Qbic II

Interuniversity Seed
& Venture Capital Fund

Sources of Capital

Starting your own business

Advanced Starter Seminar VUB
18 October 2018

Martin De Prycker
Steven Leuridan

Transforming knowledge

Agenda

- Introduction Qbic Fund II
- Financing your spin-off project
  What sources of capital at what phase of my spin-off project?
- VC funding
  What is a VC investor looking for and what to expect as founder?
  - What does a VC fund offer?
  - What does a VC fund want in return?
  - VC investment criteria
  - Valuation considerations
  - Term sheet and SSA
  - VC process
  - Practicalities (Know your investor, when to start, what to provide)

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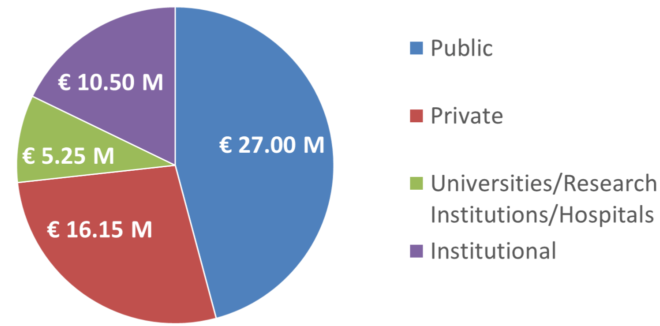
Qbic fund at a glance: Qbic I and II

- Unique independent interuniversity seed and venture fund in Belgium with close to € 100M under management
- Qbic I (2012-2022+2)
  - Fund of € 40.7M
  - Investment period closed end 2016
  - 18 companies in portfolio
  - 1 successful exit (Multiplicom) and value creation of other companies values the fund at 1.66x
  - No new investments will be made with Qbic I, the fund is in exit/divestment mode
- Qbic II (2016-2026+2)
  - Fund of € 58.9M
  - First investments done
    - Aphea.Bio (*sustainable agriculture*)
    - Blue Foot Membranes (*water treatment*)
    - Laminaria (*renewable energy*)
    - Sentea (*structural health monitoring*)
    - Aquatic Science *(biological water filtration systems)*
    - Aloxy.io (*IoT for chemical applications*)



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Qbic II: Interuniversity Seed and Venture Fund

- Qbic is an independent seed and venture fund which invests in spin-offs and emerging companies which have a valorization link with one of our cornerstone universities and research institutes
- Qbic has a dual partnership strategy:
  - **First-line partners (qualifying universities/research institutions):** first right to participate in first financing round
  - **Second-line partners (co-investment non-qualifying universities/research institutions):** co-investment right if asked by their first-line partner
- Sector diversification and broad national coverage
- Large proprietary deal flow from research partners. Expecting well over 500 investment opportunities, allowing a very selective selection procedure (**2-4%**)
- Guaranteed early view on spin-offs pipeline via regular follow-up with partners' Technology Transfer Offices
- Early hands-on involvement of Qbic team to shape companies and make them funding ready
- Portfolio company support via active BoD involvement

Qbic II Team

Investment Team

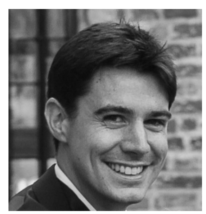
Managing Partners

Sofie Baeten

Martin De Prycker

Jean Van Nuwenborg

Investment Manager



Steven Leuridan

Investment Committee

Johan Brants
IP Counsel

Pierre De Muelenaere
ICT

Luc Dochez
Life Sciences and Med/Healthtech

Eric Peeters
Engineering and Materials

Chairwoman SAB

Sophie Manigart
Governance

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Syndication leverages Qbic II funds

ALF Agri Investment Fund
Dow
group DC
meusinvest
V-Bio Ventures
Spin venture
FABRICOM GDF SUEZ
FIDIMEC
LRM Oxygen for growth
CRONOS GROEP
CEIP Clean Energy Innovative Projects
THE INNOVATION FUND
VIB
PMV DOE- EN DURFBEDRIJF
SRIW INVESTMENT & GROWTH
finindus materializing innovation
VIVES Louvain Technology Fund
Gemma Frisius Fonds

Qbic II was able to leverage over 4 times its first 6 investments (€ 3.90M on € 17.55M)

