

Intro to Venture Capital

February 5, 2020

Mitch Mumma
Intersouth Partners

www.intersouth.com
[@intersouth](#)



Overview

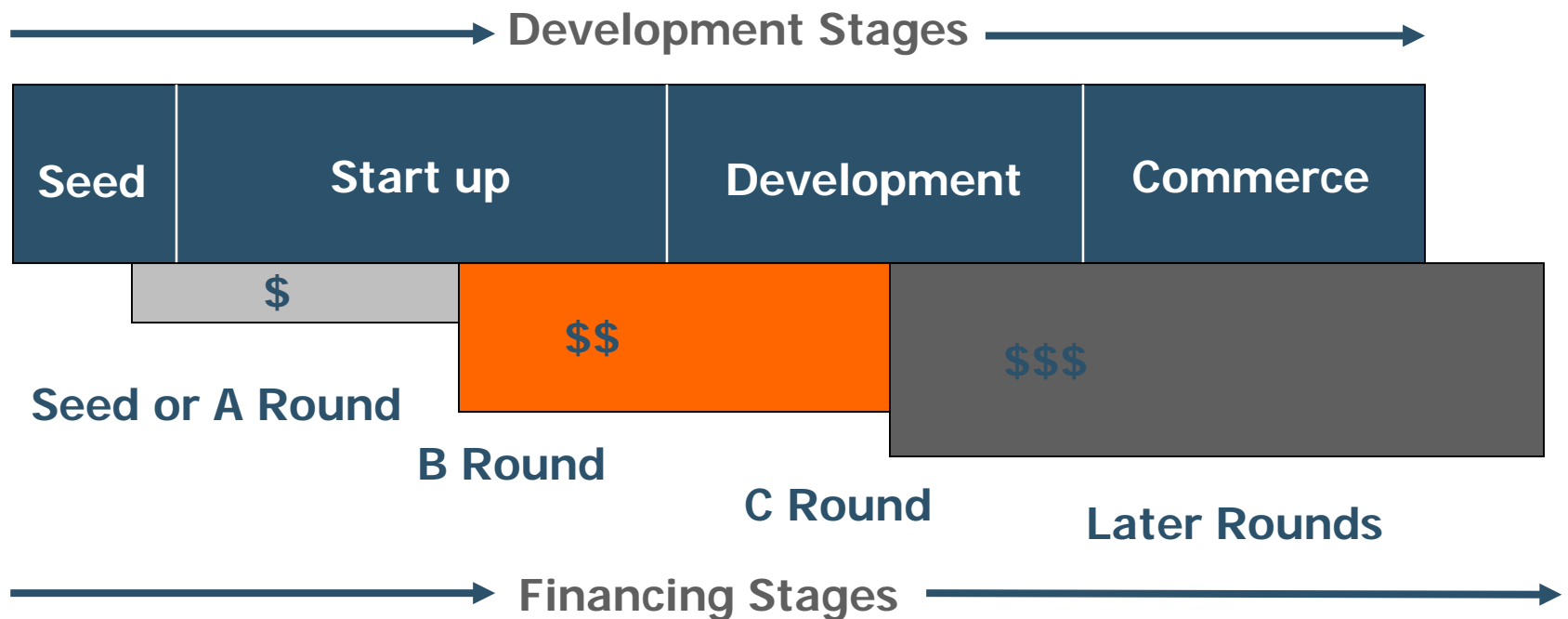
- > Intersouth Partners overview
- > The venture capital industry
- > How venture capital works
- > Helpful concepts

