

# Due Diligence for Early Stage Investing

EVCA Foundation Course  
Budapest, October 2008

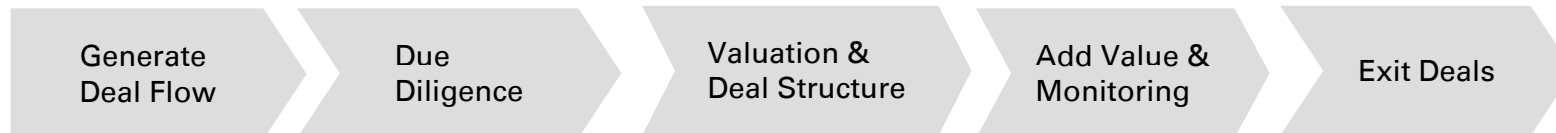
Uli W. Fricke  
Managing General Partner  
Triangle Venture Capital Group

## Due Diligence for Early Stage Investing

- Objectives
- Due Diligence Process
- Overall Investment Criteria
- Technology, Market, Team, Patent and Phase Fit
- Investment Case Modeling
- Business / Technology and Patent Due Diligence
- Termsheet Negotiation
- Investment Case Definition
- Formal Due Diligence / Final Contract Negotiation

### Due Diligence for Early Stage Investing

- Before making any investment, our goal as venture capitalist is to understand virtually every aspect of the target company.
- Address areas of concern.
- Avoid significant and otherwise unexpected liability following the investment.
- Due Diligence process integrated in value chain.

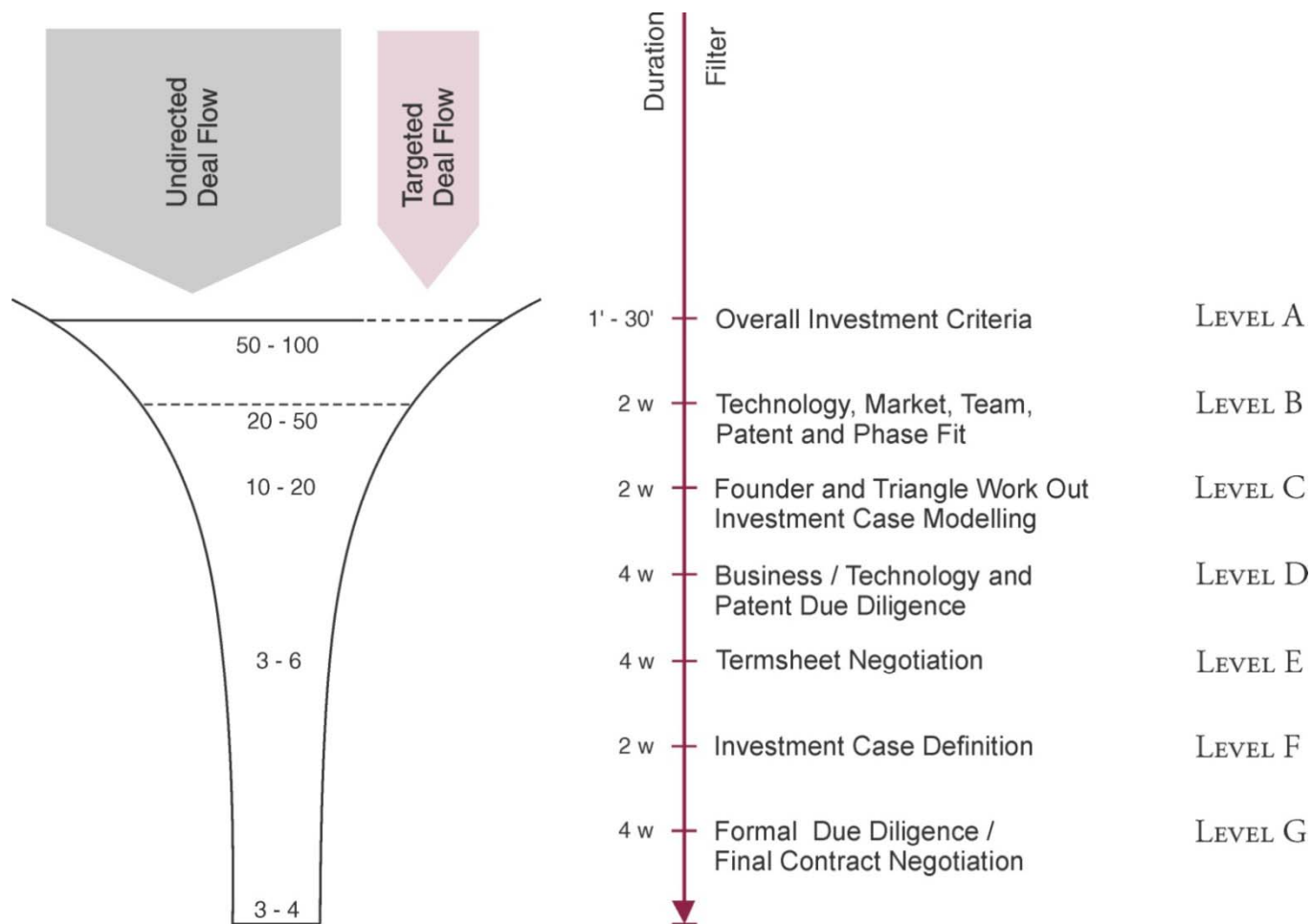


- Cost & time effective Due Diligence and early determination of break-up factors.

