

Preparing for Angel Investment

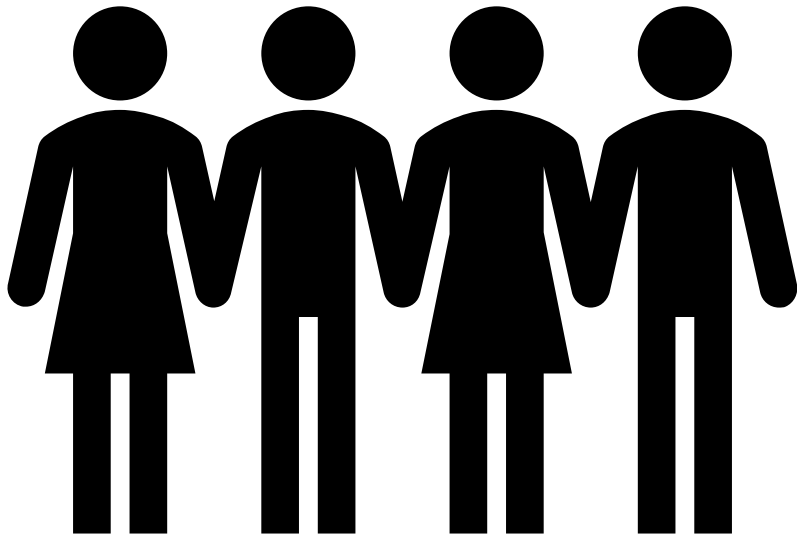
Prepared November 4th, 2020 for the [Open People Network](#)

Index

Section	Subject	Page
	Preamble	3
1	CEO's role	6
2	Idea's	11
3	Prototype	13
4	Team	15
5	Strategic Relationships	17
6	Traction	19
7	Business models	26
8	Forecasting	38
9	The ask	45
10	Use of Proceeds	54
11	Valuation	58
12	Investors	62
	Summary	65

Preamble

Recently overheard from a start-up Founder...

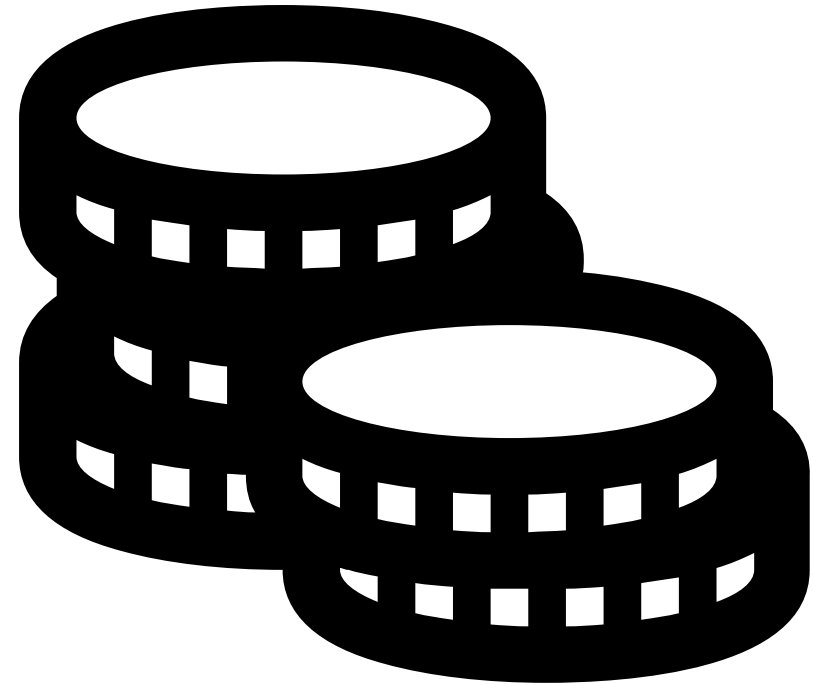


“Our number one issue is lack of capital not our drive or determination.

We can create product very quickly, but it costs \$.”

Advice to a start-up Founder...

“There is more capital available than innovative ideas to consume all the available capital... If you understand what most qualified investors are looking for and remain focused on and delivering what investors are looking for you will become a successful CEO with investors lining up to invest in you.”



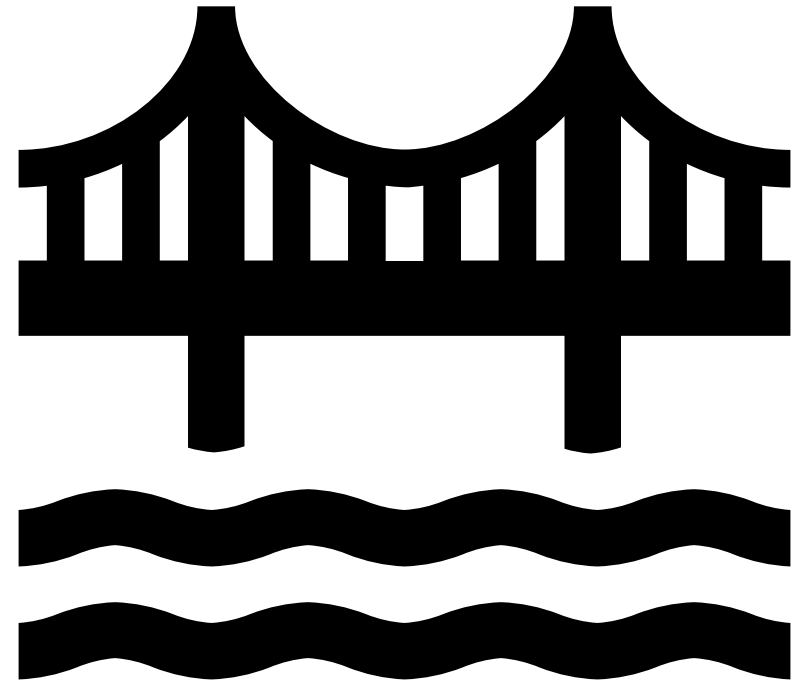
CEO's role

SECTION 1



Let me explain...

Executing or delivering as the CEO for your investors is 100% the responsibility of the CEO and what this entails can be self-taught by reading and devouring everything on the subject available online, from your advisory board members or by listening to your investors feedback.

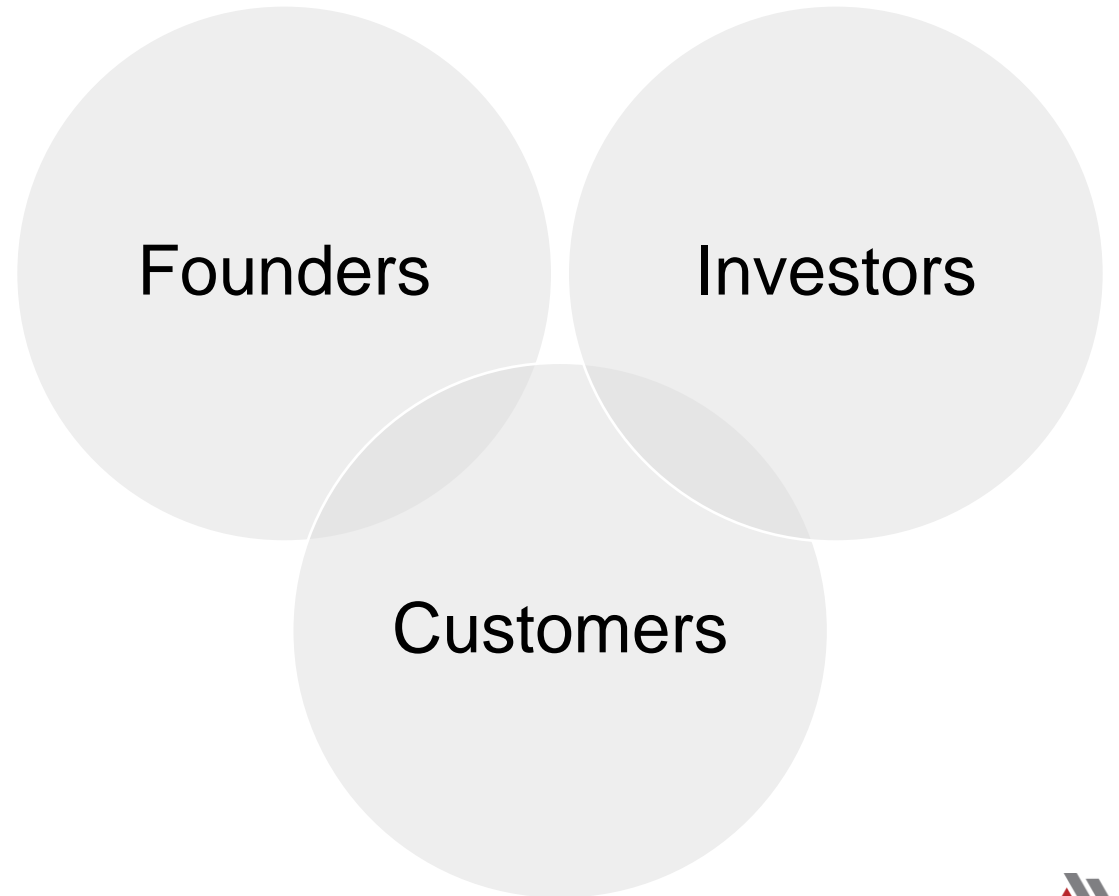


Empathy

As a startup CEO, fully embrace what investors need to understand about your investment opportunity to support you with their capital.

Investors will sense this ignorance about you if you don't demonstrate that you understand their needs and they will shy away from you.

Investors are looking for founding CEOs who understand their responsibilities to investors and all other stakeholders and can articulate the fundamentals about their business.