Intersouth Partners

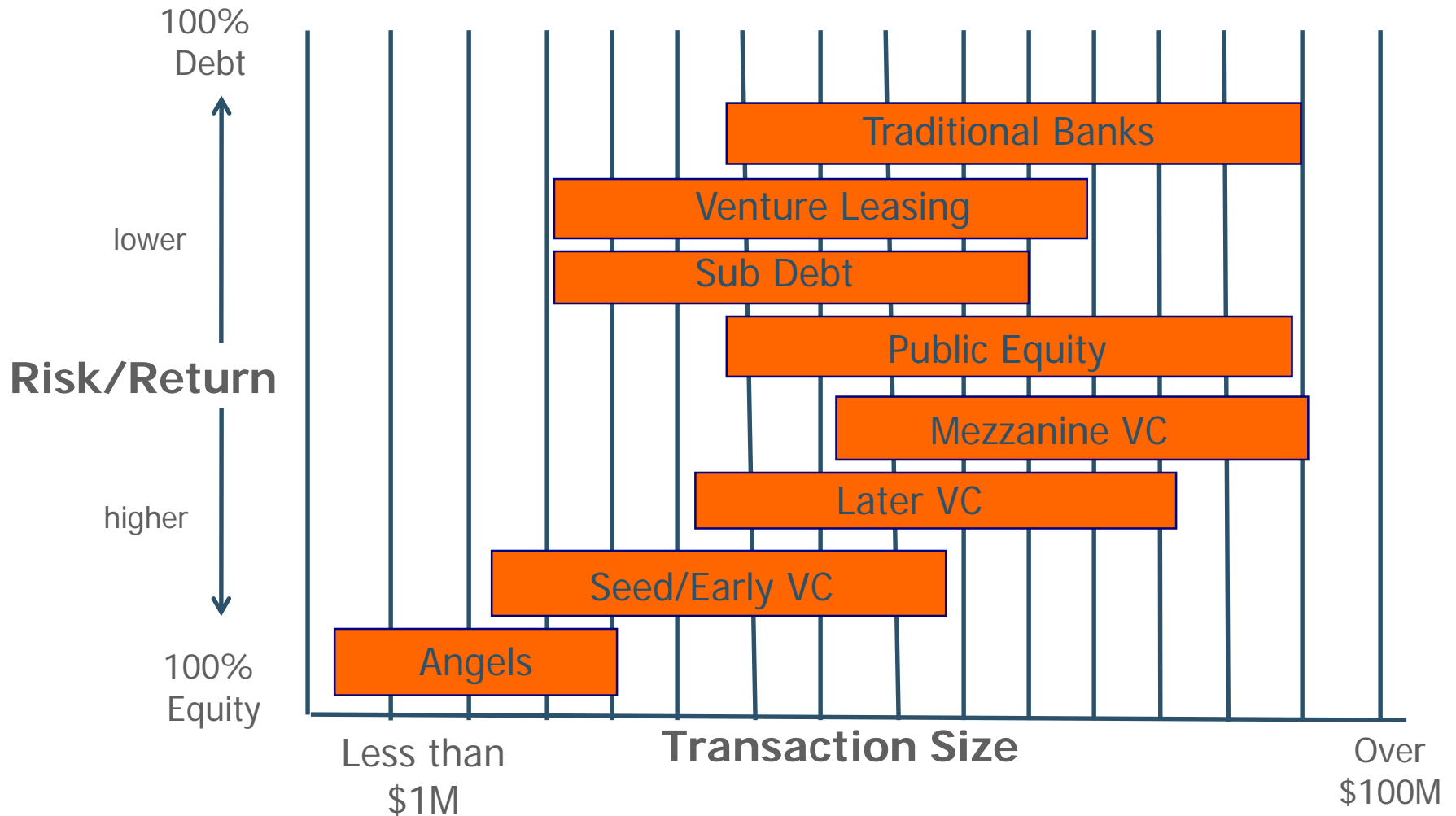
- > Classic venture funds since 1986
 - » Early stage
 - » Technology & life sciences
 - » Southeast focus
- > \$780 million under management
 - » Most recent fund \$275 million
 - » 6 prior funds from \$6 to \$200 million