### Case Study #1: Handout ADB AG

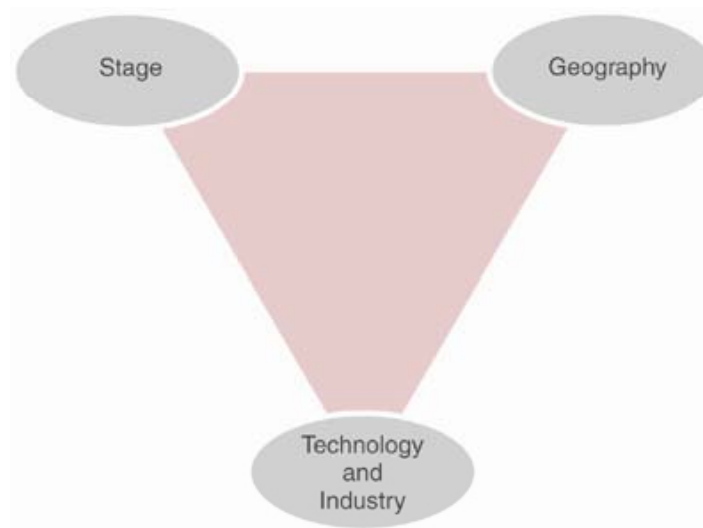
- Discuss case study in your group
- Define suitable due diligence process
- Address areas of concern
- Discuss lessons learned / impact on Due Diligence

## Multilayered Selection and Due Diligence Process



## Overall Investment Criteria

<b>Objective</b>	<ul style="list-style-type: none"><li>▪ Very quick pre-screening (few minutes) to define whether the company fits the "Overall Investment Criteria" or not.</li></ul>
<b>Criteria</b>	<ul style="list-style-type: none"><li>▪ Investment phase / stage fit</li><li>▪ Company origin fit</li><li>▪ Technology fit</li><li>▪ Industry focus fit</li><li>▪ Geographical fit</li><li>▪ Investment volume fit</li></ul>



## Use of Deal Database

ID	Name	Date of initial contact	Source	Industry focus	Short company description	Deal champion	Technology	Date BP request	Date BP received	Date NDA sent	Date decline sent	Status
080310	A	02.09.2008	Ernst&Young	ICT	Services & products for secure SAP programs	Fr	Software	02.09.2008	04.09.2008			LevelB-ongoing
080312	B	05.09.2008	Cat Cap GmbH	ICT	Mobile banking and money transfer, remote micro payments	Pa	Software				11.09.2008	LevelA-decline
080313	C	02.09.2008	Bridge Link AG	Other	Research and development company for nutraceuticals	Pa	Physical				09.09.2008	LevelA-decline
080314	D	05.09.2008	INI-GraphicsNet		a technology for infrared camouflage	Pa	Physical				11.09.2008	LevelA-decline
080316	E	11.09.2008		ICT	online platform to match successful investors with unsuccessful investors	Fr	Physical		11.09.2008		11.09.2008	LevelA-decline
080317	F	11.09.2008	Hr. Broermann Institut für Wirtschaftsberatung	MD	diagnoses and therapy of various cancer diseases inside the body	Ge	Other		23.09.2008			LevelB-ongoing
080318	G	11.09.2008		Other	software for contact center solutions	Fr	Software				15.09.2008	LevelA-decline
080319	H	03.09.2008		Other	system for public and crowd gaming	Fr	Software					LevelA-ongoing
080320	I	09.09.2008	F. Müller	ICT	software solutions for vehicles	Pa	Software					LevelA-ongoing

## Technology, Market, Team, Patent and Phase Fit

<p>Objective</p>	<ul style="list-style-type: none"><li>▪ Develop investment hypothesis</li><li>▪ Quick but well-reasoned “no” if company does not fit investment criteria</li></ul>
<p>Criteria</p>	<ul style="list-style-type: none"><li>▪ Quality of presentation</li><li>▪ Technology / Product (e.g. target segment, key innovation, key competence, level of innovation, level of complexity handled, position in value chain, mission critical application, broad application potential, disruptive character of technology, scalability of product, product development status, technology risk)</li><li>▪ Market Potential (e.g. time to market, customer needs, market size, market growth, growth driver / potential, industry cycle situation, target clients, ability to acquire initial customers, business model, earning mechanics, ability for early revenue generation, competitive situation advantage, competitive entry barriers, competitors strengths, competitors weaknesses)</li><li>▪ Team (e.g. track record, qualification, cooperativeness, completeness, size, compensation structure)</li><li>▪ Patents (e.g. patent portfolio, first impression of patent situation)</li><li>▪ Phase (e.g. how early, status of business plan, quality of business plan, extend of input required, investment required, public grants/ co-investment available, exit timing, exit potential)</li></ul>



## Evaluation Tool

Level B - 2nd Part - Technology and Product	Triangle VCG
ID Nr:	<input type="text"/>
Company:	<input type="text"/>
<b>Technology and product:</b>	
Technology:	<input type="text"/>
Target segment:	<input type="text"/>
Key innovation:	<input type="text"/>
Key competence:	<input type="text"/>
Level of innovation:	<input type="text"/>
Target product / solution:	<input type="text"/>
Level of complexity handled:	<input type="text"/>

Score input (1-6)

Textual description

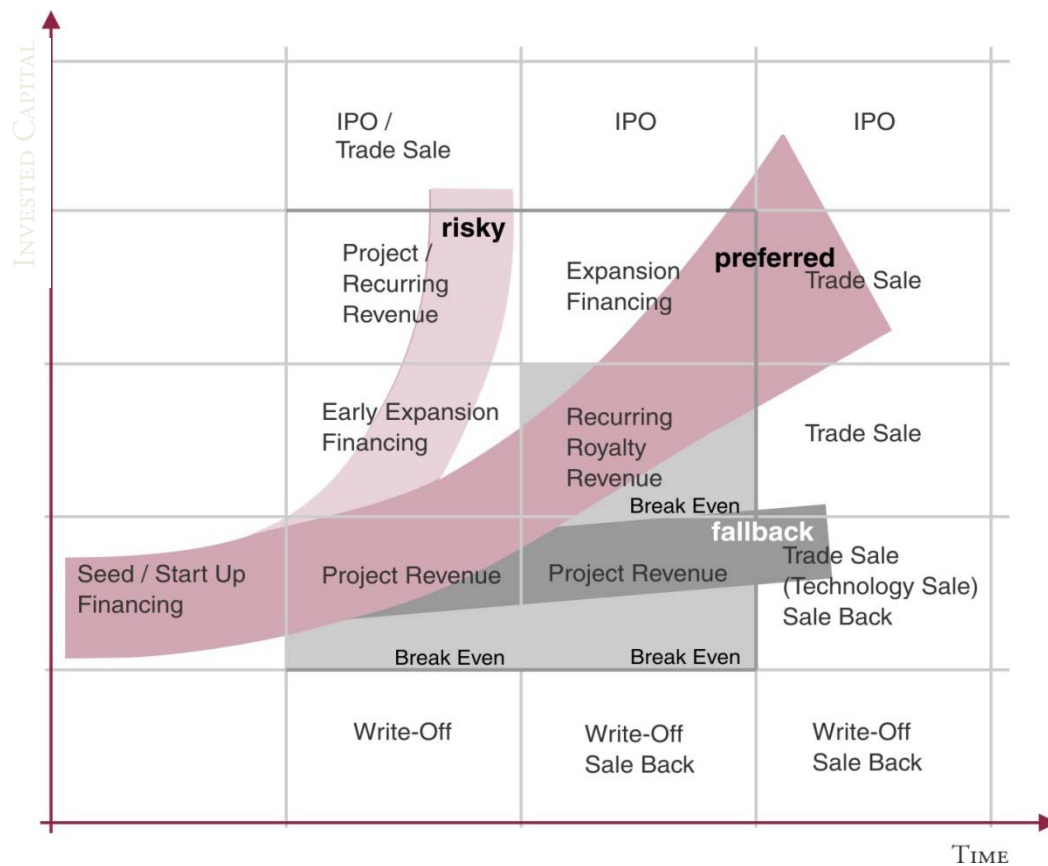
After each level, the team justifies why Triangle should continue in the process.