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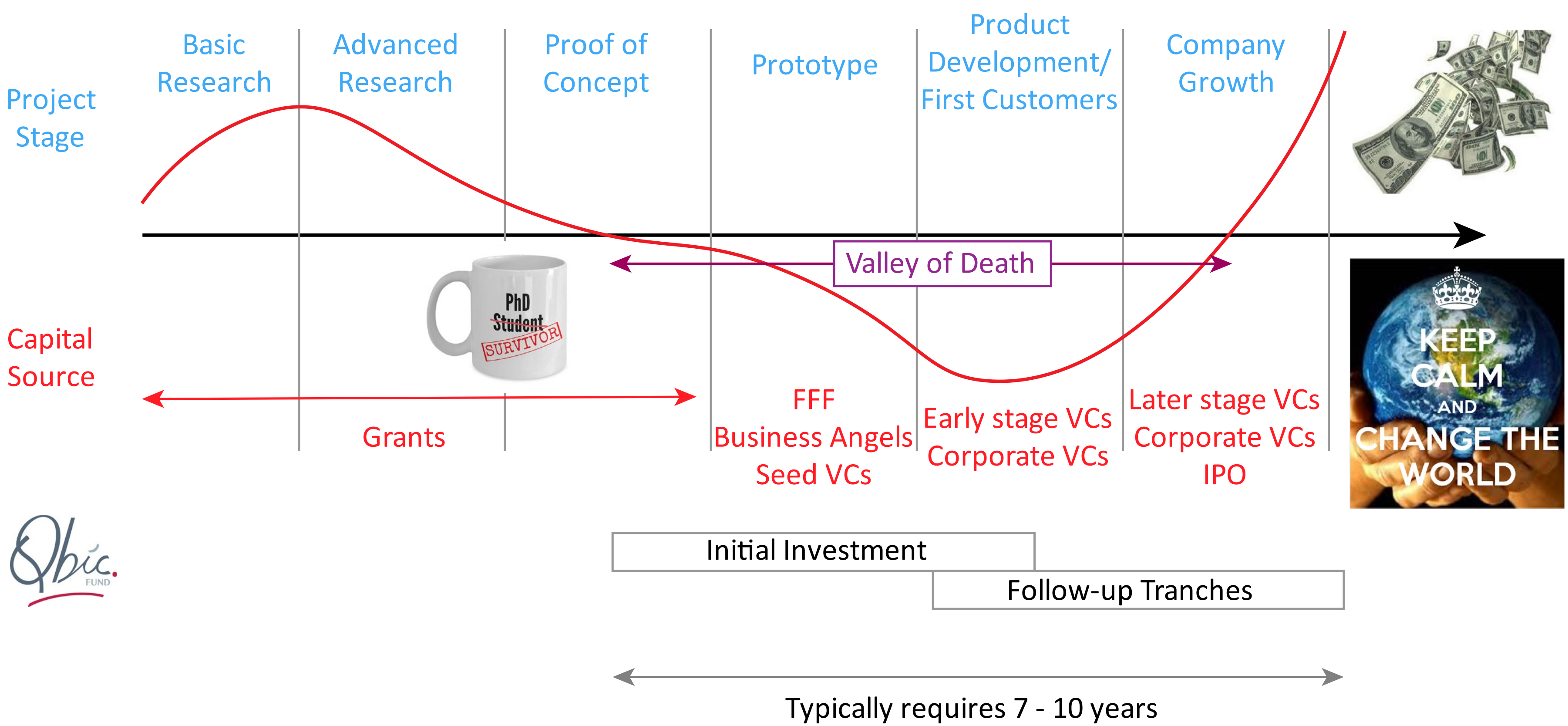
Sources of capital



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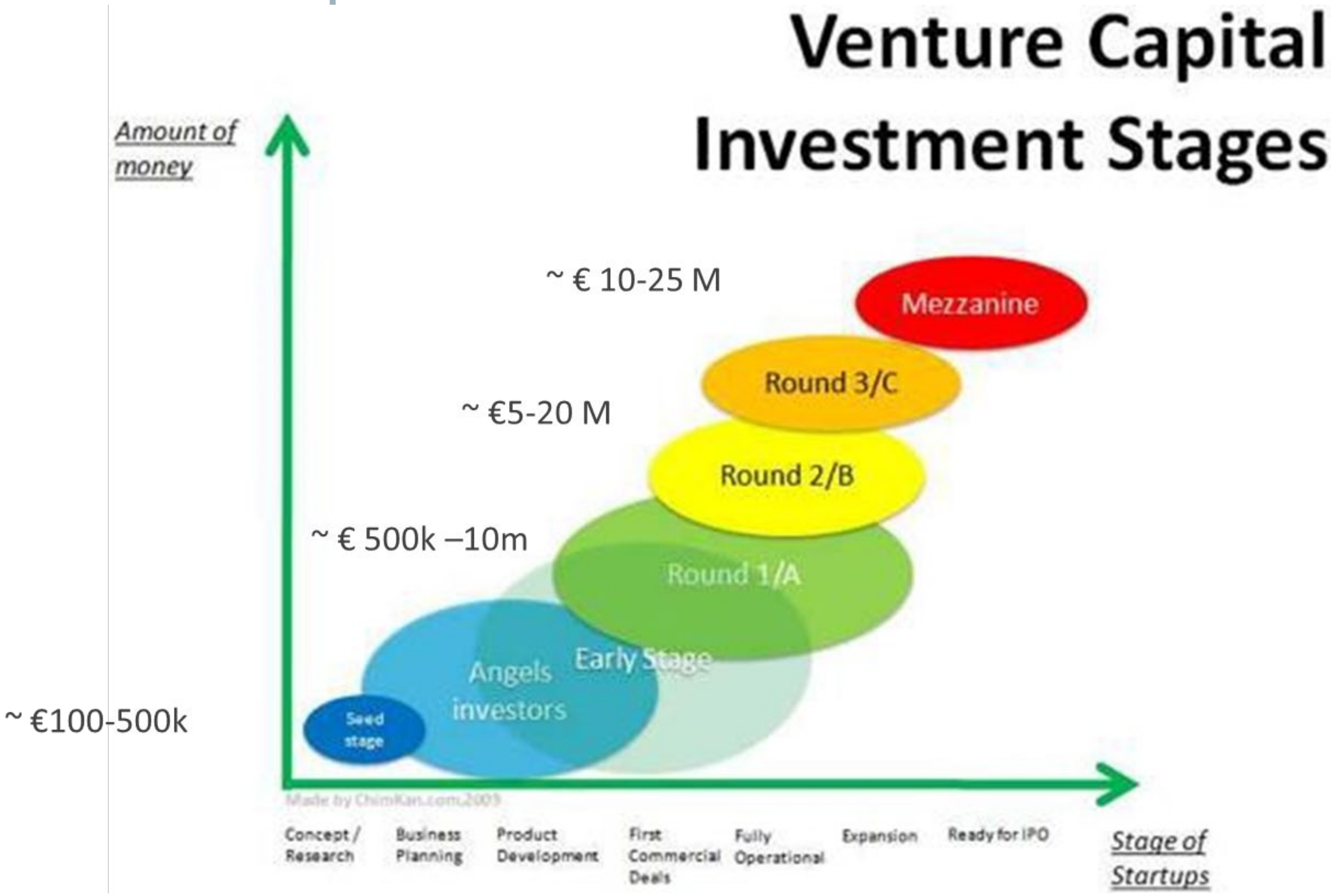
Sources of capital