Investing Style

- > Early Institutional Investor
- > Milestone Based



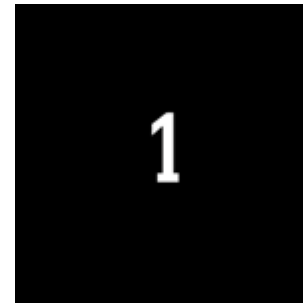
The money food chain



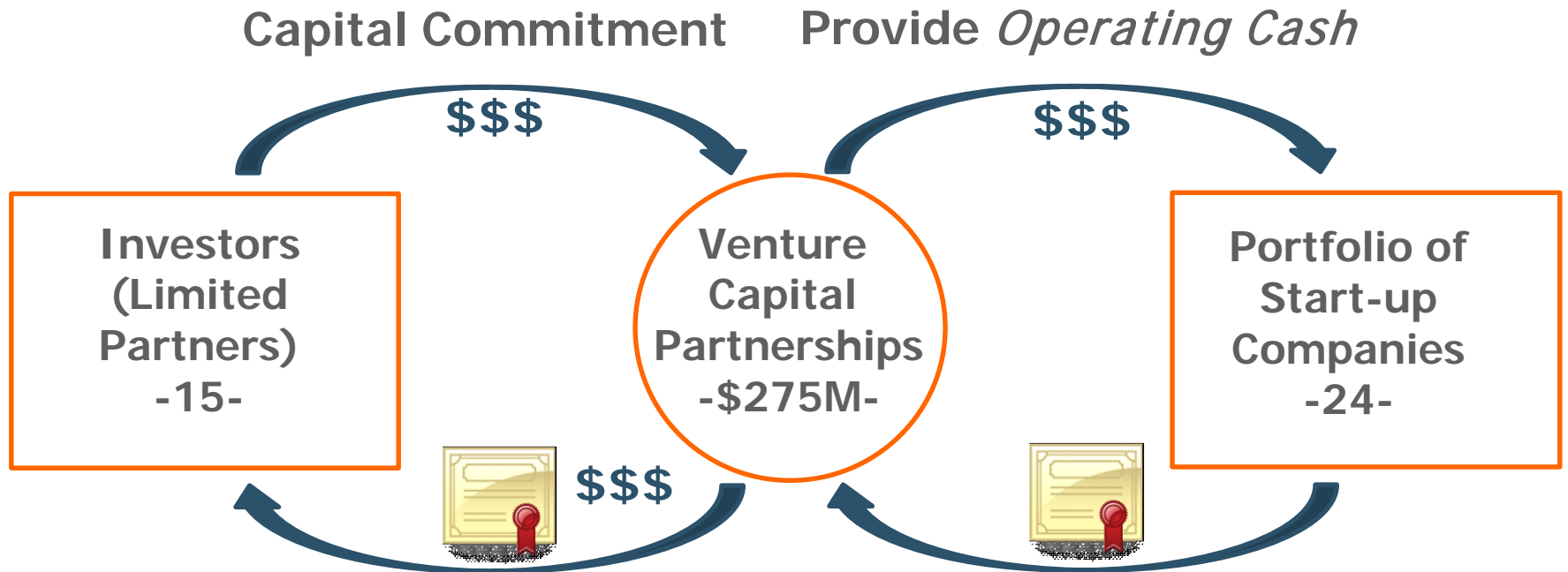
Venture debt

Specialty Finance Companies

Commercial banks



The VC cycle



VC returns remain favorable

Investment Type	1 Yr	3 Yr	5 Yr	10 Yr	15 Yr	25 Yr
Venture Capital	21.8	15.5	13.9	14.5	11.4	34.7
Nasdaq mPME	7.6	19.9	13.9	17.5	11.0	11.6
Russell 2000 mPME	-3.3	12.6	7.0	14.2	8.5	9.3
S&P 500 mPME	10.4	14.3	10.6	15.0	9.1	9.7