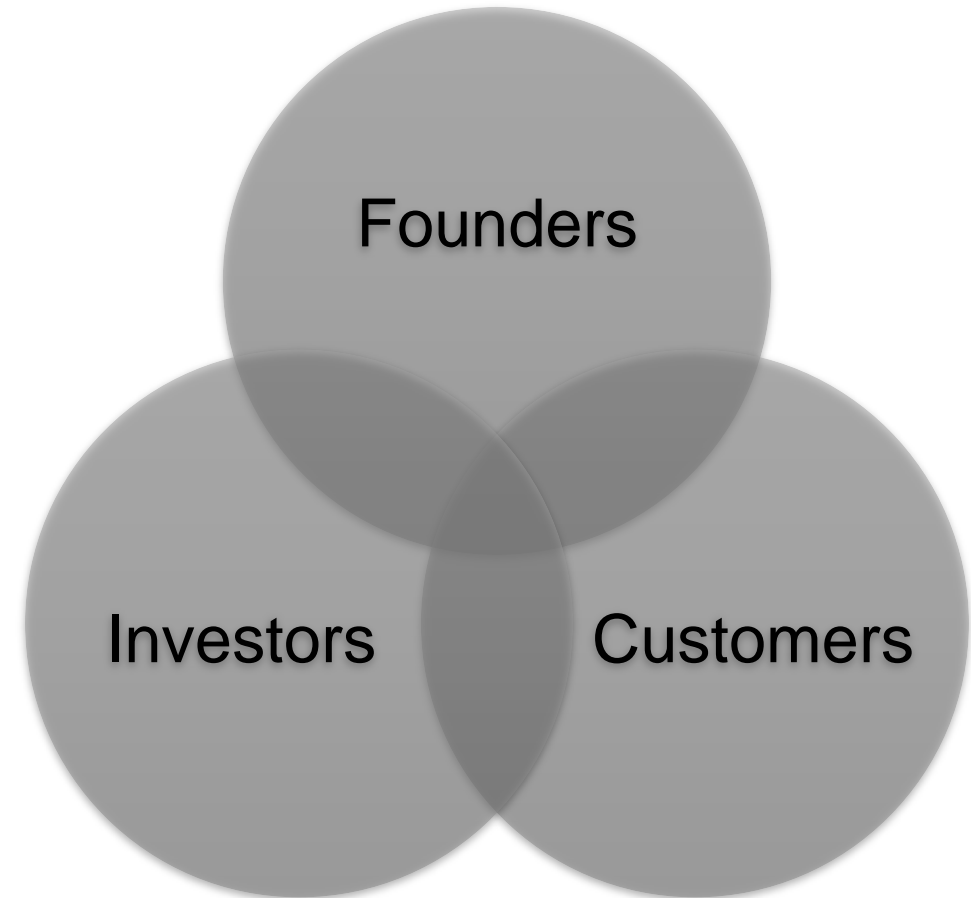


Alignment

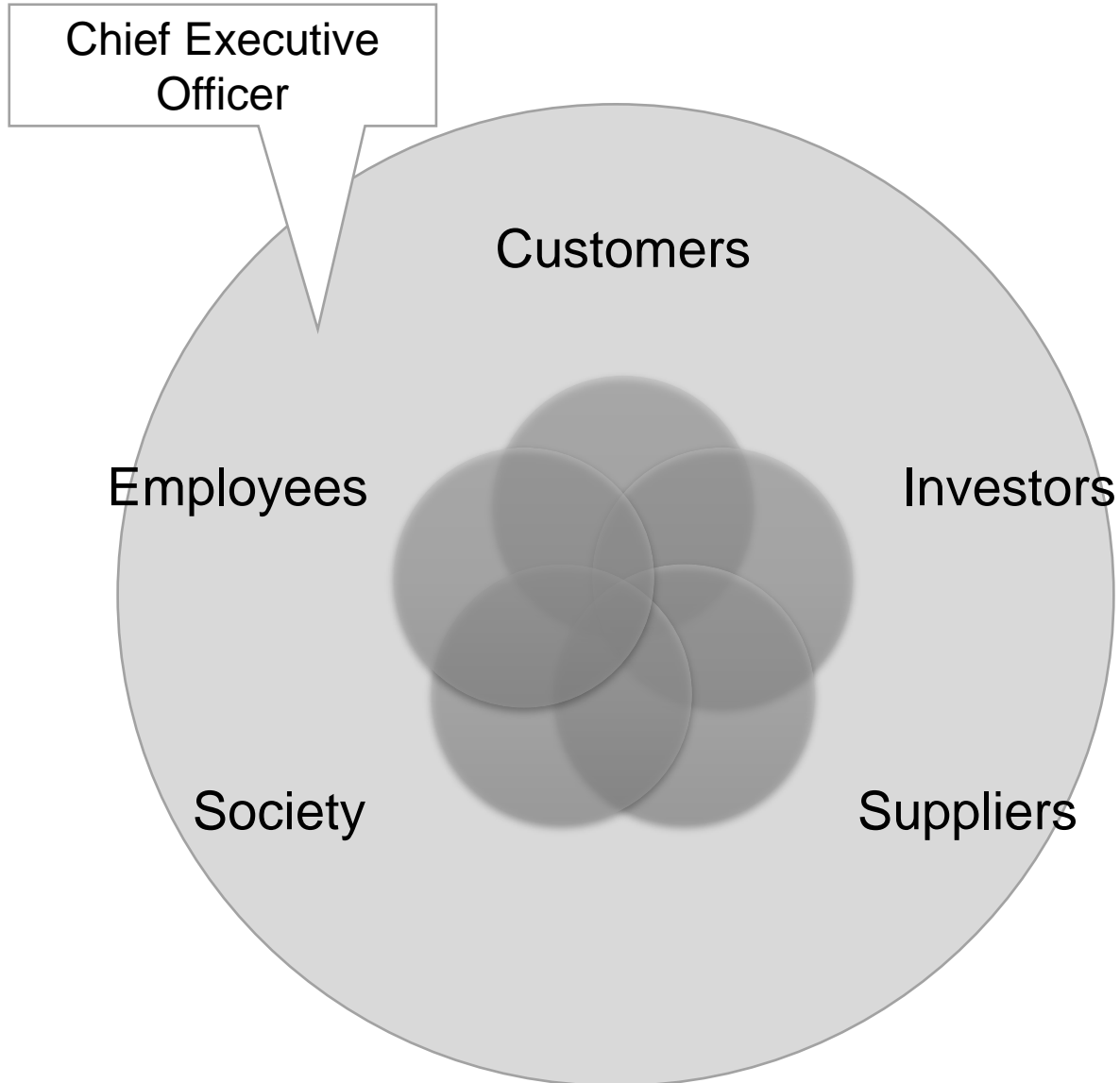
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Stakeholders



As a startup CEO, fully embrace what investors need to understand about your investment opportunity to support you with their capital.

Investors will sense this ignorance about you if you don't demonstrate that you understand their needs and they will shy away from you.

Investors are looking for founding CEOs who understand their responsibilities to investors and all other stakeholders and can articulate the fundamentals about their business.

Investor thinking

- How coachable is the Founder/CEO?
- Is the Founder willing to step aside as CEO?
- Does the CEO demonstrate values I align with?
- Does the CEO show empathy and understanding for all other stakeholder interests?

Idea's

SECTION 2



Sound new idea (basic value, product risk).



Focus in doing something other similar players (direct and indirect rivals) are not doing and cannot be easily emulated by rivals in your identified market.

Are you solving for an essential or non-essential service?

Investor thinking

- How compelling is this idea/solution, is this...
 - A nice to have (vitamins)?
 - A must have (pain killer)?
 - A must have, with no consequences (pain killer, with no side effects)?

Opportunity

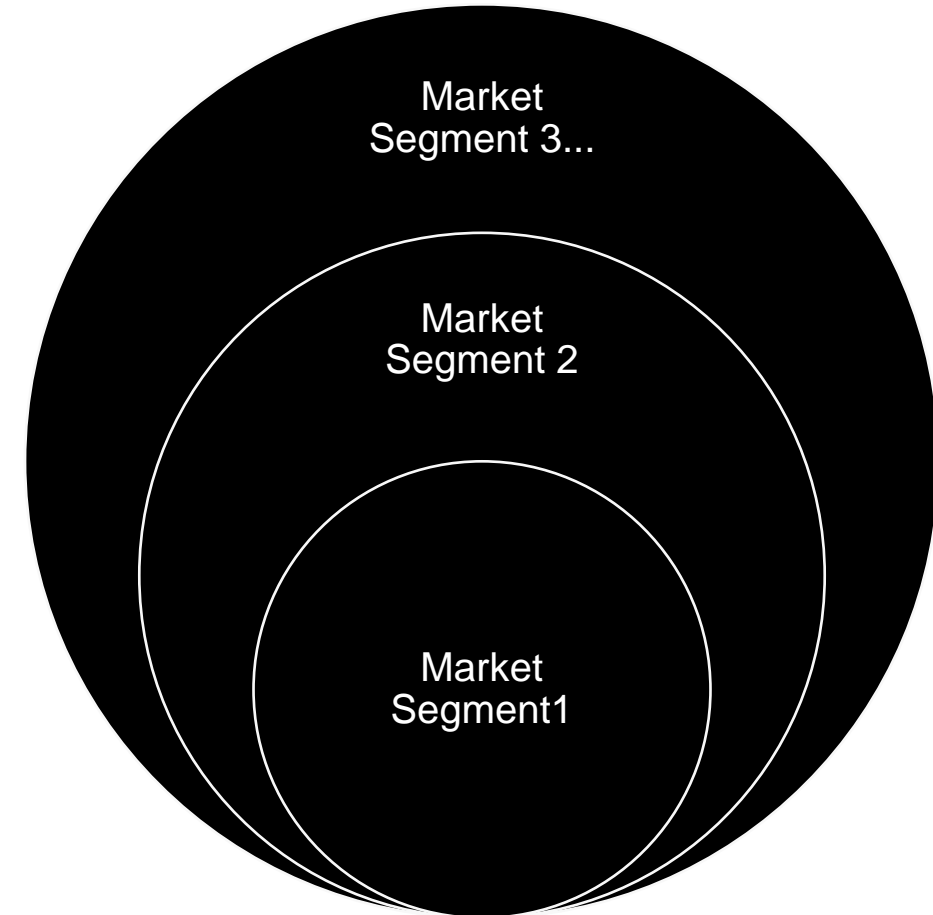
SECTION 3



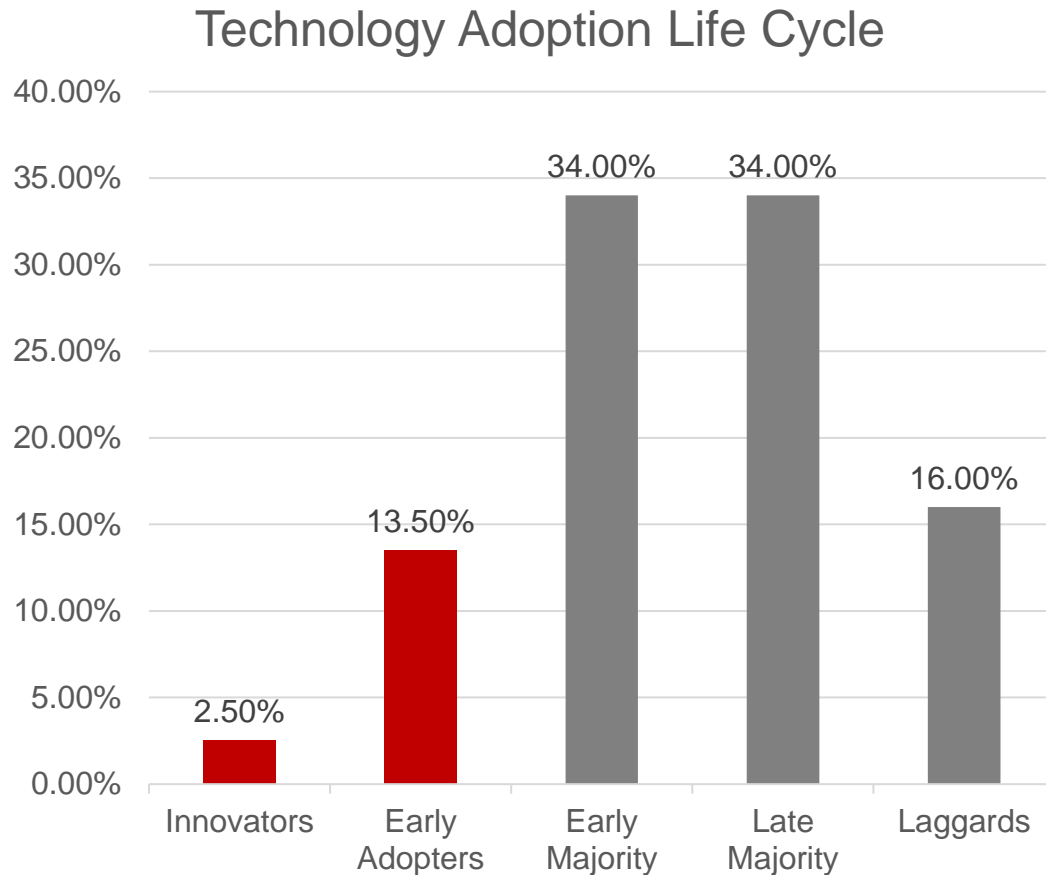
Cerebral Capital

Size of the opportunity

- Current Market size
 - How much is being spent today by customers?
 - Describe the niche/segment to initially pursue and dominate
 - What are the follow on segments
 - The identified markets long term outlook
- Size of the potential company in the niche
 - Short-term; months to revenue?
 - Mid term; months to profitability?
 - Long-term; months to growth?