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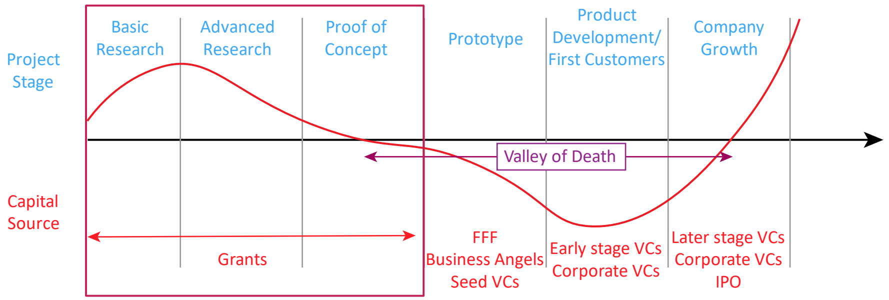
Sources of capital: Research & pre-seed



- University: IOF (technical proof of concept)
- EU: a/o ERC (European Research Council) grants to prepare a spin-off
- Vlaio: http://www.vlaio.be/subsidiedatabank
  - PhD research projects: Baekeland mandate, SBO (Strategisch Basisonderzoek)
  - Valorization of PhD research: Innovatiemandaat (preparation of a spin-off or in cooperation with existing company
- …

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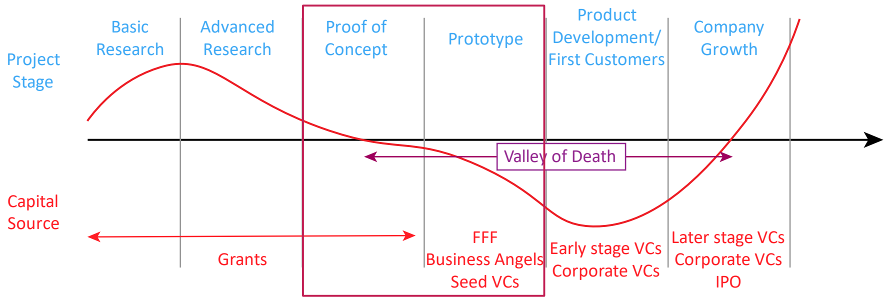
Sources of capital: Pre-seed & seed



- FFF (Friends, Fools, Family)
  - Winwinlening (up to € 200 k): see http://www.pmv.eu/nl/diensten/winwinlening
  - Tax Shelter: http://www.vlaio.be/maatregel/tax-shelter-voor-startende-ondernemingen
- Incubators:
  - Small funding programs
  - Support in advice and infrastructure
  - Network

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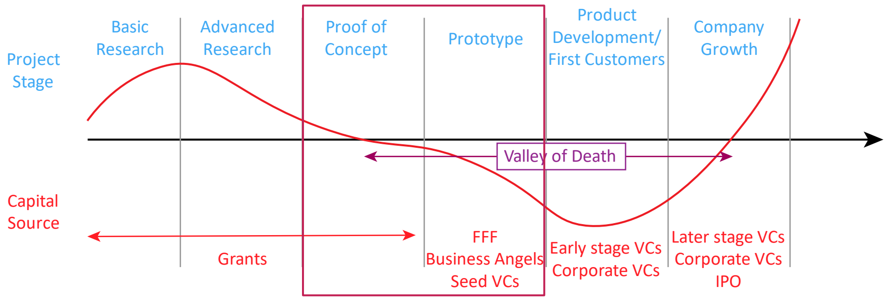
Sources of capital: Pre-seed & seed



- Business Angels
  - Individual business angels and family offices
    - Often sector specific: relevant sector experience
    - May be small tickets
    - Sometimes also bigger tickets but very selective
  - BAN Vlaanderen:
    - Mainly smaller tickets
    - In association with AAA Fund

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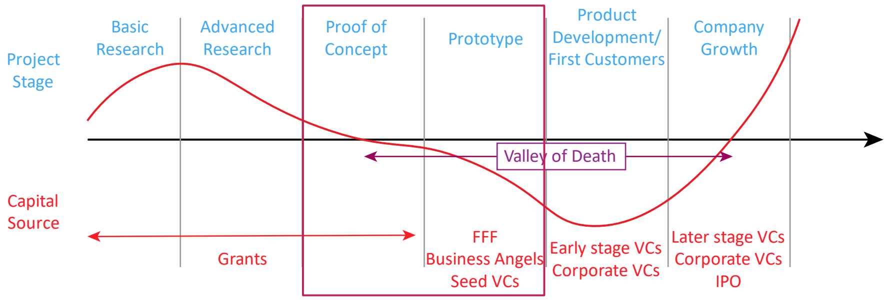
Sources of capital: Pre-seed & seed