US Venture Capital Index and Selected Benchmark Statistics

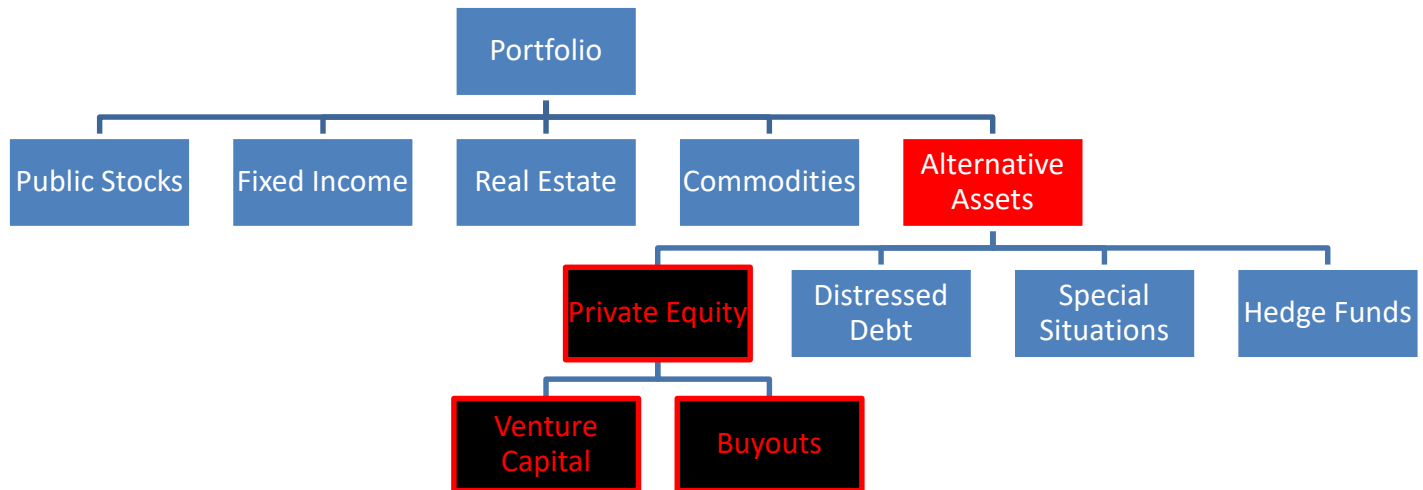
Data as of
June 30, 2018

US Venture Capital: Since Inception IRR & Multiples by Fund Vintage Year
Net to Limited Partners

Distribution: Paid In
Residual Value: Paid In
Total Value: Paid In

Vintage Year	Pooled Return (%)	Arithmetic Mean (%)	Median (%)	Equal-Weighted Pooled Return (%)	Upper Quartile (%)	Lower Quartile (%)	Standard Deviation (%)	DPI	RVPI	TVPI	Number of Funds
1988	18.88	14.26	11.87	14.68	21.65	6.61	13.79	2.43	0.04	2.46	26
1989	19.16	17.05	13.31	18.86	28.80	7.75	14.46	2.59	0.00	2.59	37
1990	33.11	24.07	21.54	26.25	31.19	14.28	19.60	3.15	0.00	3.15	17
1991	27.89	24.02	18.56	25.67	27.86	11.64	20.33	3.17	0.00	3.17	17
1992	32.53	27.71	18.31	37.95	26.88	10.60	31.20	3.07	0.00	3.07	21
1993	46.71	30.43	18.83	41.08	46.49	12.13	31.10	4.13	0.00	4.13	36
1994	59.31	34.16	25.87	43.43	48.55	6.76	47.72	5.41	0.00	5.41	41
1995	88.48	56.60	41.65	77.99	80.62	21.54	58.50	6.07	0.00	6.07	35
1996	101.41	61.71	37.06	89.14	81.04	9.11	79.02	4.96	0.01	4.97	40
1997	92.59	56.14	13.48	74.74	64.15	-1.34	102.42	3.12	0.00	3.12	70
1998	11.88	16.83	-0.26	14.28	15.19	-6.05	71.43	1.48	0.02	1.50	81
1999	-0.78	-3.48	-3.02	-1.31	3.20	-11.44	18.08	0.92	0.03	0.95	110
2000	0.82	-2.17	-0.88	0.43	5.07	-6.11	12.56	0.97	0.09	1.06	153
2001	3.24	0.54	2.25	4.61	8.06	-2.59	19.05	1.10	0.13	1.23	54
2002	-0.46	0.26	-0.89	2.61	5.57	-6.00	8.90	0.86	0.11	0.97	33
2003	9.42	2.54	1.94	6.04	9.33	-5.77	13.37	1.55	0.22	1.77	38
2004	8.50	2.52	2.75	8.28	8.78	-4.65	21.41	1.32	0.38	1.70	67
2005	7.53	3.00	4.82	7.36	10.26	-0.98	17.35	1.11	0.50	1.61	64
2006	9.16	4.68	7.90	7.54	12.59	-3.11	11.83	1.15	0.57	1.72	80
2007	15.65	14.26	10.77	16.07	21.91	5.01	15.59	1.36	0.78	2.15	68
2008	11.78	9.85	6.99	11.37	18.15	1.34	12.26	0.91	0.81	1.71	66
2009	15.75	13.81	12.95	14.45	18.78	6.36	12.54	0.94	1.05	1.99	23
2010	27.98	20.10	15.46	23.71	25.75	9.05	19.54	1.16	1.88	3.03	50
2011	19.42	12.63	13.98	15.53	22.18	1.94	14.95	0.57	1.48	2.05	45
2012	18.15	13.92	13.27	16.39	19.74	6.15	14.55	0.39	1.47	1.86	56
2013	20.27	22.64	14.08	18.17	21.28	7.73	51.25	0.25	1.39	1.64	58
2014	15.56	15.29	11.47	9.98	20.84	4.82	25.31	0.12	1.27	1.39	81
2015	17.32	17.58	11.97	15.12	23.54	3.75	37.86	0.07	1.21	1.28	61
2016	13.79	9.74	2.34	14.35	22.10	-4.94	27.51	0.01	1.11	1.12	68