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## Investment Case Modeling

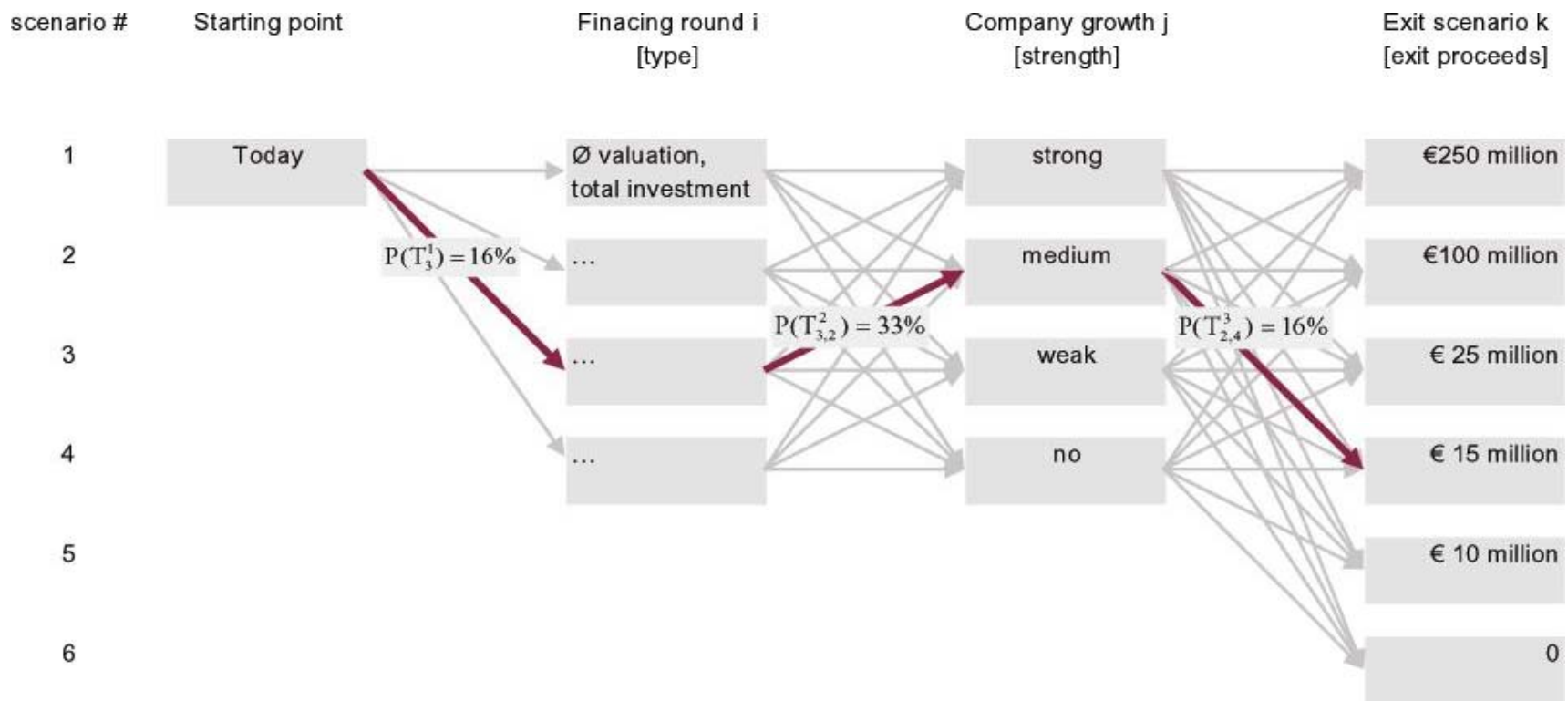
<p>Objective</p>	<ul style="list-style-type: none"><li>▪ Learn in depth about investment opportunity</li><li>▪ Develop financial model</li><li>▪ Determine areas to focus Due Diligence on</li></ul>
<p>Criteria</p>	<ul style="list-style-type: none"><li>▪ Amount (e.g. amount this round total, amount until exit, public loan programs, syndication, entry valuation)</li><li>▪ Timeframe (e.g. liquidity secured until, liquidity buffer, Cash flow)</li><li>▪ Milestones (e.g. technology, patents, market / sales, team, revenue, EBIT, liquidity)</li><li>▪ Exit (e.g. when, main target, multiple goal)</li><li>▪ Opportunities (e.g. technology, patents, market, people, exit, other)</li><li>▪ Challenges (e.g. technology, patents, market, people, exit, other)</li></ul>