- Crowdfunding
  - Better suited for B2C, relatively small tickets
  - Good idea for testing product-market fit
  - Only money
  - Only a tiny portion of crowdfunding money goes to equity investments

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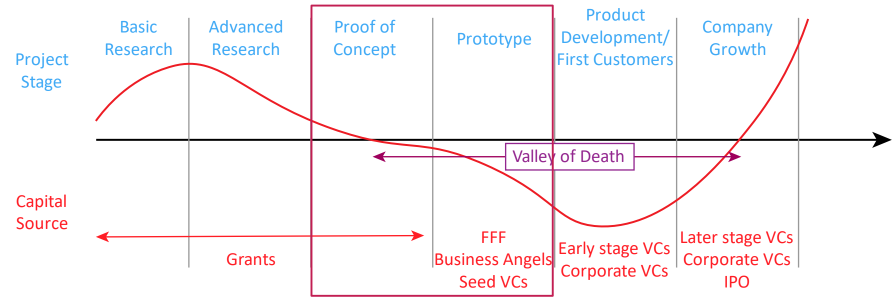
Sources of capital: Pre-seed & seed



- Public
  - Vlaio:
    - Applied research projects: O&O Bedrijfsprojecten
    - Feasibility studies, strategic advice: KMO portefeuille
  - Innoviris
  - PMV:
    - Innovation Mezzanine (convertible loan of up to € 500k for beneficiaries of an IWT R&D subsidy): http://www.pmv.eu/en/services/innovation-mezzanine
  - Other: imec (iStart), sector specific or thematic grants (Vlaio, Innotek, EU, …): check Subsidiedatabank

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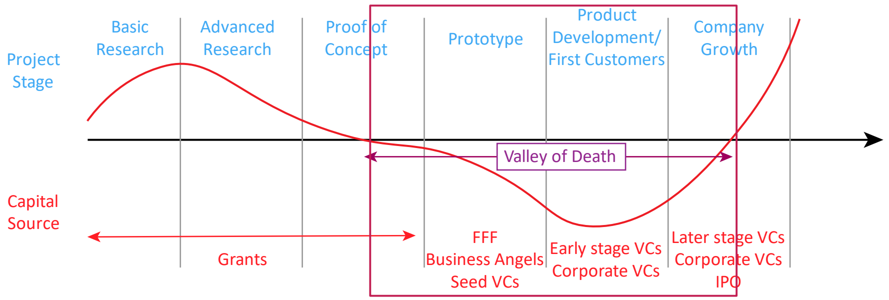
Sources of capital: Seed & series A



- VC Funding

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What does a VC fund offer?

Pre-investment (for Qbic style VC funds)

- Feedback on the business plan and alternative strategies
- Sounding board
- Access to network and know-how to test idea's

Post capital raising

- Hands-on assistance
  - No operational interference (unless in case of emergency)
  - Advice on operational issues
  - Help building the team
  - Sounding board for strategic decisions
  - Professionalizes governance from the start (e.g. independent board member)
- A strong network
  - Industrial as well as financial
- Capital (follow-up)

→ **Look for a long-term partnership instead of a cash provider**

Where to find money?

Where to find the resources you need to become a successful company?

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What does a VC fund want in return?

- A stake in the company's **equity** – strong investor syndicate for the long-term

- **Insight** in how the company's business evolves
  - Representation in the company's board of directors
  - A say in strategic key decisions

- An attractive **exit horizon**
  - Most funds are closed-end (10-12 year) – exit horizon of 5 to 7 yrs
  - High investment return multiples : target of 10x
  - Good spectrum of potential buyers (M&A, MBO, secondary, IPO) – trade sale opportunities

"My error, sir. On the phone I thought you said 'venture' capitalist."

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VC criteria

- Team
- Product/market fit
- Sustainable competitive advantage
- Entry barriers / FTO (Freedom To Operate)
- Scalable business model / high potential
- Market size/global reach
- Technology risk
- Value chain complexity
- Exit potential
- Pre-money expectation

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VC criteria - Team

The team is extremely important

→ "VC Funds invest in teams, not in businesses"

- Has the team all the required complementary **skills** and experience to execute the companies' plan?
- Team does **not have to be complete** before an investment, but a core team should be present or identified. Limitations of the existing team should be identified and willingness to improve
- Are team members **flexible** enough to **change plans** drastically when needed?
- Can teams live with the fact that investors participate in the company as an important shareholder ("**Founderitis**")?

The team will have to convert the potential into a successful business

"I don't have to be a team player, Crawford. I'm the team owner."