Typical Asset Allocation



The Top 20 VC Firms* (April 2016)






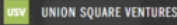














“Rank the top 20 firms as if you were an LP,
i.e. who would you invest in?”

- 70 VC firms based on track record and who had a realistic shot at getting a peer vote were polled.
- Only venture capital general partners were surveyed.”

* CBI and New York Times – April 2016

https://www.cbinsights.com/blog/venture-capital-peer-rankings/?utm_source=CB+Insights+Newsletter&utm_campaign=cd9af37674-ThursNL_04_7_2016&utm_medium=email&utm_term=0_9dc0513989-cd9af37674-86283193

As judged by the valid GP submissions, here's how the rankings shook out:

VC Peer Rankings 2016	
Rank	Investor
1	 SEQUOIA
2	 BENCHMARK
3	 ACCEL PARTNERS
4	 greylockpartners.
5	 ANDREESSEN HOROWITZ
6	 USV UNION SQUARE VENTURES
7	 First Round
8	 BESSEMER VENTURE PARTNERS
9	 KPCB
10	 NEA
11	 LOWERCASE CAPITAL
12	 FOUNDERS FUND
13	 LIGHTSPEED VENTURE PARTNERS
14	 FOUNDRY GROUP
15	 Index Ventures
16	 khosla ventures
17	 SOCIALCAPITAL
18	 emergence CAPITAL
19	 true ventures
20	 FLOODGATE

CB INSIGHTS

Local VC Landscape is Changing



RTPCapital
Associates, Inc.