## Managing Risks and Roads to Exit

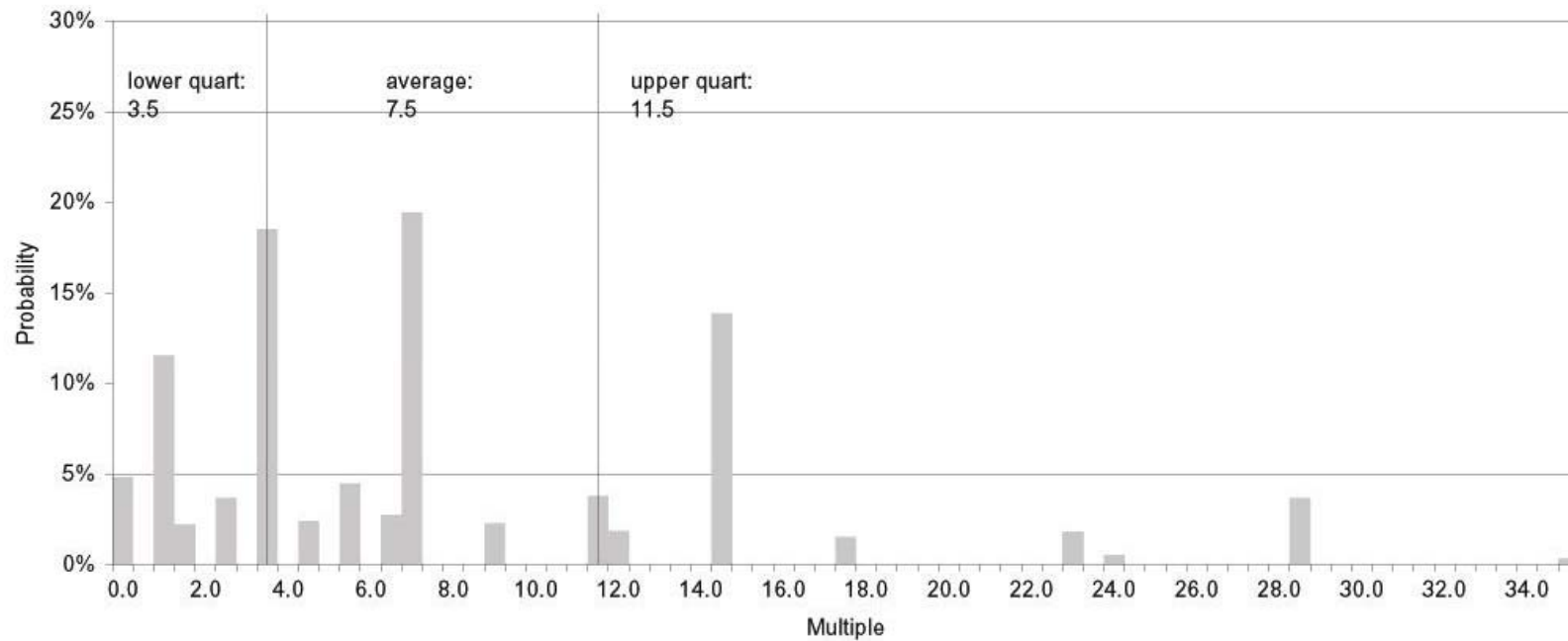


- Use of sophisticated financial monitoring systems to control risk and measure progress
- Focus on early revenue generation
- Tightly manage costs against milestones
- Leverage Triangle's expertise and connections

## Scenario Analysis



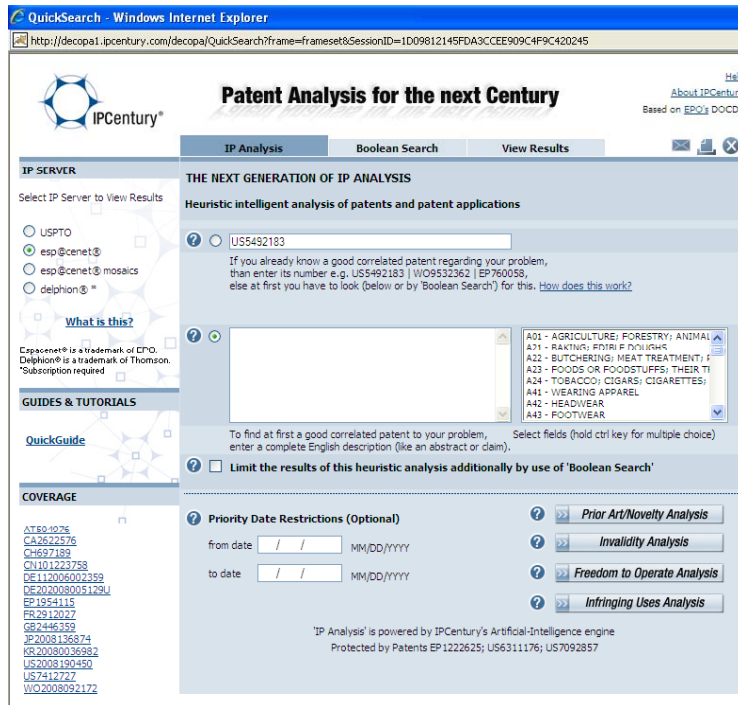
Scenario Analysis



## Business / Technology and Patent Due Diligence

<p><b>Objective</b></p>	<ul style="list-style-type: none"><li>▪ Confirm investment hypothesis</li><li>▪ Understand risks</li><li>▪ Advocate the deal</li></ul>
<p><b>Criteria</b></p>	<ul style="list-style-type: none"><li>▪ Technological Due Diligence (e.g. advisors involved, IP status, IP potential, IP infringement, competing technologies, amount of current applications, development stage of applications, quality of applications, potential for future applications, competing applications)</li><li>▪ Commercial Due Diligence (e.g. geographical region with largest technology threat, geographical region with largest market potential, timing of revenue generation, scalability of sales, sustainability of revenue growth, risk factor in business model, target clients)</li><li>▪ Financial Planning (e.g. reliable pattern of expectations and considerations, planning scarce resources driven, all necessary information and data included, realistic basis for execution)</li><li>▪ Shareholder (e.g. current structure, risks in shareholder structure, social event with / meet founders wives / family)</li><li>▪ Sales and Marketing Plan (e.g. selected target markets - appropriate / attractive, status business development activities, existing sales pipeline, sales plan and budget in line with revenue target, marketing support - appropriate)</li></ul>

## Patent Due Diligence



**QuickSearch - Windows Internet Explorer**  
 http://decopa1.ipcentury.com/decopa/QuickSearch?frame=frameset&SessionID=1D09812145FDA3CCE909C4F9C420245

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- esp@cenet®
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- delphion® \*

**What is this?**

Esp@cenet® is a trademark of CPO. Delphion® is a trademark of Thomson. \*Subscription required