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VC criteria - Team

- CEO
  - Only one - someone has to decide!
  - Coordinates communication with stakeholders and board
  - There has to be a match between the company CEO and the VC
- Engineering: technical functions
  - In general not the biggest problem
  - Cooperation with universities can be established (independence can grow over the first 5 years)
  - Identify needs (search for partners or additional hires)
- Marketing / Business Development / Sales
  - Product management (strategic): assesses market requirements by talking to customers (outside in) and defines product development priorities
  - Marketing communication and inbound marketing - lead generation (tactical)
  - Direct sales, channel sales, SaaS sales
  - Pre-sales: tenders, technical sales
- Support functions: HR, legal, accounting, … typically outsourced in an early stage

VC criteria - Product/market fit

- Identify your market (broad enough)
- 2 aspects:
  - the start-up's solution should respond to a strong perceived market need (also referred to as "pain" or "problem")
  - the solution solves this problem in a more (cost) effective and efficient way ("gain")
- Is market share **defendable**? e.g. IP
- **Software/service** is easier to modify than **hardware/product**: this allows to **iterate** in order to find the best product/market fit

VC criteria - Sustainable competitive advantage

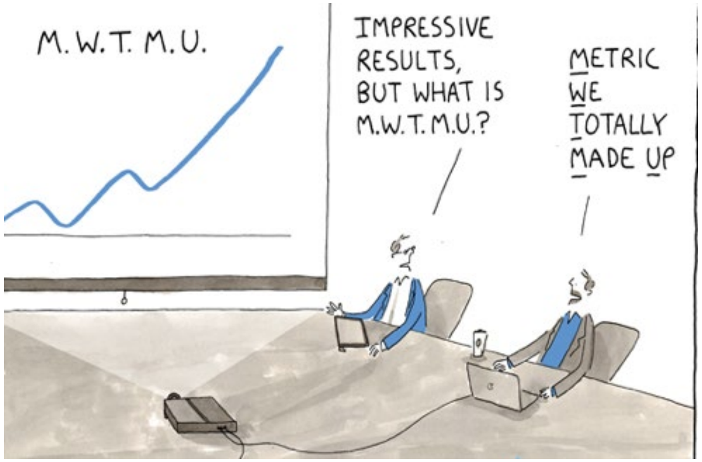
- The start-up has found a good product/market fit, its approach is unique and its solution provides more customer value than the competition
- But can it **maintain this competitive lead**?
- This question is especially important if the start-up competes directly against **established market leaders**
- Possible strategies include:
  - **IP protection/trade secrets/know-how**
  - Maintain a feature advantage through **continuous development investment**
  - **Increase market share** / addressed markets
  - **Many happy customers** = strongest competitive advantage
  - **Brand building**

VC criteria - Entry barriers / FTO

- Refers to the **absence of barriers and blocking patents**
- If such patents are identified: is a work-around possible?
- If not: no go! (**FTO**)
- Importance is **sector specific**, usually less important for **software start-ups** but very important in **pharmaceutical** or **medical equipment**

VC criteria - Scalable business model / high potential

- Refers to the potential of a company to **grow revenue faster than its cost base**
- **VCs** invest in **scalable businesses**
- Not every business is scalable
  - Example: **Service and consulting** companies are not easily scalable: to double revenue you have to double the number of employees
- Most **software start-ups** are inherently scalable: the same program can be resold over and over again
  - Exception: **project-based development** for customers with specific requirements, or with a specific environment / architecture, e.g. for hospitals
  - Beware of the **consulting pitfall** – although consulting isn't always bad: it can allow you to remain in touch with your market, or be a marketing tool



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VC criteria - Market size/global reach

- Big difference between the total market and the **Total Addressable Market**
  - A small TAM means a smaller exit potential and a smaller return: some investors shy away from small addressable markets
- **Top-down** approaches are only relevant if detailed numbers are available
- A **large global market** means also that team and strategy need to be adapted for a global business
- Another important metric is the market's compound annual growth rate or **CAGR**: the year over year growth of the market

VC criteria -Technology risk

- We have a technical **proof of concept**, or a lab scale model, but can we grow the solution into a commercial product?
  - Process takes often between 2 and 5 years
- Examples of challenges include:
  - Certification (e.g. CE, FDA...)
  - Mass production (in service it means for example scaling the teams)
  - Use outside lab
  - Miniaturization
  - ...

VC criteria - Value chain complexity

- Complex markets are notoriously difficult to penetrate (see e.g. next slide)
- Some markets have a “defective” value chain, where the entity who pays for a solution is not the entity that benefits from a solution, e.g.:
  - In smart metering, the grid operators have to invest in smart meters, while consumers and the electricity providers are the ones who benefit
  - Container tracking is important for shippers (the party who owns the goods that are shipped), but devices to track containers have to be paid for by the container owners