Buyer persona segmentation



- **Innovators** seek out novel technology; it's like a hobby for them. There aren't many Innovators, and because they'll try new things, they are important. Other people see them use new things and feel braver themselves about trying them.
- **Early Adopters** are quick to understand the benefits of new technology. Unlike the Innovators, they don't love technology for its own sake. This group relies on its own intuition and vision to make buying decisions.
- **Early Majority** are practical minded. If a product seems useful, this group will try it. The Early Majority are cautious of fads.
- **Late Majority** wait for something to become well established. They don't feel confident in their ability to deal with technology and often buy from big companies.
- **Laggards** are those who, for personal and/or economic reasons, are not looking to buy new technology.

Investor thinking

- Have they clearly identified the market ? or the larger market that the solution is used by?
- Is this; a less than \$50M, \$100M, or more than \$100M opportunity?
- Can this become; a less than \$20M, \$50M, or more than \$100M company?
- Is this opportunity; dominated by a single dominant large player, several large players, fragmented smaller players?
- Incumbent solutions; are they excellent or weak?
- Other solutions; are they great or awful?
- Does the sector in general have; a high/low Net Promoter Score?
- What is the beachhead market segment and buyer persona?

Prototype

SECTION 4

Prototype (reduces technology risk).

Have a 10X better solution than the current incumbents targeting the same problem/users/market.



Investor thinking

- What are the strengths of product/intellectual property..
 - Not well defined, still looking at prototypes?
 - Well defined, prototypes looks interesting?
 - Good feedback from potential customers?
 - Orders or early sales from customers?
- Can this product/service be duplicated by others...
 - Easily copied, no intellectual property, know-how or trade secrets?
 - Duplication is difficult?
 - Product unique and protected by trade secrets and know-how?
 - Solid patent protections?

Team

SECTION 5



Cerebral Capital

Quality & Quantity of the Management Team (reduces execution risk).



Have a founding team with the fundamental domain knowledge, experience, and proven record of successful accomplishment and executing. One sole founder is not enough and four becomes too many.

Investor thinking

- Does the person(s) pitching and the other cofounders have...
 - Many years of business experience?
 - Experience in this sector?
 - Experience as a CEO?
 - Experience as a CFO, COO, CTO?
 - Experience as a Product Manager?
 - Experience in sales or technology?
 - No business experience?

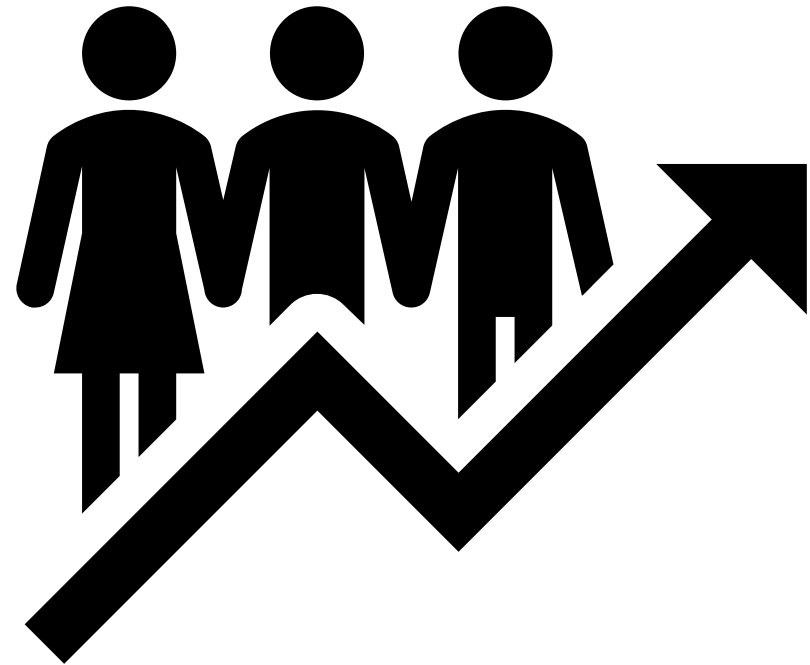
Strategic Relationships

SECTION 6

Strategic Relationships (reduces market risk and competitive risk).

Secured partnerships with various key players in your ecosystem promoting your elements of a total solution in the ecosystem.

Are you creating resilient revenue stream(s) through diversified sales channels?



Investor thinking

- What are this organizations Marketing/sales/partners...
 - Haven't discussed sales channels?
 - No partners identified?
 - Key beta testers identified and contacted or better yet,contracted?
 - Channels secured customer placed trial orders?
 - Key partners in place?

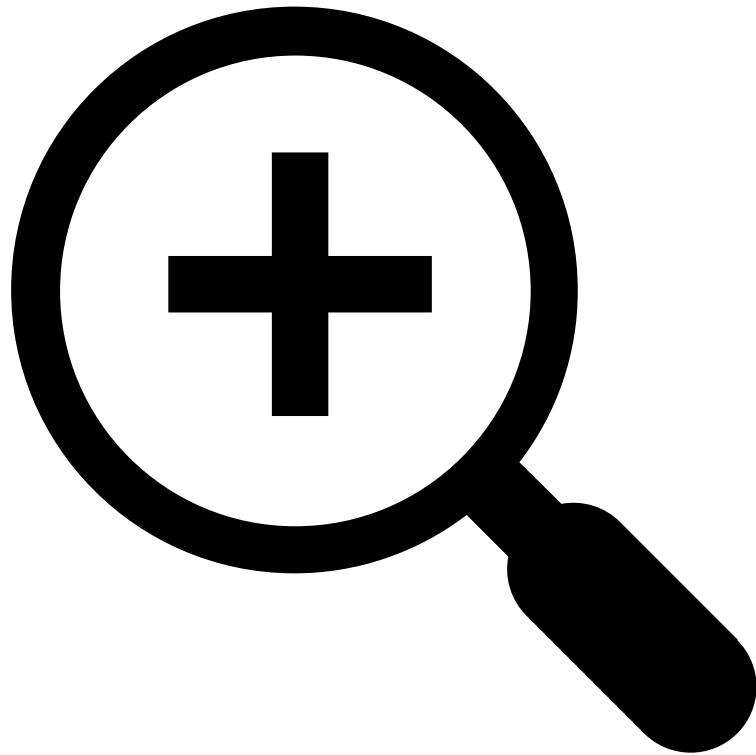
Traction

SECTION 7



Cerebral Capital

Product Rollout & Sales (reduces financial or production risk).



Are you creating web visitors?

- ✓ Your web sites search engine optimization should yield organic traffic.
- ✓ Thought leadership; networking at events, should produce more direct traffic.
- ✓ Encouraging, incenting, and making it easy for existing users of your offering to post reviews online and or introduce your solution to their contacts digitally thereby generating viral traffic.

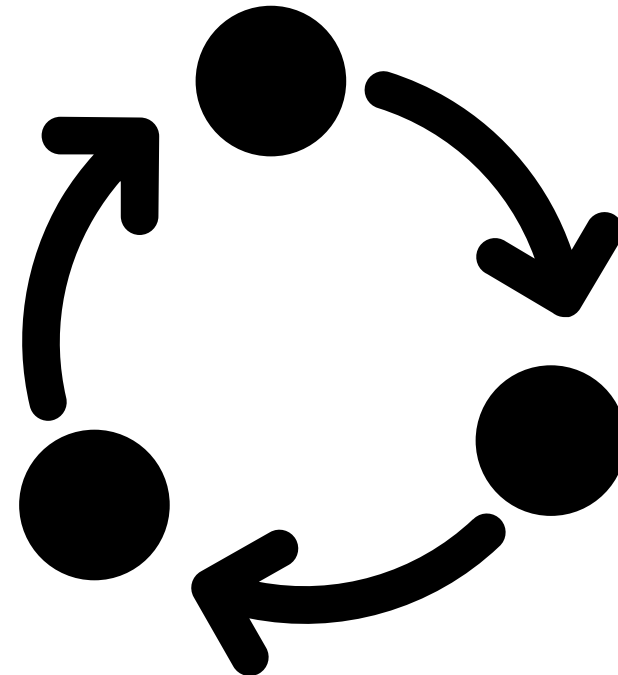
Product Rollout & Sales (reduces financial or production risk).

Are you causing conversions?

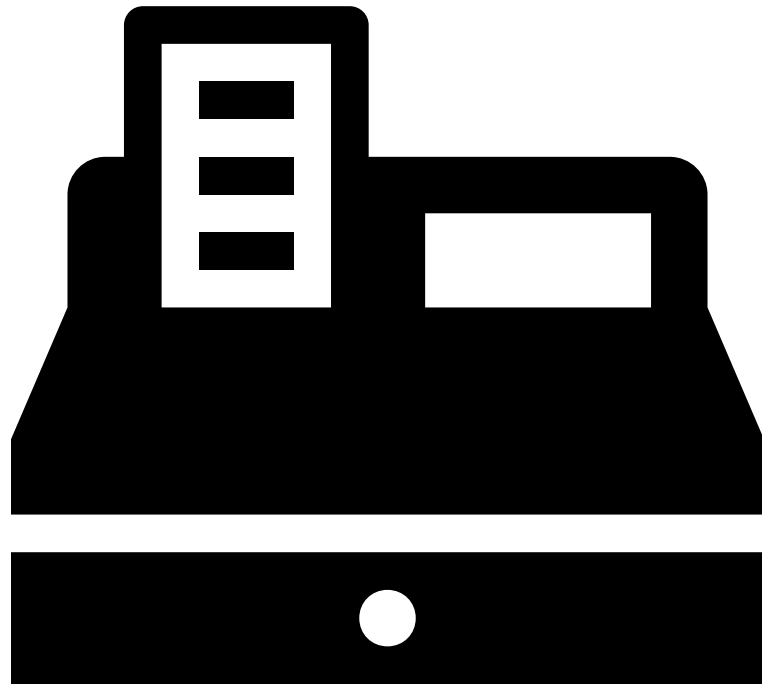
How effective is your website, your landing pages or app store page at communicating the value proposition?

Do you close with compelling strong "Call to Action" and are your visitors converting from;

- ✓ Visitors to subscribers?
- ✓ Subscribers to free users?
- ✓ Free users to paid users?



Product Rollout & Sales (reduces financial or production risk).



Are you generating cash?