**GUIDES & TUTORIALS**  
 QuickGuide

**COVERAGE**

- AT694026
- CA2622276
- CH697189
- CN101223758
- DE112005002359
- DE2020080051294
- EP1554115
- FR2912027
- GB2446359
- JP2003136874
- KR20080036882
- US2008190450
- US7412727
- WO2008092172

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US5492183

If you already know a good correlated patent regarding your problem, then enter its number e.g. US5492183 | WIO9532362 | EP760058, else at first you have to look (below or by 'Boolean Search') for this. [How does this work?](#)

A01 - AGRICULTURE; FORESTRY; ANIMAL  
 A21 - BAKING; FLOUR; DOUGH  
 A22 - BUTCHERING; MEAT TREATMENT; F  
 A23 - FOODS OR FOODSTUFFS; THEIR TI  
 A24 - TOBACCO; CIGARS; CIGARETTES;  
 A41 - WEARING APPAREL  
 A42 - HEADWEAR  
 A43 - FOOTWEAR

To find at first a good correlated patent to your problem, enter a complete English description (like an abstract or claim). Select fields (hold ctrl key for multiple choice)

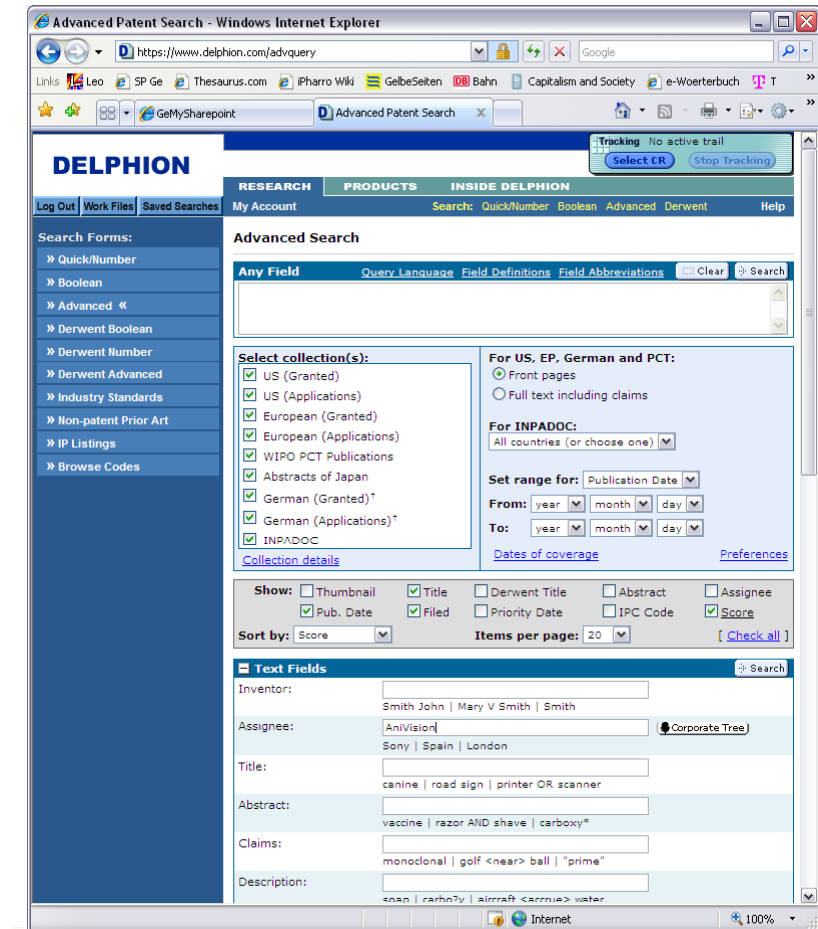
Limit the results of this heuristic analysis additionally by use of 'Boolean Search'

**Priority Date Restrictions (Optional)**

from date: / / MM/DD/YYYY  
 to date: / / MM/DD/YYYY

**Prior Art/Novelty Analysis**  
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**Advanced Search**

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- Advanced
- Derwent Boolean
- Derwent Number
- Derwent Advanced
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- Non-patent Prior Art
- IP Listings
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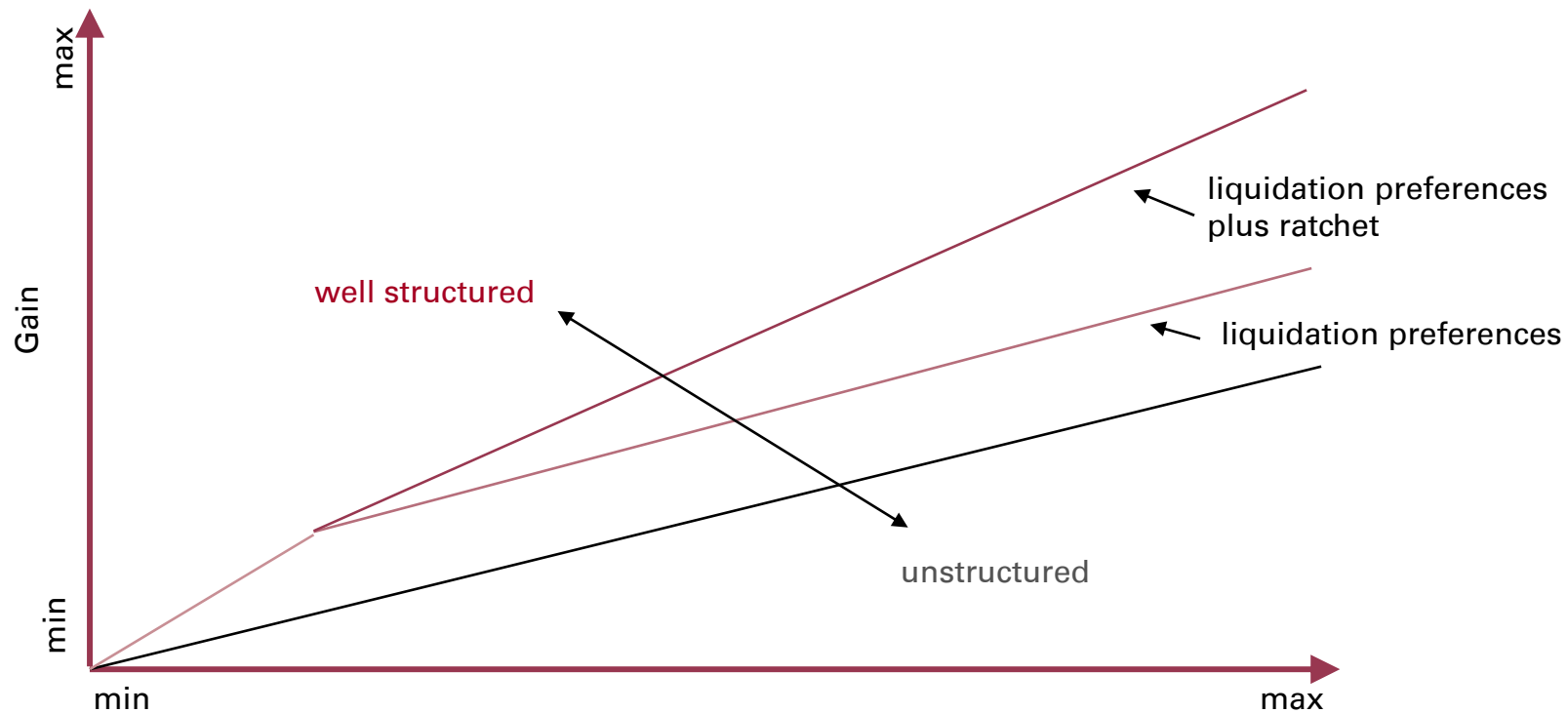
**Text Fields** | Search