IMAF - RTP
Inception Micro Angel Fund

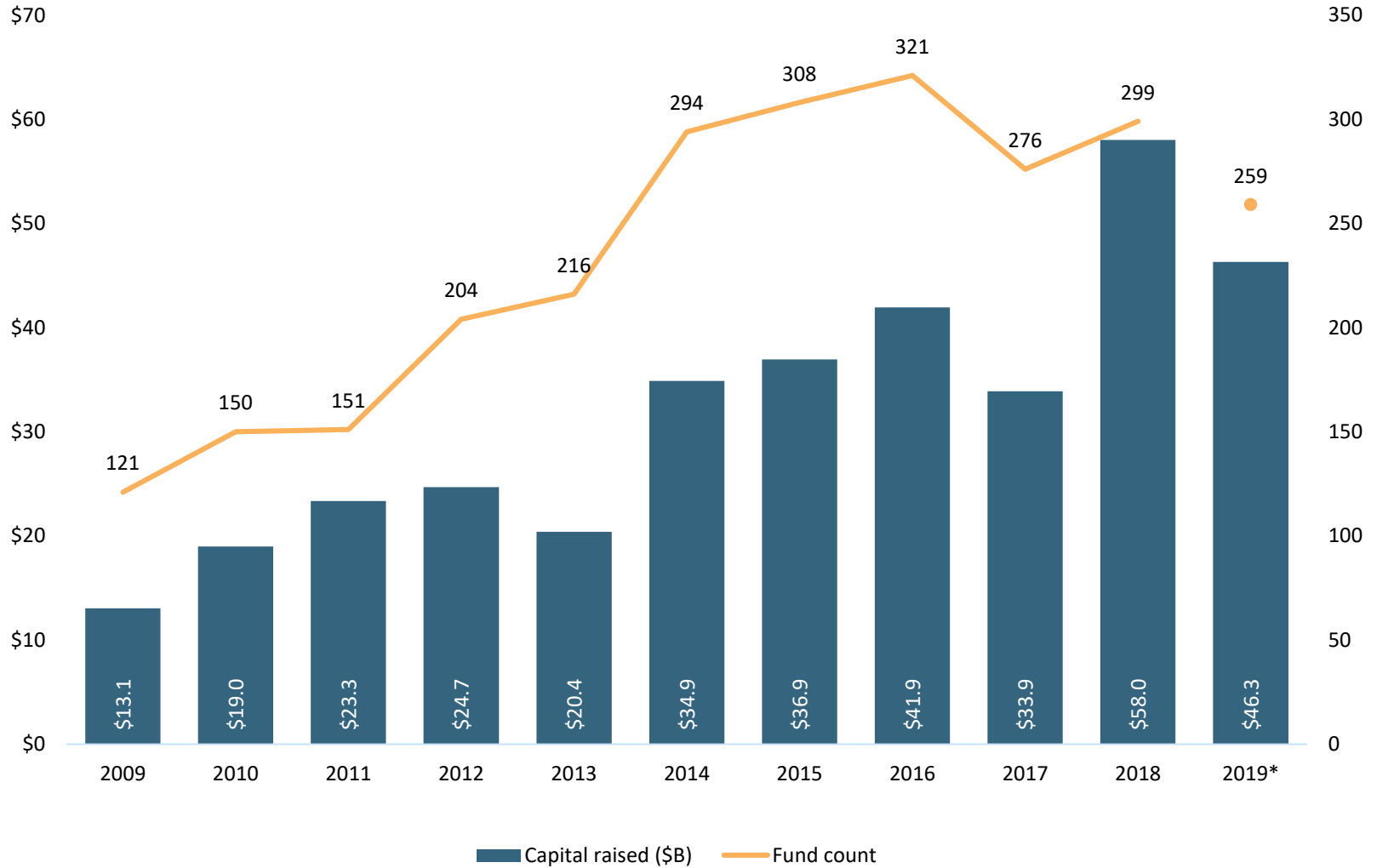


Rex Health
Ventures

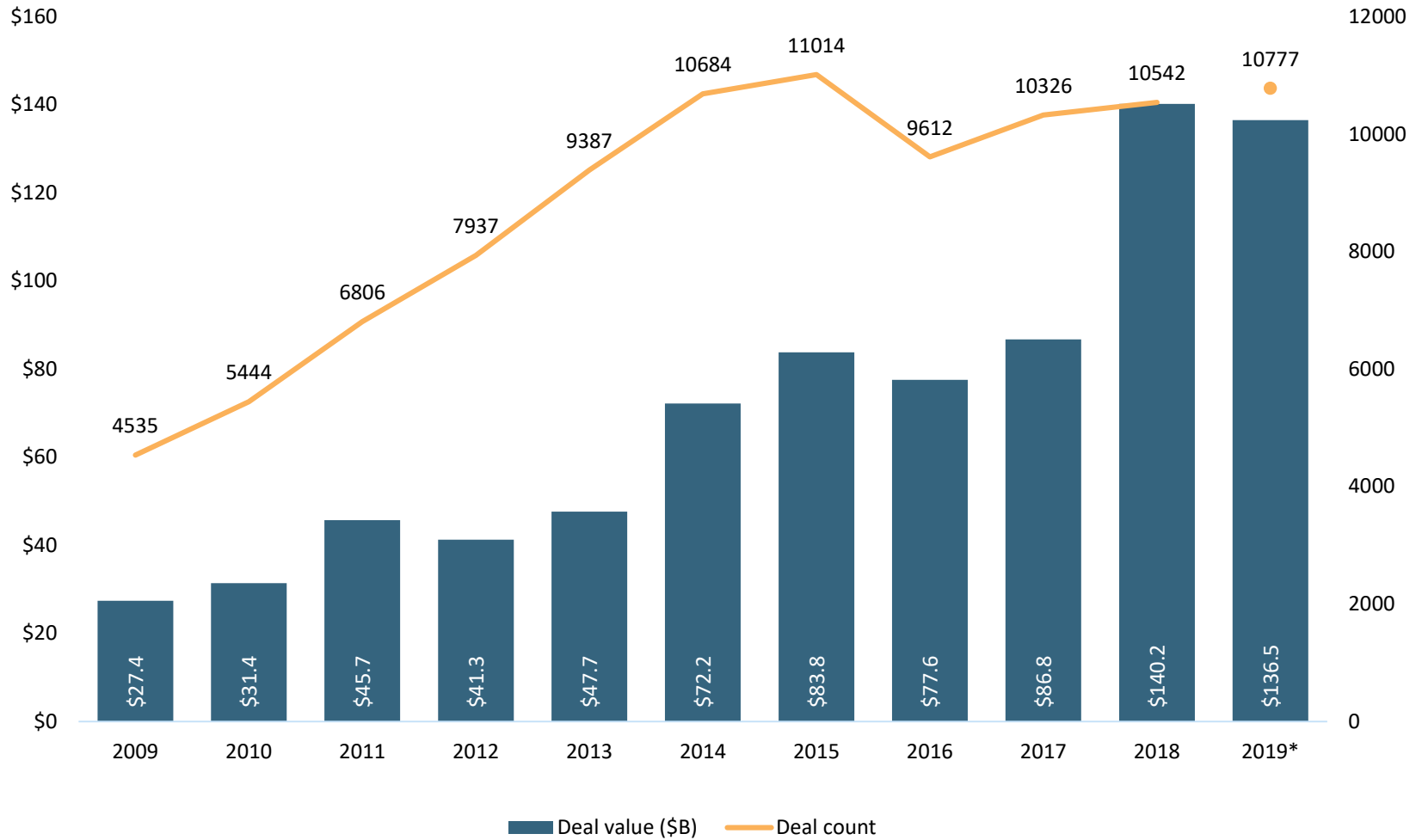


HATTERAS
VENTURE PARTNERS

VC Fundraising



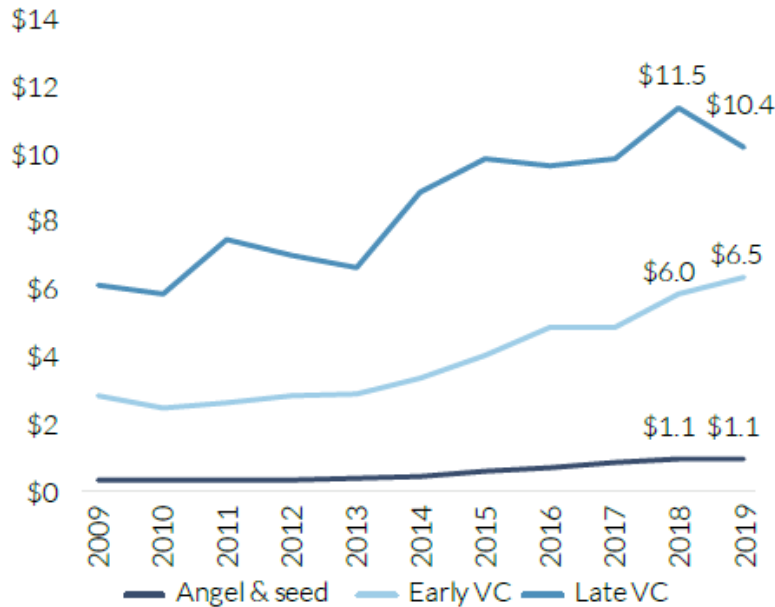