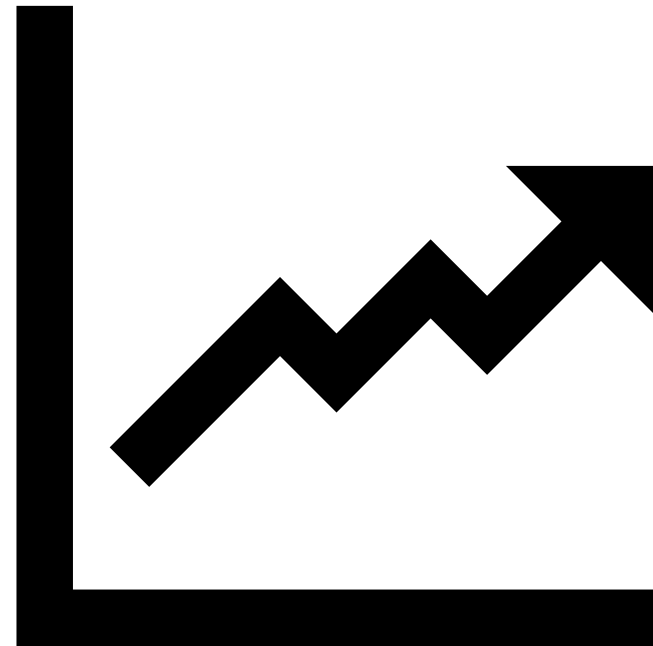
"Show me the money" , a well-known phrase uttered by characters in the 1996 film Jerry Maguire. Are user converting from:

- ✓ Paid users to more feature rich upgraded offerings?
- ✓ More feature rich upgraded offering to premium paid users?
- ✓ Extending user adoption through your partner solutions where your offering is becoming part of a more complete ecosystem, and you earn potential referral commission?

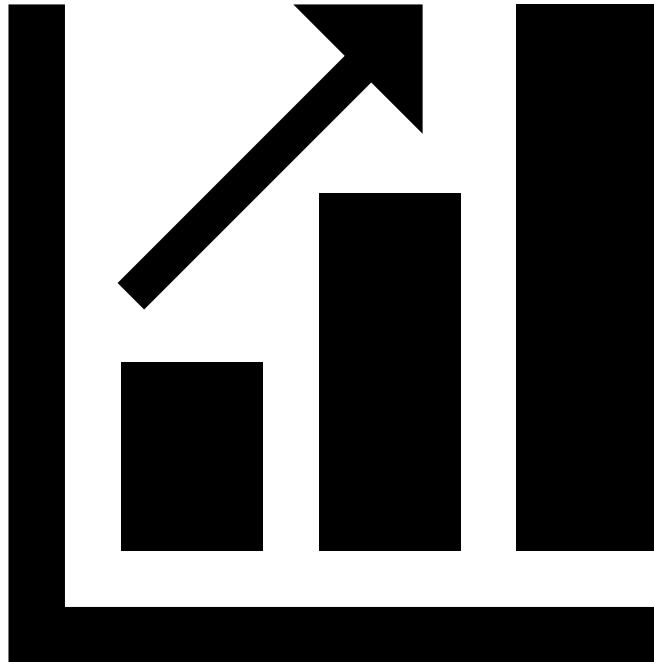


Product Rollout & Sales (reduces financial or production risk).

- ✓ The metrics of **Traction**, if the conversion ratios are improving week over week, month over month you have traction!
- ✓ **Traction** makes it easier to interest existing friends & family investors for a follow on round and new investors to participate in your Seed round.



Product Rollout & Sales (reduces financial or production risk).



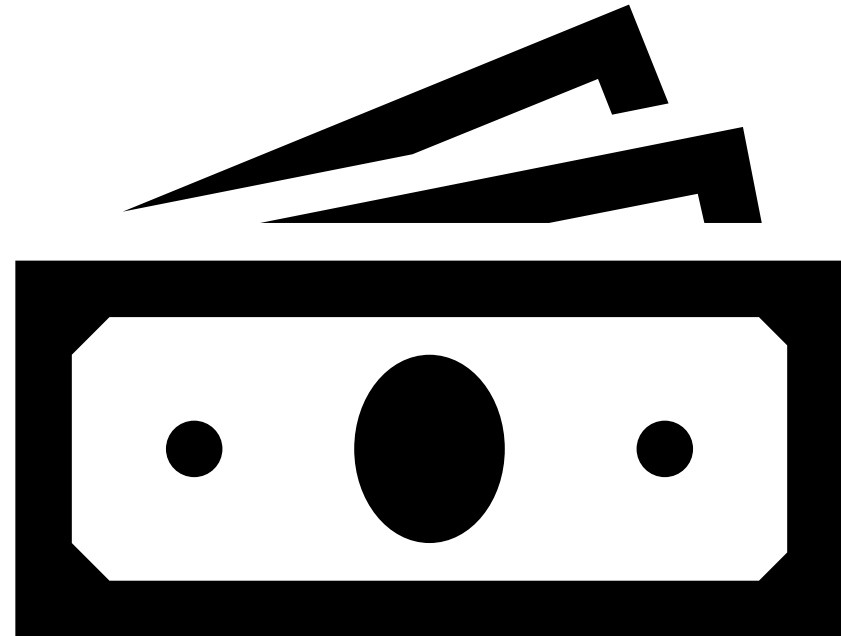
As Martin Zwilling wrote "*Traction is evidence that your product or service has started that “**hockey-stick**” adoption rate which implies a large market, a valid business model and sustainable growth.*

*Investors want evidence that the “**dogs are eating the dog food**” and your financial projections are not just a dream.”*

Product Rollout & Sales (reduces financial or production risk).

✓ Profitability

- ? What is the gross margin of each sale (by product)?
- ? What are your fixed monthly costs?
- ? What are your variable monthly costs?
- ? What is your monthly break-even point?
- ? Do you have diversified revenue streams?
- ? Have you created supply chain integrity?



Investor thinking

- Is the Traction tangible...
 - Do they have paying users?
- What is the Life Time Value (LTV) of the customers...
 - Is it properly calculated?
 - actual versus projected value?
 - Is the value increasing?
- What is the cost of customer acquisition (CAC)?
 - Is it properly calculated?
 - actual versus projected value?
 - Is the cost diminishing?

Business models

Section 8

What is a business model?

“Answers the fundamental questions: How do we make money in this business? What is the underlying economic logic that explains how we can deliver value to customers at an appropriate cost?”

Harvard Business Review: What Is a Business Model? by
Andrea Ovans, January 23, 2015

Types of business models (some examples)



Subscription



Enterprise



E-commerce



SaaS



Transactional



Advertising



Usage-based



Marketplace



Hardware

Enterprise

An enterprise company sells services or software to other businesses on a single-license basis.

These contracts have fixed terms, designated contract values, and come up for renewal at the end of the term.

METRIC	DEFINITION
BOOKINGS	<i>Sum of value of all customer contracts (note: letters of intent and verbal agreements ≠ bookings)</i>
TOTAL CUSTOMERS	<i>Total number of unique contracted customers today</i>
REVENUE	<i>Revenue is recognized when the service is actually provided or ratably over the life of the agreement</i>

Common mistakes

- Don't use Bookings and Revenue, or Bookings and ACV (Annual Contract Value), interchangeably
- Don't include letters of intent (LOIs) and verbal agreements in bookings → they are NOT yet bookings!

SaaS

A SaaS (software-as-a-service) company sells subscription-based licenses for a cloud-hosted software solution

METRIC	DEFINITION
MRR (Monthly Recurring Revenue)	Revenue recognized for recurring services rendered in a given month (does not include one-time, or non-recurring, revenue such as fees and professional services revenue)
ARR (Annual Recurring Revenue)	Measure of revenue components that are recurring in nature on an annual basis ($ARR = MRR * 12$)
GROSS MRR CHURN	Monthly recurring revenue lost in a given month / monthly recurring revenue at the beginning of the month
PAID CAC	Cost per customer acquired through paid marketing channels (total sales and marketing spend in a given month / total customers acquired via paid channels, including via sales, in a given month)

Common mistakes

- Don't use Annual Recurring Revenue (ARR) and Annual Revenue Run-Rate interchangeably
- Multiplying one month's all-in revenue by 12 = Annual Run-Rate, not Annual Recurring Revenue
- Don't include one-time or non-recurring revenue such as fees and professional services revenue in your monthly recurring revenue (MRR) calculation → only include recurring revenue

Usage-based

A usage-based company prices their service based on a customer's usage over a given period, denominated by what the company's service is (e.g., \$ per API call)

METRIC	DEFINITION
MONTHLY REVENUE	Total Revenue recognized for services rendered in a given month
REVENUE CMGR (Compound Monthly Growth Rate)	Implied compounded monthly revenue growth rate between two disparate months [CMGR = (latest month revenue / first month revenue) ^ (1 / # of months) - 1]
REVENUE RETENTION	Total revenue from customers in the current month who were also customers in the previous month/ total revenue from all customers in the prior month. Also often looked at on an annual basis
GROSS MARGIN	Gross profit in a given month / total revenue in the same month (gross profit equals total revenue less cost of sales and goods sold)

Common mistakes

- Referring to usage-based revenue as recurring revenue.
- Usage-based revenue is dependent on volume and is not recurring in nature. Do not use the terms interchangeably

Subscription

A subscription company sells a product or service, usually to a consumer, on a recurring basis.

METRIC	DEFINITION
MRR (Monthly Recurring Revenue)	Revenue recognized for recurring services rendered in a given month (does not include one-time, or non-recurring, revenue such as fees and professional services revenue)
MRR CMGR (Compound Monthly Growth Rate)	Implied compounded monthly MRR growth rate between two disparate months [CMGR = (latest month MRR / first month MRR) ^ (1 / # of months) - 1]
GROSS USER CHURN	Total lost customers (cancelled subscriptions) in a given period / prior period total customers
PAID CAC	Cost per customer acquired through paid marketing channels (total sales and marketing spend in a given month / total customers acquired via paid channels, including via sales, in a given month)

Don't measure CMGR as a simple average of discrete monthly growth rates → use right CMGR formula!

Transactional

A transactional company enables a financial transaction on behalf of a customer and collects a fee (usually a percent of the underlying transaction).

METRIC	DEFINITION
GROSS TRANSACTION VOLUME	<i>Total sales or payment dollar volume transacted in a given period</i>
NET REVENUE	<i>The portion of GTV that the company recognizes as revenue for services rendered</i>
USER RETENTION	<i>Percent of customers who go on to make at least one purchase in month 2 (note: this is a cohort metric)</i>
PAID CAC	<i>Cost per customer acquired through paid marketing channels (total sales and marketing spend in a given month / total customers acquired via paid channels, including via sales, in a given month)</i>

Common mistakes

- Gross Transaction Volume and Revenue are NOT the same thing → revenue = the \$'s you keep!
- User retention is a cohort* metric, meaning it is re-calculated to include each new cohort acquired
- *Cohort = a group of customers acquired within a given period (usually a 28-day “month”)
- *Retention can be calculated on a month 2, month 6, or month 12 basis (depending on your business model)

Marketplace

A marketplace company acts as an intermediary in the sale of a good or service between sellers and buyers, generally collecting a percent of the total transaction value.

METRIC	DEFINITION
GMV (Gross Merchandise Value)	Total sales dollar volume of merchandise transacted in a given period
NET REVENUE	The portion of GMV that the company recognizes as revenue for services rendered
NET REVENUE CMGR (Compound Monthly Growth Rate)	Implied compounded monthly net revenue growth rate between two disparate months [CMGR = (latest month net revenue / first month net revenue) ^ (1 / # of months) - 1]
USER RETENTION	Percent of customers who go on to make at least one purchase in month 2 (note: this is a cohort metric)
PAID CAC	Cost per customer acquired through paid marketing channels (total sales and marketing spend in a given month / total customers acquired via paid channels, including via sales, in a given month)

- Common mistakes
- Paid CAC: failing to include all costs associated w/ user acquisition such as referral incentives, discounts, credits, etc

E-Commerce

An e-commerce company sells physical goods online.

Some, e-commerce companies manufacture and inventory those goods.