Inventor: Smith John | Mary V Smith | Smith  
 Assignee: AnIVision | Sony | Spain | London (Corporate Tree)  
 Title: canine | road sign | printer OR scanner  
 Abstract: vaccine | razor AND shave | carboxy\*  
 Claims: monoclonal | golf <near> ball | "prime"  
 Description: snan | carboxy | aircraft <carria> water

## Termsheet Negotiation

### Objective

- Definition of key terms, financials and milestones
- Agreement of all parties on key terms before continuation





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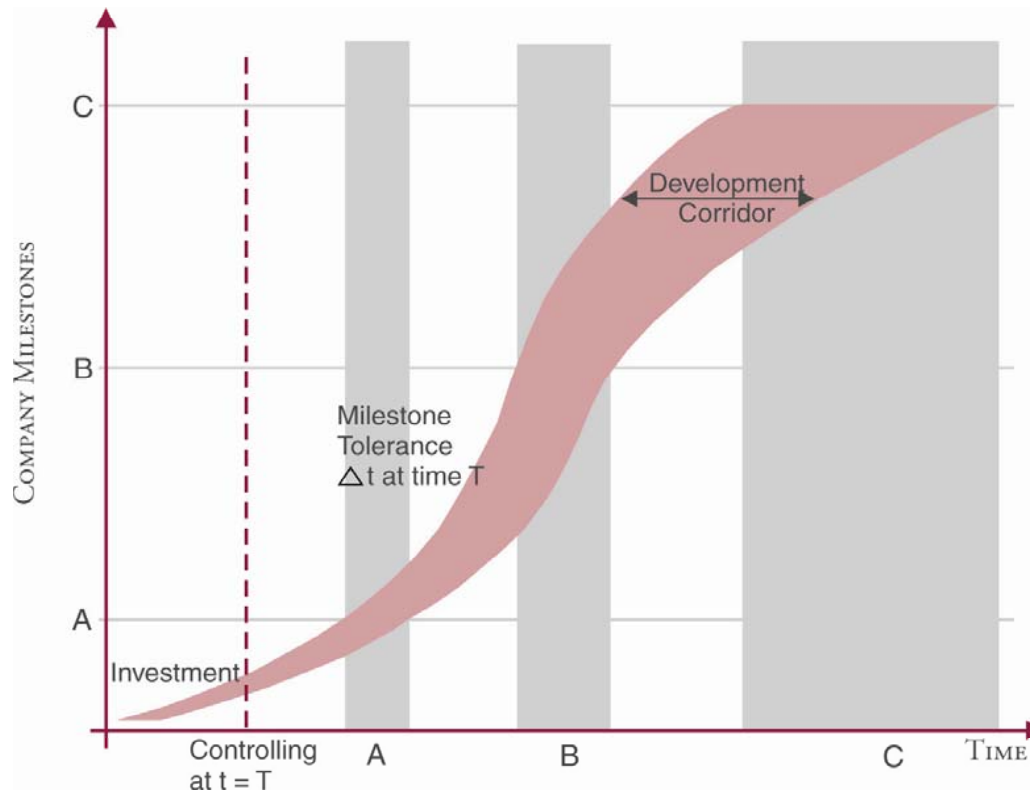
## Termsheet Negotiation

<p><b>Rights to exert control and influence (Board)</b></p>	<ul style="list-style-type: none"><li>▪ Non compete clauses (management team)</li><li>▪ Reps and warranties</li><li>▪ Board representation</li><li>▪ Board approval guidelines</li><li>▪ Reporting</li><li>▪ Veto rights</li></ul>
<p><b>Rights to secure / maximize value</b></p>	<ul style="list-style-type: none"><li>▪ Liquidation preferences</li><li>▪ Anti dilution clauses</li><li>▪ Ratchets</li><li>▪ Milestones</li><li>▪ Protective provisions / RoFR</li><li>▪ Vesting</li><li>▪ IP representation</li></ul>
<p><b>Right to exit, exit trigger and process</b></p>	<ul style="list-style-type: none"><li>▪ Tag – along</li><li>▪ Drag – along</li><li>▪ Trade sale &amp; IPO provisions</li></ul>