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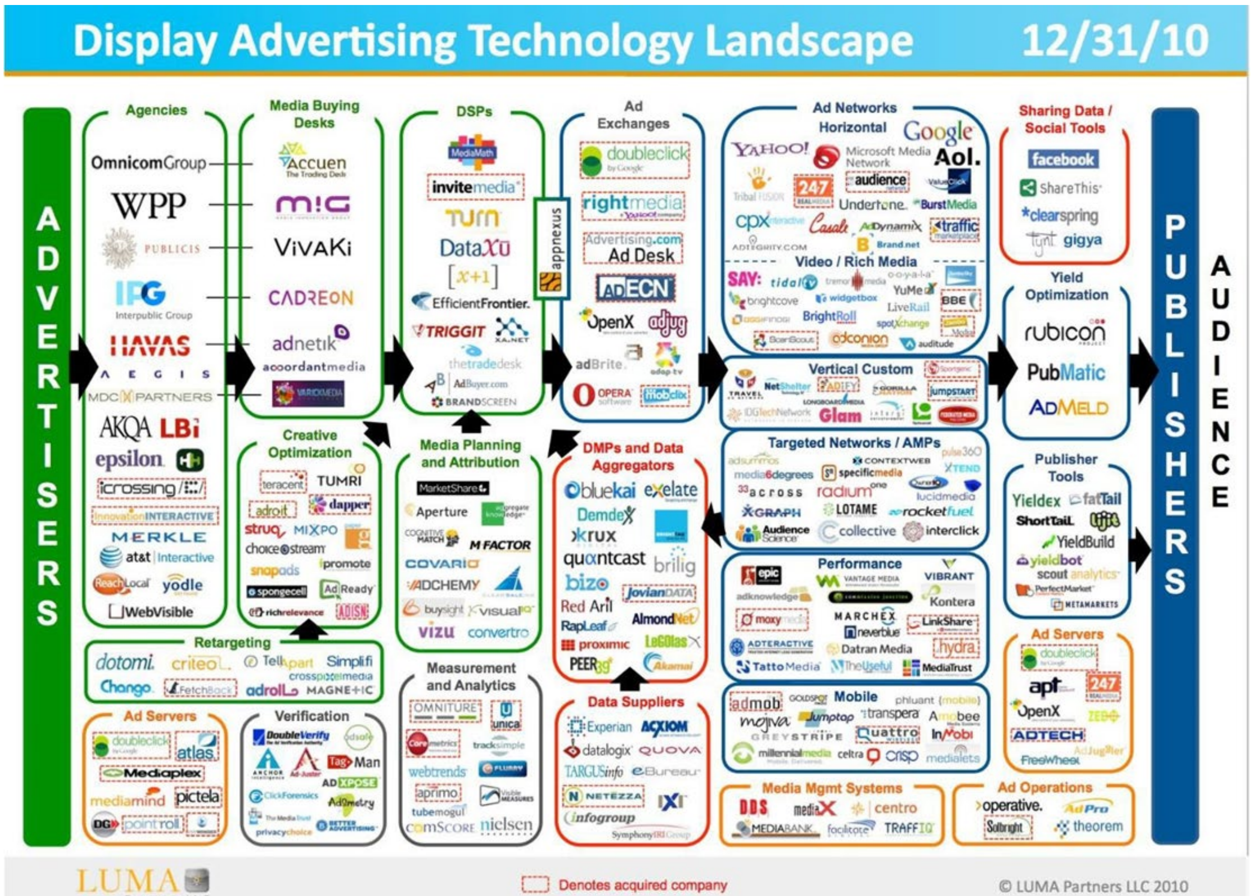
VC criteria - Value chain complexity



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VC criteria – Exit potential

- Agree on **willingness to sell**
- Depends partly on previous factors:
  - product/market fit
  - good execution by the team
  - competitive advantage
  - a sizable TAM and high CAGR
- Major **exit scenarios**: an acquisition by an industrial player (**trade sale**) or another financial player (**LBO/add-on platform/secondary**), a Management Buy Out (**MBO**) or IPO (**Initial Public Offering**)
- At the moment of the initial investment the exact scenario or acquirer is usually not known, but **potential acquirers** must be identifiable
- **Need for competition** (strategic premium)
- Company strategy needs to be adapted to eventual sale

VC criteria - Pre-money expectations

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Valuation considerations

- Pre-money valuation is the company value that **existing and new investors** agree upon **before the investment is made**

post-money value = pre-money value + investment

- Pre-money valuation has a direct impact on return
- Many VC deals go south because the founders have inflated expectations about the value of their company (See VC readiness)
- Valuations in the US are typically higher, but the US market is more scalable than the EU market

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Valuation considerations – Pre-money

- Economic theory says: $$DPV = \sum_{t=0}^{N} \frac{FV_t}{(1+r)^t}$$
- Problem: in a pre-revenue situation there is no way to know the **future free cashflows** other than through MWTMU
  - You would have to risk-adjust the DCF value anyhow…
  - A 4 year business plan for a pre-revenue company still makes sense, but mainly to get a grasp on burn rate and strategy – **Costs are better predictable than revenues**
- This means that alternative valuation methods such as **multiples** are also problematic
- Comparables are not available, and would be difficult to use anyhow
- A few methods:
  - Estimate the **exit potential** and the **required investments**, and calculate a possible IRR (**10x potential!**)
    - In order to reach our fund's target and compensating for failures in our portfolio, we are looking for an IRR of at least 30% for any individual investment
  - **Pre-money** = know-how contribution + management (incl. material financial participation of management)
  - …

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Valuation considerations – 10x potential