METRIC	DEFINITION
MONTHLY REVENUE	Total revenue in a given month
REVENUE CMGR (Compound Monthly Growth Rate)	Implied compounded monthly revenue growth rate between two disparate months [CMGR = (latest month revenue / first month revenue) ^ (1 / # of months) - 1]
GROSS MARGIN	Gross profit in a given month / total revenue in the same month (gross profit equals total revenue less cost of sales and goods sold)
PAID CAC	Cost per customer acquired through paid marketing channels (total sales and marketing spend in a given month / total customers acquired via paid channels, including via sales, in a given month)

- Common mistake
- Gross profit: not breaking down all costs included and those excluded in gross profit calculations

Advertising

An advertising company offers a free service to consumers and derives revenue entirely, or predominantly, from advertisers. Common advertising companies include social networks and content sites.

METRIC	DEFINITION
DAILY ACTIVE USERS (DAU)	Total number of unique users active in a 24-hour day, averaged over a given period of time
MONTHLY ACTIVE USERS (MAU)	Total number of unique users active at least once in last 28-days
PERCENT LOGGED-IN	Total monthly active users with a registered account ("logged-in") divided by the total unique visitors (inclusive of both "logged-in" and "logged-out") during the same 28-day window

- Common mistake
- Not defining what “active” means in the context of your business

Hardware

Hardware company sells physical devices to consumers or businesses

METRIC	DEFINITION
MONTHLY REVENUE	Total revenue in a given month
REVENUE CMGR (Compound Monthly Growth Rate)	Implied compounded monthly revenue growth rate between two disparate months [CMGR = (latest month revenue / first month revenue) ^ (1 / # of months) - 1]
GROSS MARGIN	Gross profit in a given month / total revenue in the same month (gross profit equals total revenue less cost of sales and goods sold)
PAID CAC	Cost per customer acquired through paid marketing channels (total sales & marketing spend in a given month / total customers acquired via paid channels, including via sales, in a given month)

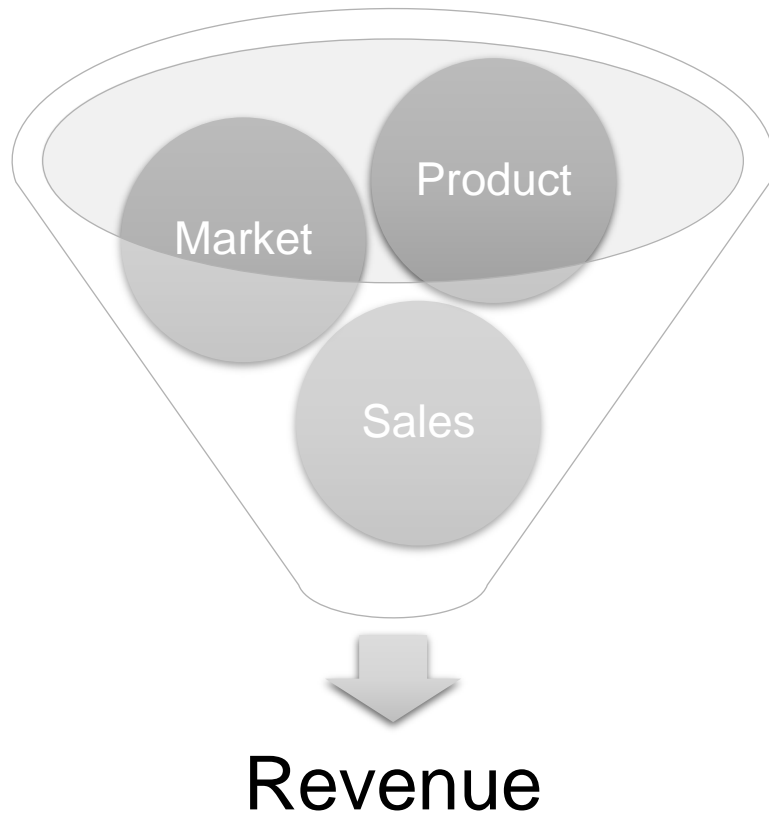
Investor thinking

- What is the business model...
 - Have they identified their model correctly?
 - A simple model?
 - A complex mix of models?

Forecasting

Section 9

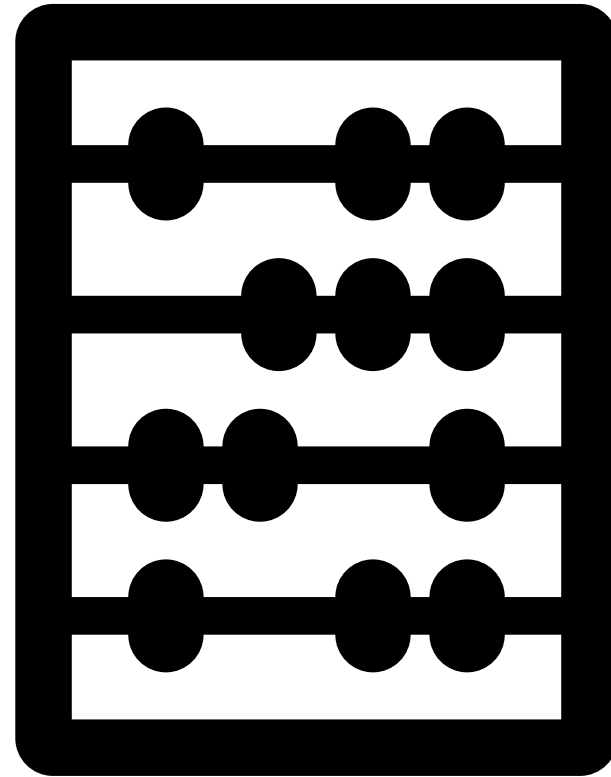
Forecasts



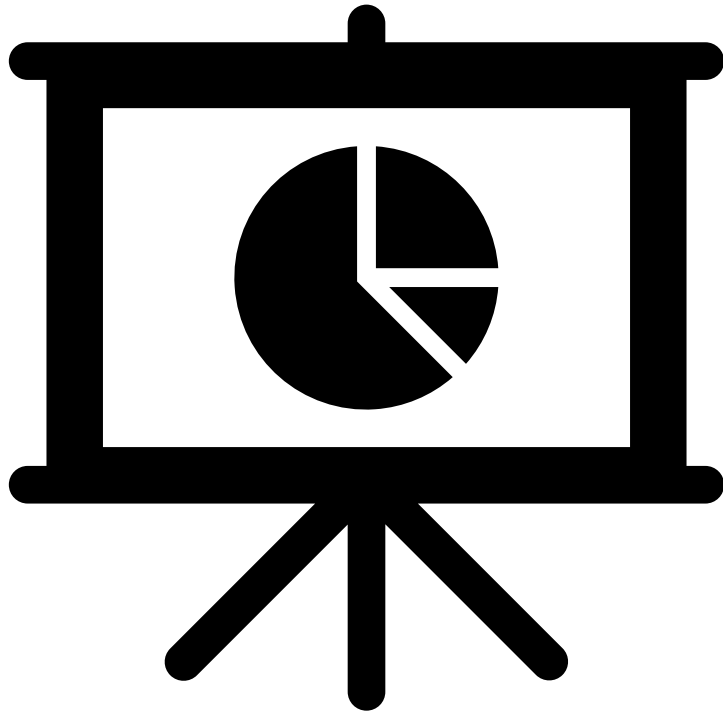
Until you have a predictable sales engine, forecast revenue extremely **CONSERVATIVELY**.

Forecasts

DON'T build a lot of cushion into your expense forecast.



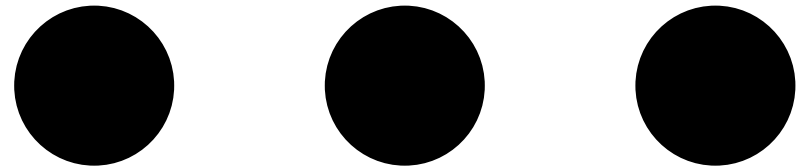
Forecasts



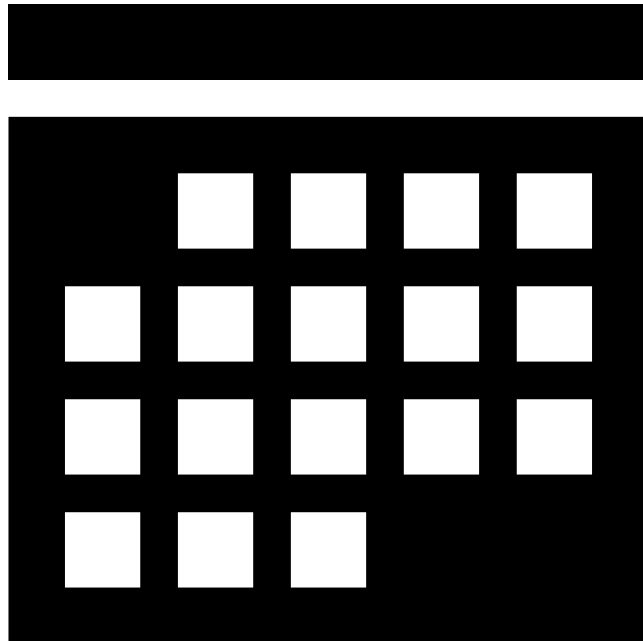
Compare actual results to your forecast EVERY MONTH.

Forecasts

Don't blindly assume you will
make up a sales shortfall in the
following period



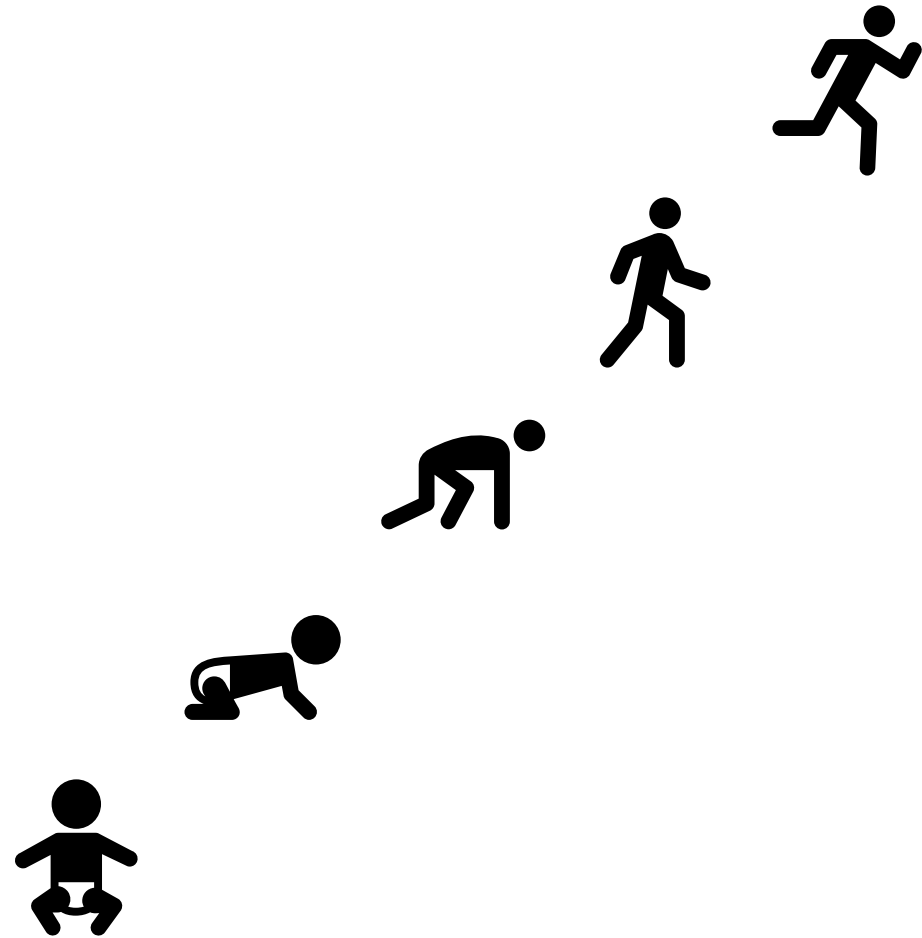
Forecasts



- Forecast for a shorter period
- Number of Months to Revenue
- Months to profitability
- Show past quarters and next 8 quarters

