights that prevent future rounds
- Founder liability for warranty breaches
- Bad Leaver definition (gross misconduct; resignation)

Documentation

Type of instrument	Description	Good For	Bad For	S/EIS compliant
Advance Subscription Agreement (ASA)	Binding non-refundable subscription for shares with shares issued later	Onboarding UK investors wanting tax relief without need for long-form SSA	Alignment of multiple investors – particularly with different discounts and valuations; dealing with conversion of multiple instruments	**Yes** if (i) incapable of amendment (ii) converts within 6 months.
SAFE	US version of an ASA; generally longer conversion period	US investors - familiar with structure and avoids negotiation of long-form SSA	UK investors – usually US format; non-compliant with S/EIS; challenges with conversion mechanism	**No** - long stop date is usually longer than 6 months; preferential rights for investor; capable of amendment.
SeedFast	Effectively an ASA branded by a precedent platform	Onboarding UK investors wanting tax relief without need for long-form SSA	Alignment of multiple investors – particularly with different discounts and valuations; dealing with conversion of multiple instruments	**Yes** subject to the documents working as intended.
Convertible Loan	Term loan that can be repaid or converted into shares	Corporate & non-UK investors; flexible as it allows for repayment; puts off valuation to a later date.	UK angels wanting tax relief; long-stop date needs to be long enough to allows company to raise a round at a decent valuation	**No**
Subscription Agreement	Investment with shares issued upfront at an agreed valuation	Everyone	No-one	**Yes** (subject to rules of schemes being complied with)

Due diligence

Ownership of intellectual property rights

- Intellectual property created by third parties who are not employees of your business belongs to the creator
- In order for you to own the intellectual property rights, there must be a written IP transfer agreement

Complexity of software IP

- Proprietary IP: Licence to use
- Third party software: List of licences & Licence to use
- Open-source software: list of licences & understanding of restrictions
- Foreground IP: transfer of IP

Due diligence

Trading risks addressed

- Contract with your customers: limitation of liability & disclaimers
- Insurance to cover risks
- Adequate policies in place
- Staff training
- Cashflow forecasting and planning
- Coherent business plan that is followed

Due diligence

Regulatory compliance

- Data protection: privacy policy, risk assessment and ICO registration
- Financial promotions regime: certificates for high net worth and sophisticated investors
- Anti-money laundering compliance (registration; investors; counter-parties)
- Sanctions compliance: all investors and counterparties
- Sector-specific compliance
- Modern day slavery
- Bribery
- ESG

Due diligence

AI implementation

Intellectual property issues

- AI engine licensed or created
- Purchase in of IP from another business
- Where AI engine is licensed, who owns IP generated from it?
- Use of open source – copyleft licences

Accountability

- phantom results
- algo bias

Being prepared

- Build your network
  - Tell everyone about your business
  - Manage ongoing engagement
- Get your public messaging right
  - PR
  - Pitchdeck
  - Website
- Engage with your customers
  - Customers can be a key source of investment via crowdfunding
- Understand your financials
  - 3 year forward looking P&L and Cashflow forecasts
  - Clarity on valuation methodology, assumptions and metrics
  - Understanding of how investment monies will be spent

How to engage with investors

- ✓ Get the preparation right: good PR, great pitchdeck and coherent financials
- ✓ Reach out to your network
- ✓ Have qualified for tax reliefs if you are seeking investment from UK angels
- ✓ Be clear on how much you want to raise, the valuation and the commercial terms.
- ✓ Identify a lead investor

- ✗ Use precedent documentation
- ✗ Take the first offer you receive
- ✗ Agree complex structures you don't understand
- ✗ Issue shares until you have received the investment monies

Top 3 mistakes

Hiding away

- Ideas have no value
- Investors invest for execution
- Founders who won't discuss their business will fail

Making it complex

- Get investment upfront – tranched investment doesn't make sense
- Price the round – delaying valuation generally doesn't make sense

Raising too much / too little

- Your valuation will increase as you spend investment money
- Valuation is partly based on how much is being invested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&
SEIS/EIS Eligibility
Calculator
SCAN
ME

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Feedback about the masterclass, "Pitching for Investment"

Give your feedback:

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Thank you!