€ 100 M
Fund size

€ 20 M
Fund costs

€ 80 M
Invested

€ 26,67 M = € 0 M
Fails

€ 26,67 M = € 26,67 M
1x return

€ 26,67 M = € 266,67 M
10x return

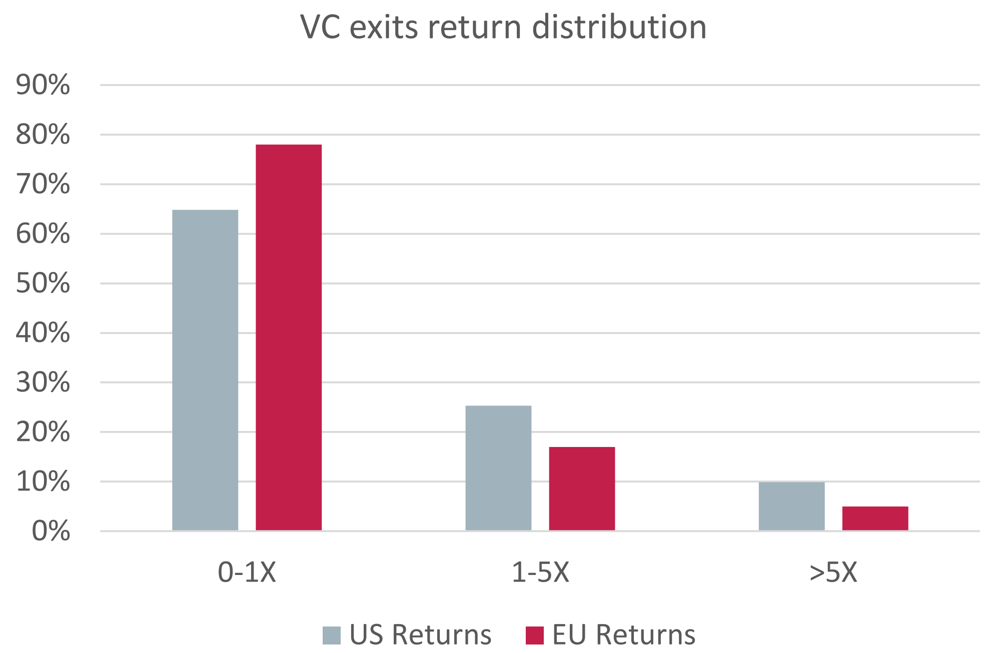
+

€ 293,37 M
Total return

€ 193,37 M
Profit

12%
IRR

Valuation considerations – 10x potential



Sources: Correlation Ventures https://correlationvc.com/ ,
The European venture capital landscape: an EIF perspective:
http://www.eif.org/news_centre/publications/eif_wp_41.pdf

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Term sheet and SSA

VC's mariage and divorce contracts

- Equity investment
  - Contribution in kind
  - In tranches with milestones
- Share classes (A,B…) and rights
  - Anti-dilution
  - First liquidation
  - Transfer of securities
    - Pre-emptive right
    - Tag along right
    - Drag-along right
- IP provider warranties
  - Right of first refusal
- Team
  - Non – compete, Good Leaver/Bad leaver…
  - ESOP
- Board of Directors
  - Composition of the board
  - Board meetings & shareholder meetings – majorities
- Reporting
- Exit
- Undertakings by the company
  - Exclusivity

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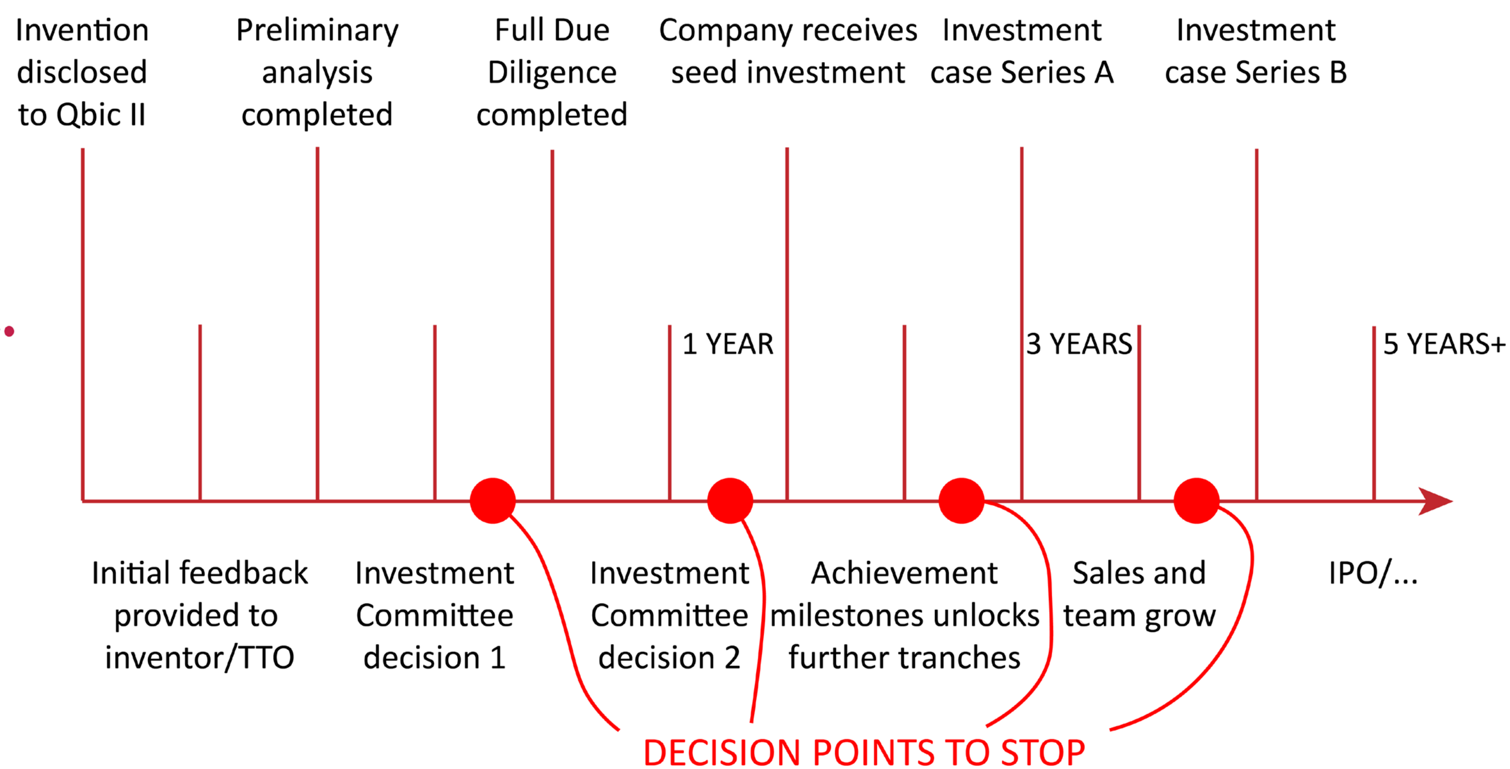
VC – a long and intensive process