VC Investments



Investments by Stage and Valuation

Early-stage deal sizes hit unprecedented level

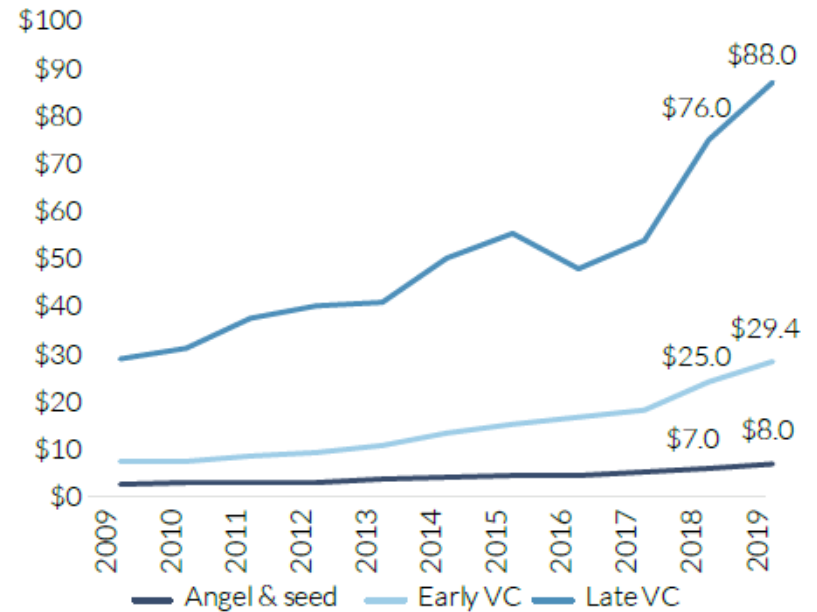
Median US VC deal sizes (\$M) by stage