Forecasts

Update weekly your rolling 13-weekly sources and use of cash forecast



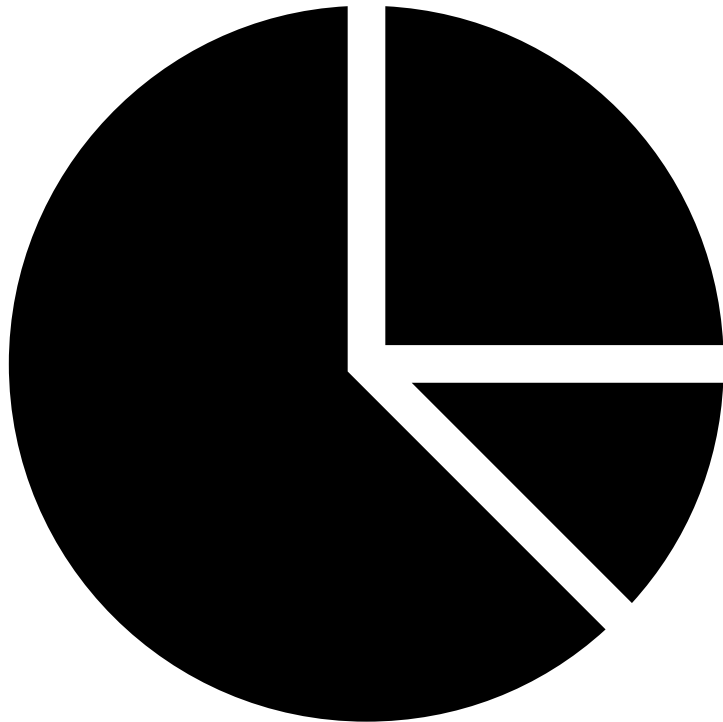
Investor thinking

- Conservative forecasts?
- Churn rate? Causes?
- Compound growth rate?
- Past forecasts met, over, under achieved past forecast?
- What have been the learning for the team?

The ask

Section 10

Ask



- Consider implied ownership cost.
- The more equity you raise the more ownership you will need to give up.
- Understand market comparables

Ask

Type of investor.

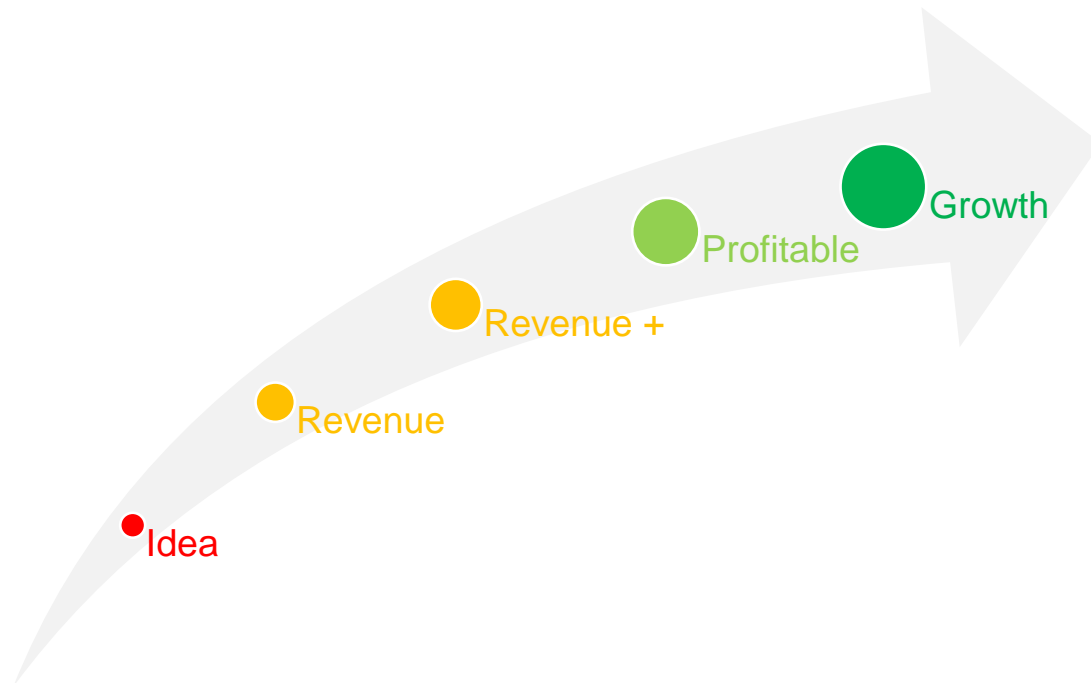
Venture Growth / Institutional  \$3MM+

Seed / Angel Investors  \$25K – \$2MM*

Friends & Family  \$10K - \$250K*

* The Investment round consists of more than one investor

Ask

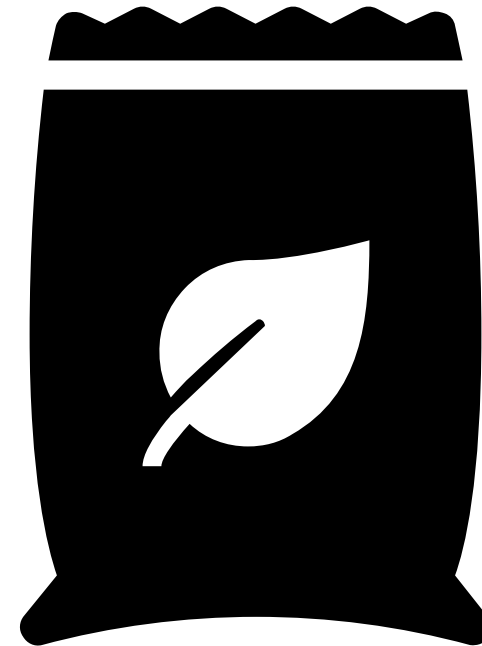


Company stage:

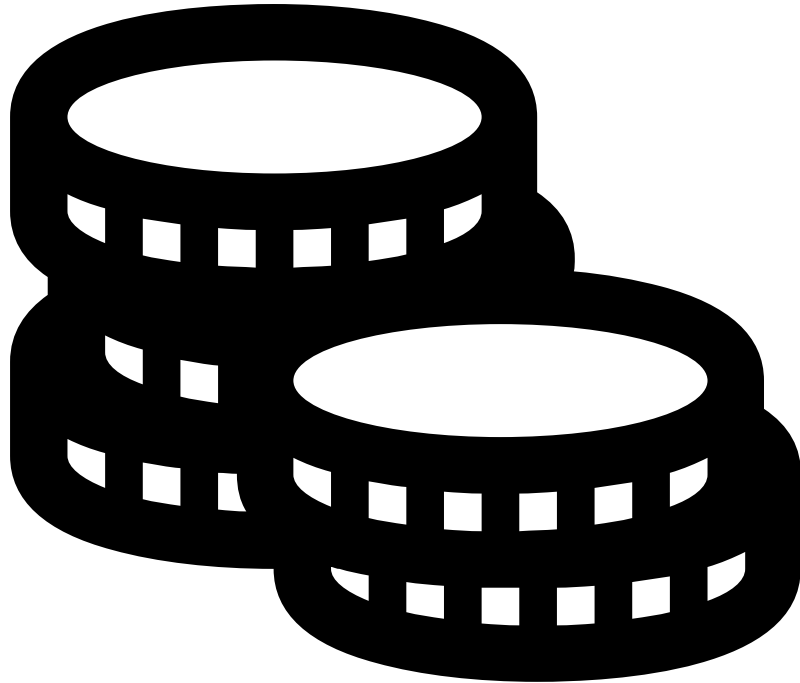
- **Idea = Founders, Friends & Family**
- **Revenue -\$3MM = Angels**
- **Revenue \$3MM+ = Venture Capitalist**
- **Profitable = Venture Capitalist**
- **Growth = Venture Capitalist**

Ask

Calculate what you need and
add a buffer.



Ask

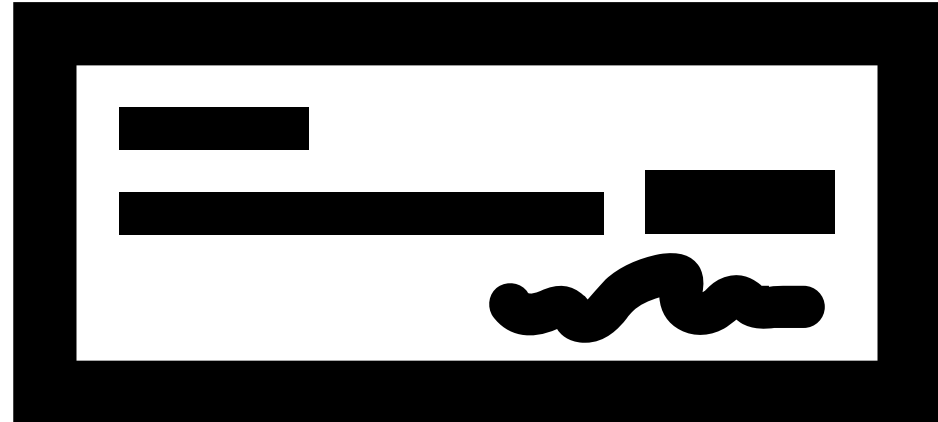


Investment terms.

- SAFE
- Convertible Note
- Equity

Ask

Single or staged delivery.



Ask

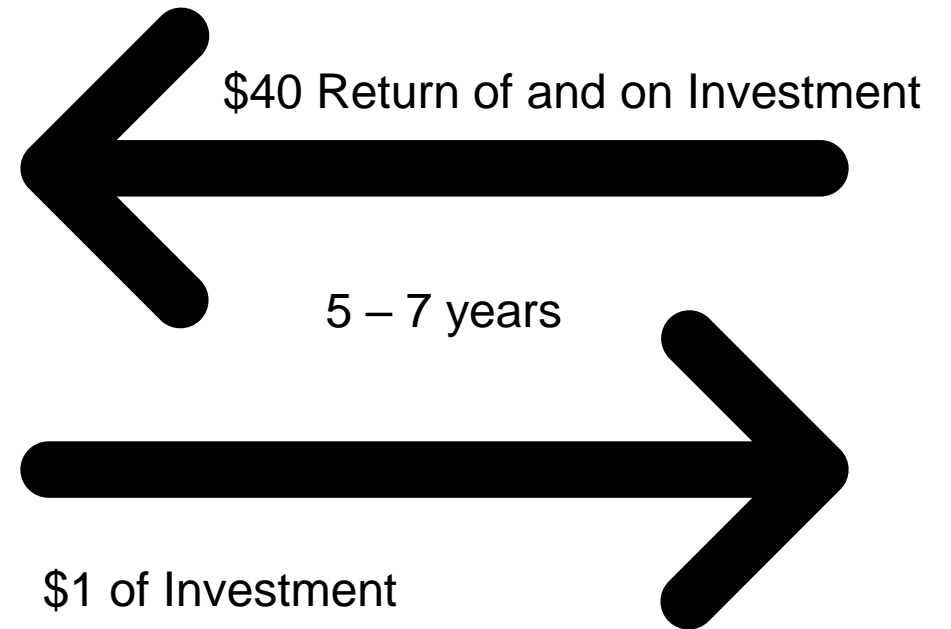


Use of funds.