## Investment Case Definition

**Objective**

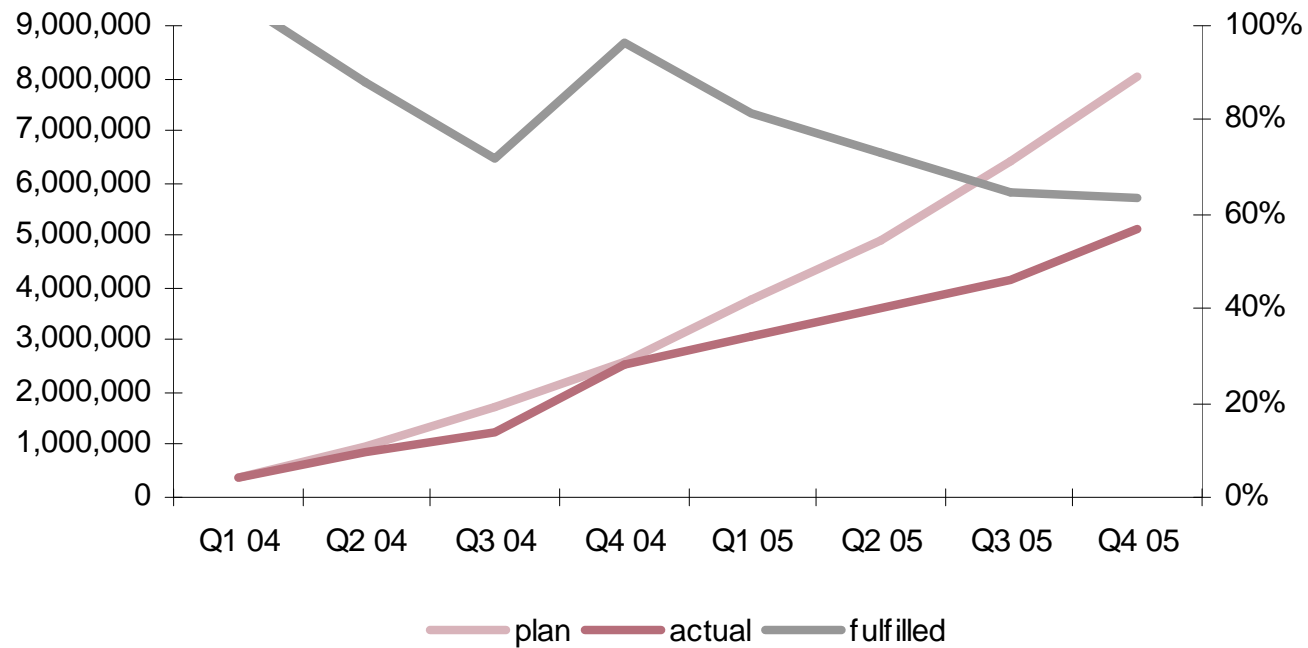
- Finetuning of Level C outcome



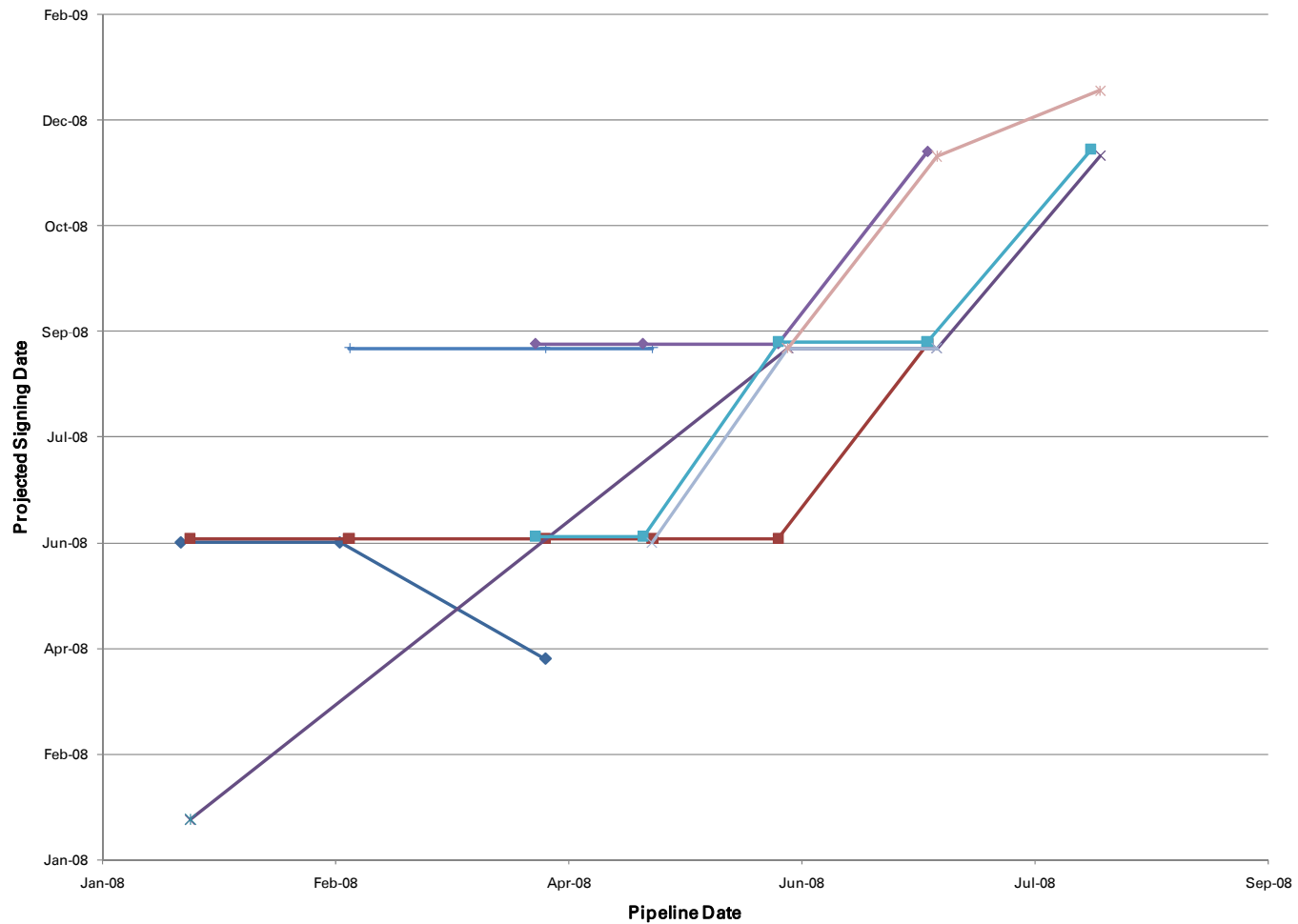
## Risk Management – Measurements and Tools