VC – a long and intensive process

- First contact: the company pitch
- Evaluation of the business plan, financial plan and investment proposal
  - NDA
- Term sheet: terms & conditions to be agreed upon
  - Non-binding intention to continue – exclusivity period
  - Terms of investment:
  - Founder team
  - Investment amount
  - Valuation
  - Classes of shares and their rights
  - BoD, Shareholders meeting
  - Drag along, tag along, pre-emptive rights
  - Exit clauses
  - ….
- Due diligence: technical, commercial, IP, legal, financial, …
- Syndication
  - Lead investor vs follower
- Subscription & Shareholders agreement (+ other contracts)
- Closing

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Practicalities - Know your investor

- All investors **have investment criteria**:
  - **Ticket size**

    Qbic: min. € 250k, max. € 6M (total investment over several rounds)
  - **Stage**, including minimal revenue requirements

    Qbic: pre-seed to series A for initial investment
  - **Sector**, e.g. big data, or IoT, or ICT, or software only, …

    Qbic: sector agnostic, but technology link with partner knowledge institution required
  - **Other** (e.g. minimum required % after initial investment)

    Qbic: no other formal requirements
- Fit into **fund timeline** (e.g. long time horizon investments become more difficult as the fund nears the end of its investment period)

Practicalities – When to start

- Start search for a **lead investor**
- The process takes **6m to 12m** (start well in advance taking into account your burn rate)
- The average VC has a dealflow **of 200+ proposals** per year => you usually only get 1 chance
  - Make sure that you comply with the **investor's criteria**
  - Make sure that your **executive summary** is clear, concise and to the point
  - Check the **investor's websit**e: most have an e-mail address to submit proposals
- **Introductions** may help

Practicalities – What to provide

- **Executive Summary** (1 or 2-pager) or **short presentation**:
  - (Core) **Team** (education, relevant experience, responsibilities)
  - **Product** offering
    - Description | features
    - Product status
    - What problem does it solve?
    - Value proposition: how well does it solve this problem
  - **Market**
    - Target market
    - Size of the addressable market (TAM)
  - **Competitive analysis**
    - Major competitors
    - Differentiators: how does the venture's solution compare to competition? How and why is it better?
    - Sustainable competitive advantage: how will this competitive advantage be maintained in the future
    - (IP protection, development lead, partnerships, …)
  - **Sales & marketing plan: GTM**
  - **Funding needs**; amount, timing and **use of proceeds**
  - Detailed financial statements can be provided in a follow up meeting
- Be concise and to the point: teaser!
- No NDAs

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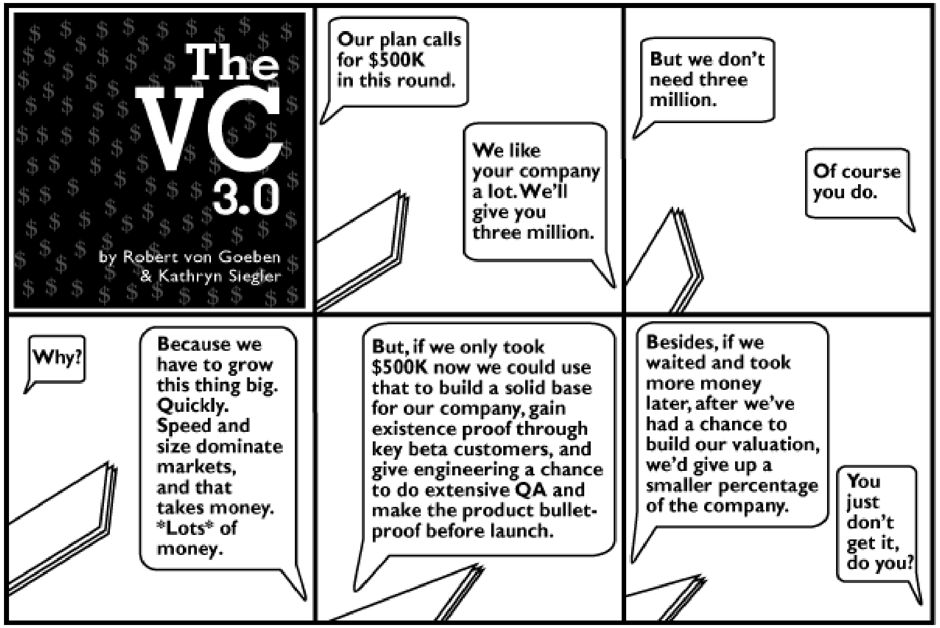
A few take-home points…

- Take into account the 10x criteria
  - Team!
- Know your investor
- Concise and to the point executive summary
- Concise and to the point introduction presentation
  - More detailed information sessions will follow if the VC is interested
- Be confident (but respectful) when presenting: you sell your company, act as a sales person!
- Keep on trying – nobody has a crystal ball
  - But ask for constructive feedback and take feedback seriously

Thanks !



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