- Research Development
- Sales & Marketing
- General & Administrative

Ask

Projected return on investment.



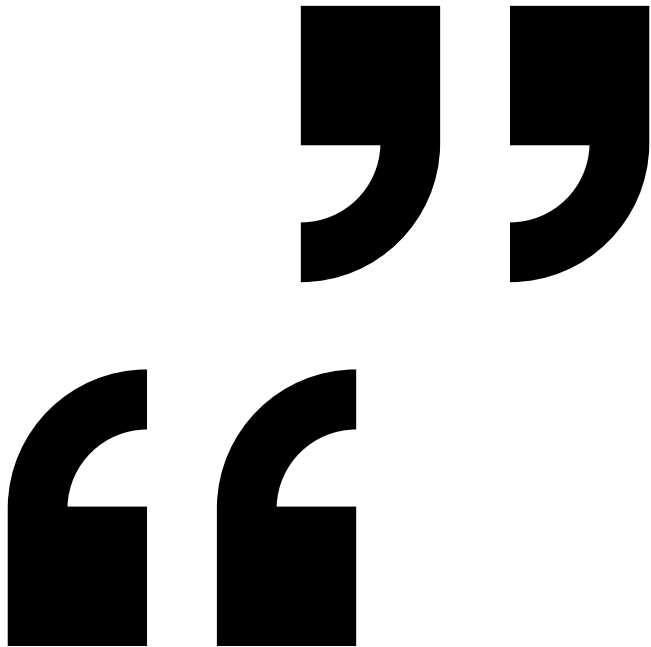
Investor thinking

- Founders paid above or below market?
- Capital allocation R&D versus S&M makes sense for stage of business?
- Fixed expenses are too high, too low, about right?
- Raise is too small, too large, sufficient to reach their objective?
- Have they exhausted Government grants and receivable financing?

Use of Proceeds

Section 11

Use of Proceeds



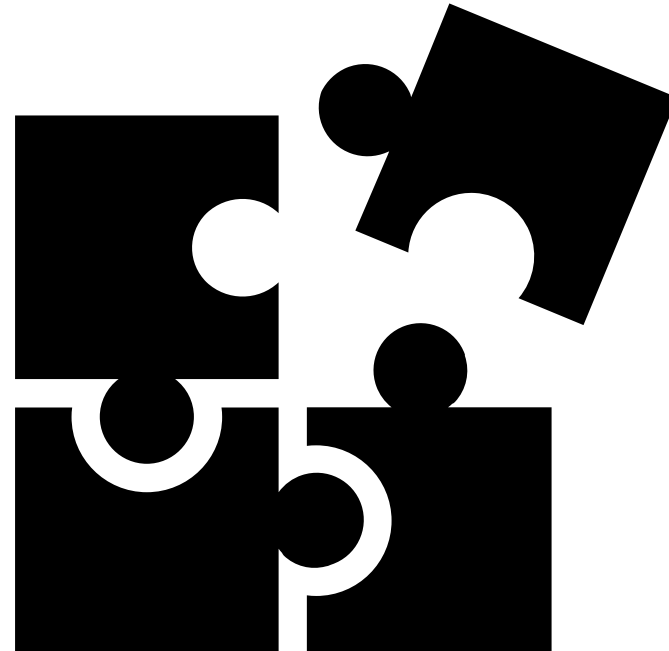
Written summary

- In the written summary, the company’s management lists the areas of the business that require financing and how much money will be invested in each area.
- The statement starts with the amount of net proceeds. In real life, the amount of net proceeds is lower than the amount of total proceeds due to the expenses associated with the issuance of shares or debt instruments.
- The author can then list the areas of expected expenditures, with the amounts of money allocated to each area.
- Note that the figures presented in the use of proceeds statement are generally rounded off to the nearest thousand or million.

Use of Proceeds

Graph or chart

- Alternatively, the use of proceeds can be presented in the form of graphs or charts.
- The graph format is particularly suitable for presentations shown to prospective investors.
- Generally, a pie chart and a donut chart are the primary options for a graphical representation, but other types of charts may also be used.



Importance of the Use of Proceeds Statement

In some cases, the use of proceeds statement can significantly affect a company's ability to raise capital successfully.

A properly created statement, with a reasonable allocation of money, can be an easy "convincer" for investors.

Conversely, if a company fails to show a justifiable explanation of the allocation of funds, investors may not be interested in contributing capital.

Investor thinking

- Am I providing a blank cheque?
- How many ways can I ensure a return **of** my Capital?
- How many ways can I ensure a return **on** my Capital?

Investor thinking

- Cash is all going into the company's Treasury?
- No existing debt to retire?
- No contingent liabilities?
- No outstanding shares being bought back?
- Existing outside shareholders participating in this round?
- No creation of separate share classes?

Valuation

SECTION 12



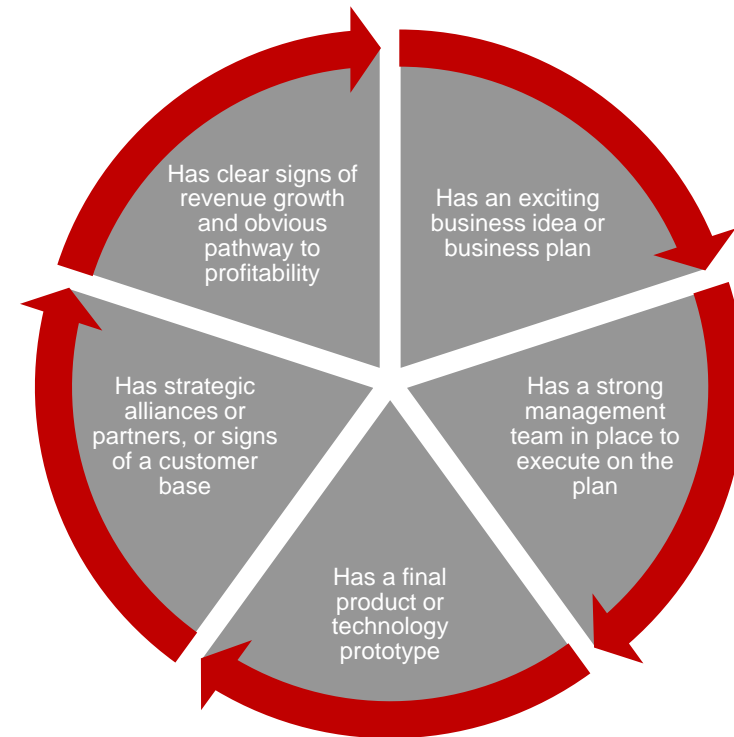
Cerebral Capital

What determines the value in an early stage organization?

Methodologies (not exhaustive)

- Cost-to-duplicate
- Market multiple
- Discounted cash flow (DCF)
- Valuation by stage
- What an independent 3rd party paid
- Comparable transaction
- Fear of missing out (FOMO)

Estimated qualitative potential



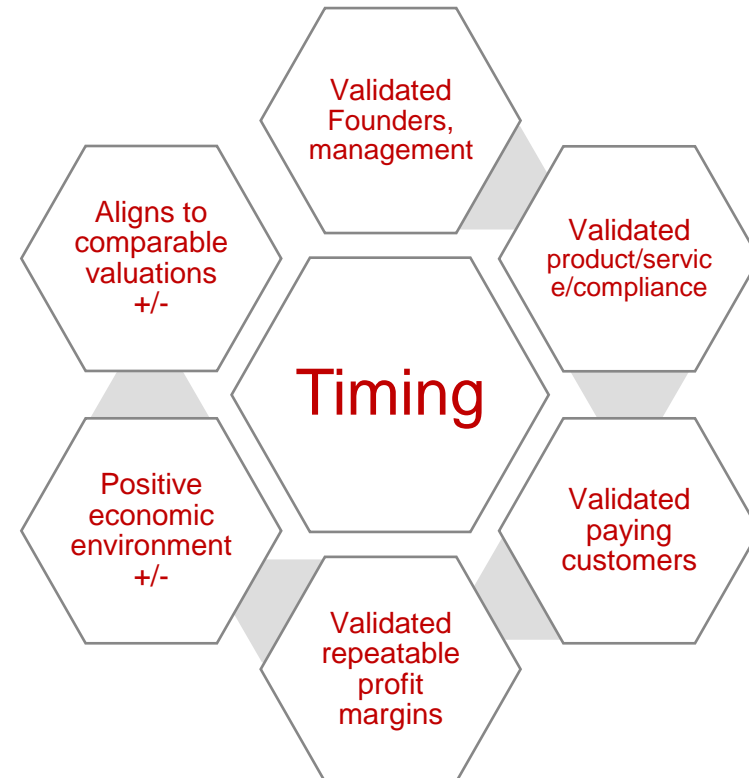
Not always chronological, each of the above elements reinforces the other

What determines the value in an early stage organization?

Methodologies (not exhaustive)

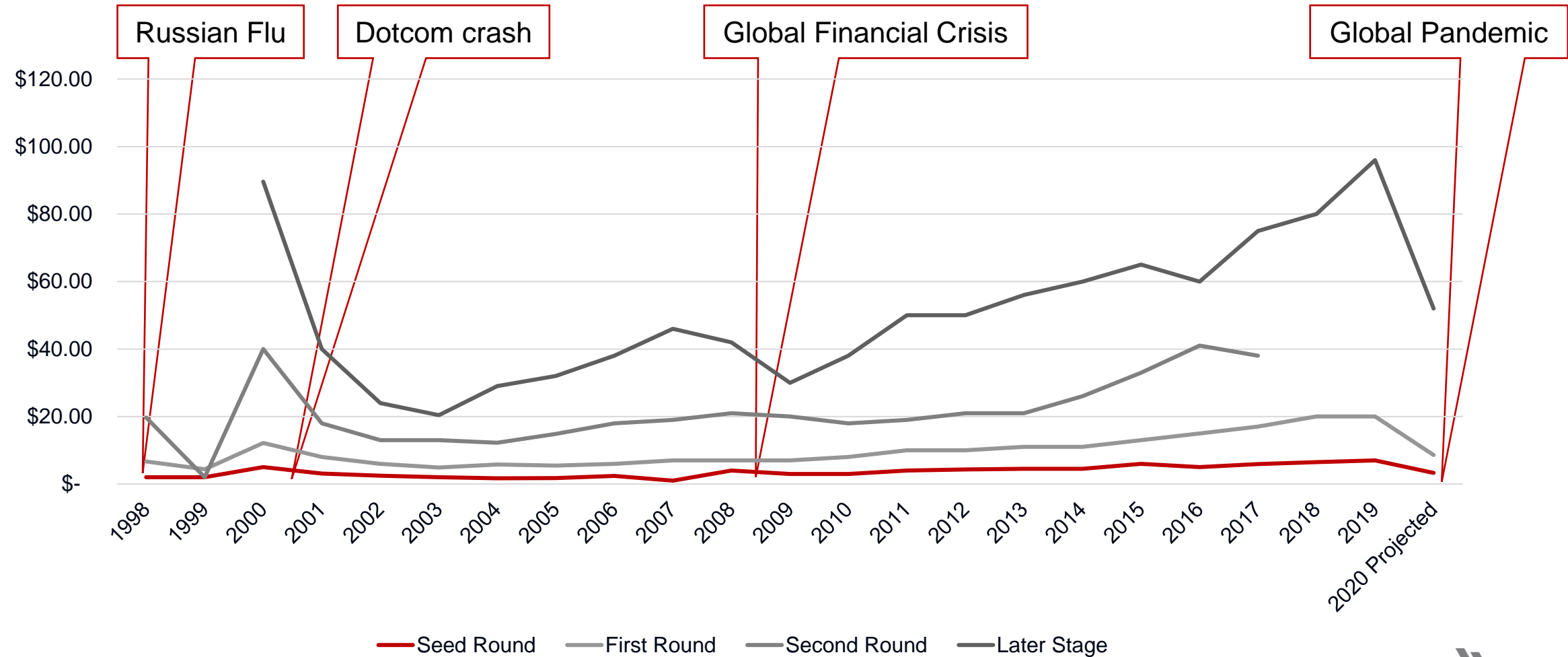
- Cost-to-duplicate
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Estimated qualitative potential



Discount the potential if it lacks elements of the above...