<b>Objective</b>	<ul style="list-style-type: none"><li>▪ Performance analysis for strategy analysis and review</li><li>▪ Early recognition of challenges and hurdles</li><li>▪ Early –stage signal for performance deficits</li></ul>
<b>Criteria &amp; Tools</b>	<ul style="list-style-type: none"><li>▪ Balance Scorecard based on company’s business plan and milestones<ul style="list-style-type: none"><li>➢ Analysis of derivations plan – actual</li></ul></li><li>▪ Pipeline Analysis<ul style="list-style-type: none"><li>➢ Analysis of delays of order projection</li><li>➢ Analysis of changes in order number of volume</li><li>➢ Lost order statistics and analysis</li></ul></li><li>▪ Project Tracking of R&amp;D Projects</li><li>▪ Ongoing todo list monitoring</li></ul>

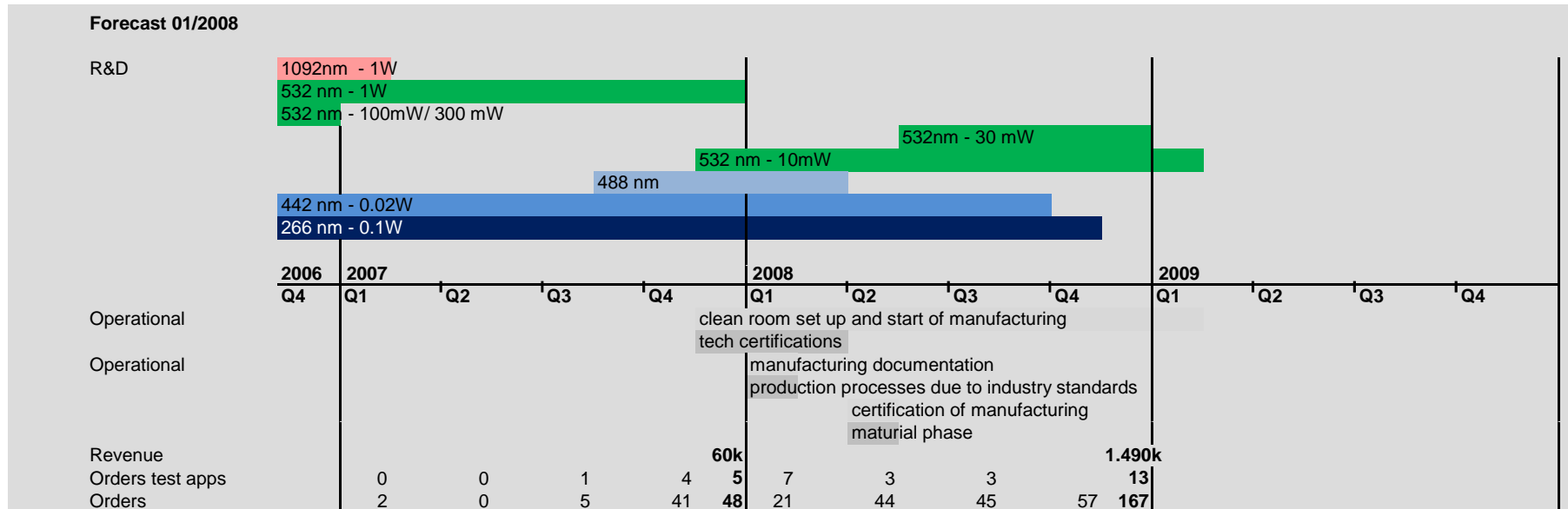
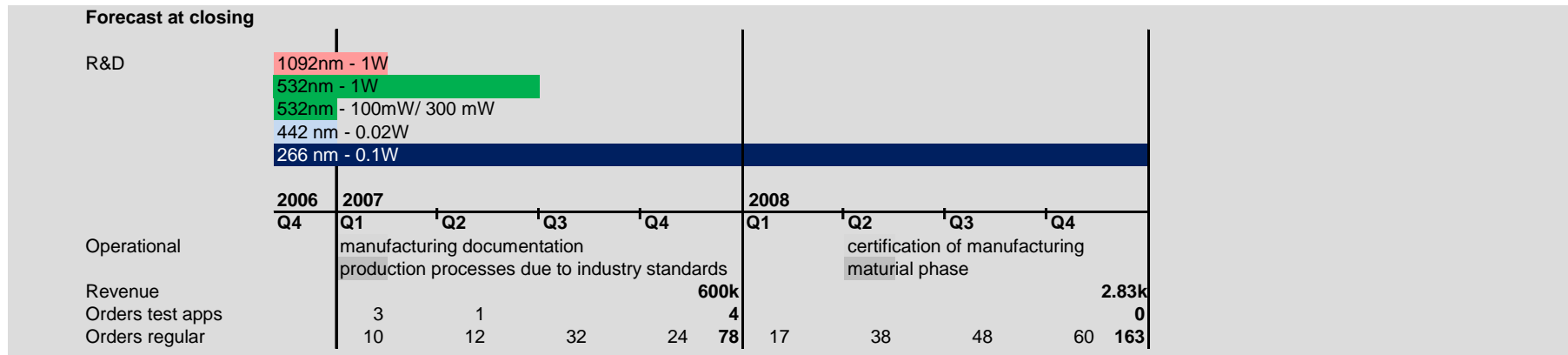
## Risk Management – Derivation Analysis with BSC



## Risk Management – Analysis of delays and changes of orders projected



## Risk Management – Project Tracking of R&D Projects



### Formal Due Diligence / Final Contract Negotiation\*

Document/Information about (cross if not applicable)	Where to locate: (file#, section/ dataroom)
1. Legal Basis	
1.1. Current bylaws/partnership agreements of companies involved in the current round and their predecessor companies.	
1.2. Articles of incorporation, and certificates of partner/shareholder resolutions that amended the bylaws since the company was founded	
1.3. The complete paper trail of notarial acts on the assignment of interest in the company from its establishment to date.	

\*Please refer to backup

### Formal Due Diligence / Final Contract Negotiation\*

1. Legal basis
2. Other legal affairs of the company
3. Important agreements
4. Accounting and financial conditions
5. Technology & products
6. Market & competition
7. Marketing & distribution
8. Risks
9. Management & organization
10. Planning
11. Publications
12. References
13. List of all peer companies
14. Exit role models and scenarios
15. VC's active in this field
16. Risk management
17. Post closing todo's

\*Please refer to backup



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