Median pre money valuations



Sources; Kaufman Foundation, Pitch book

Investor Thinking

- Valuation proposed recognises where we are at in the credit cycle?
- Can they defend their valuation?
- What is the rationale for the valuation?
- Is it reasonable valuation?

Understand Investors

SECTION 13

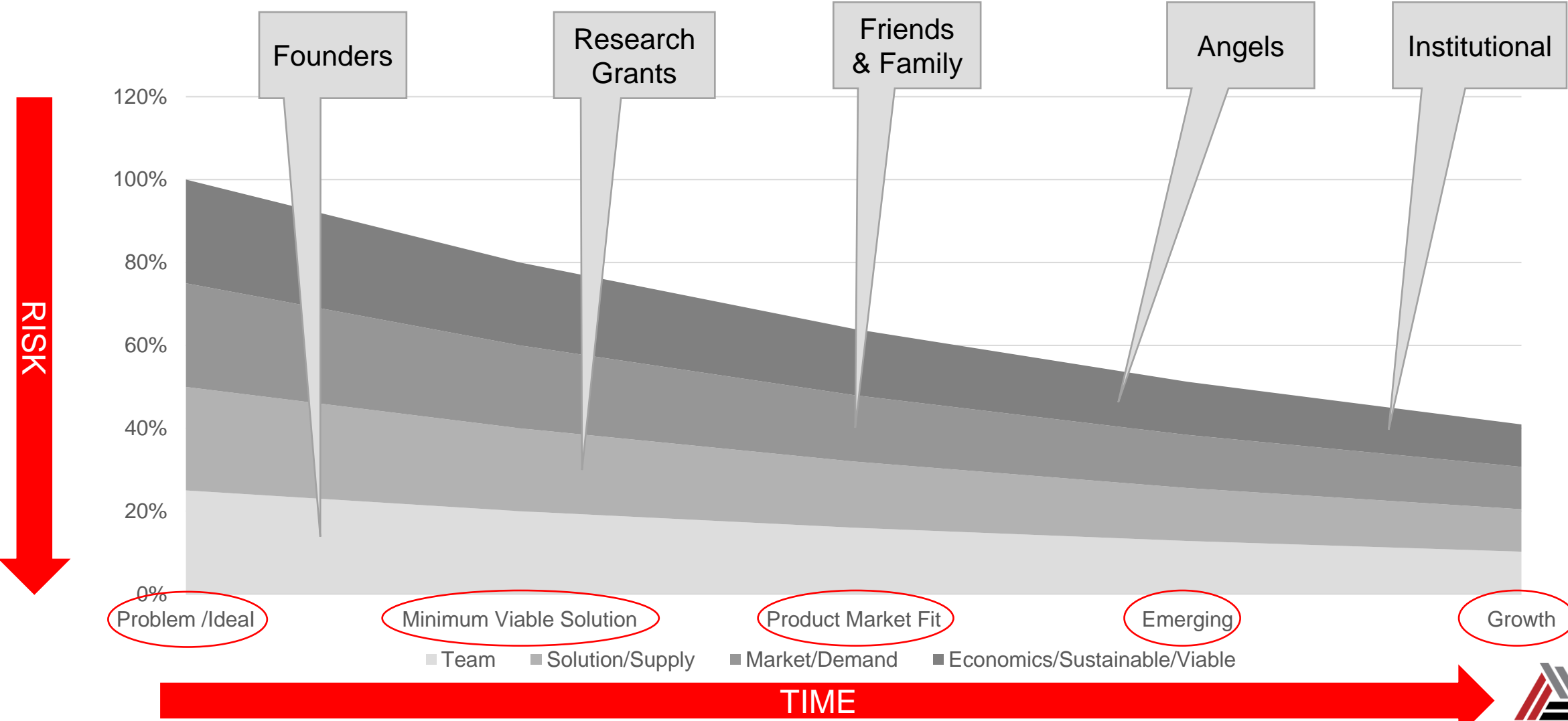
Demonstrate your ability to understand and share the concerns of an investor.



Imagine yourself in the shoes of the investor;

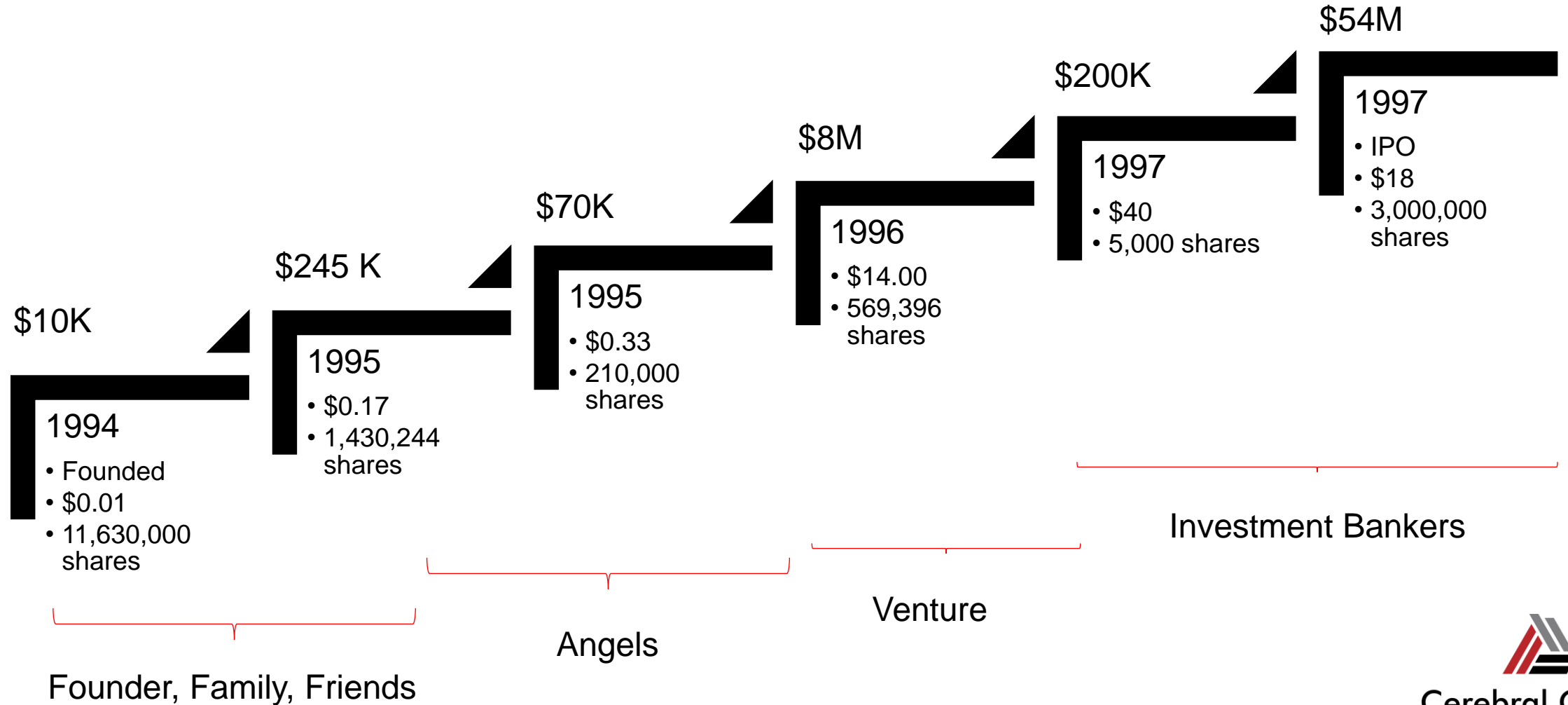
Would you as an investor. An individual, who is constantly looking at many emerging investment opportunities, invest in a business without the qualitative elements working very well?

Investor risk



An example

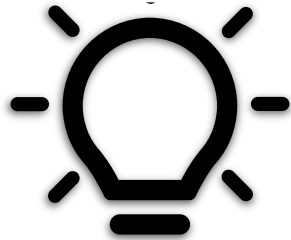
Funding of a start-up



Summary



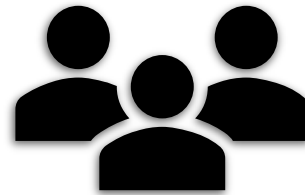
CEO role



Idea



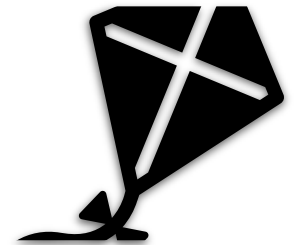
Prototype



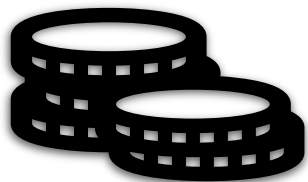
Team



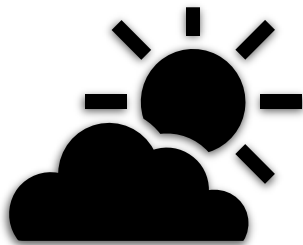
Strategic Relationships



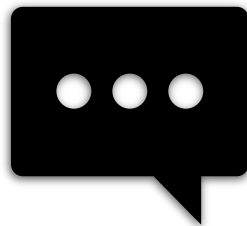
Traction



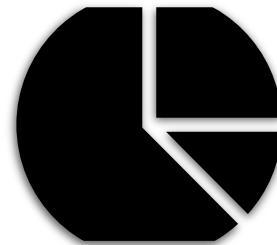
Business Models



Forecasting



The Ask



Use of Proceeds



Valuation



Investors



End

Questions & Answers

About

Cerebral Capital Inc. was founded in 2002 as an advisory & investment vehicle through which I advise and or invest in startups and established companies.

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I serve as an Advisor to founders, entrepreneurs, chief executives, mentoring recent business school graduates & newly immigrated executives.

Seeking board governance roles and advisory work aiding founders and business owners through strategic and financial decisions.

I'm a pioneering technology and financial service executive. Leading, innovating and building multiple high-performing teams that scaled to grow 80X' assets 25X revenues and 18X earnings.

A founding member of 5 privately-owned start-ups, 2 start-up business units within the public company environment, having led turnarounds of 3 Canadian and 1 European subsidiary of a public company.

Built cultures and led teams that achieved Growth 500 #growthlist status for 5 consecutive years and Top 100 Small & Medium Enterprise Employer honors for 2 consecutive years.



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