PitchBook-NVCA Venture Monitor

Valuations still rising

Median US VC pre-money valuations (\$M) by stage



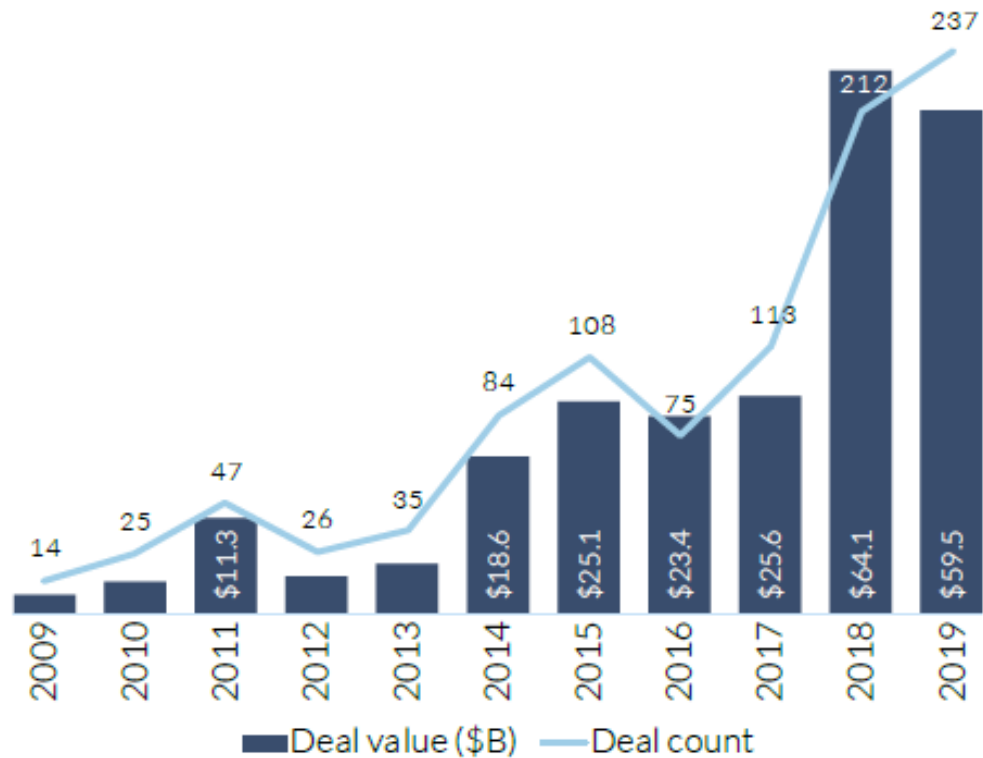
PitchBook-NVCA Venture Monitor

Mega-Deals Rising

(Round Size >\$100 million)

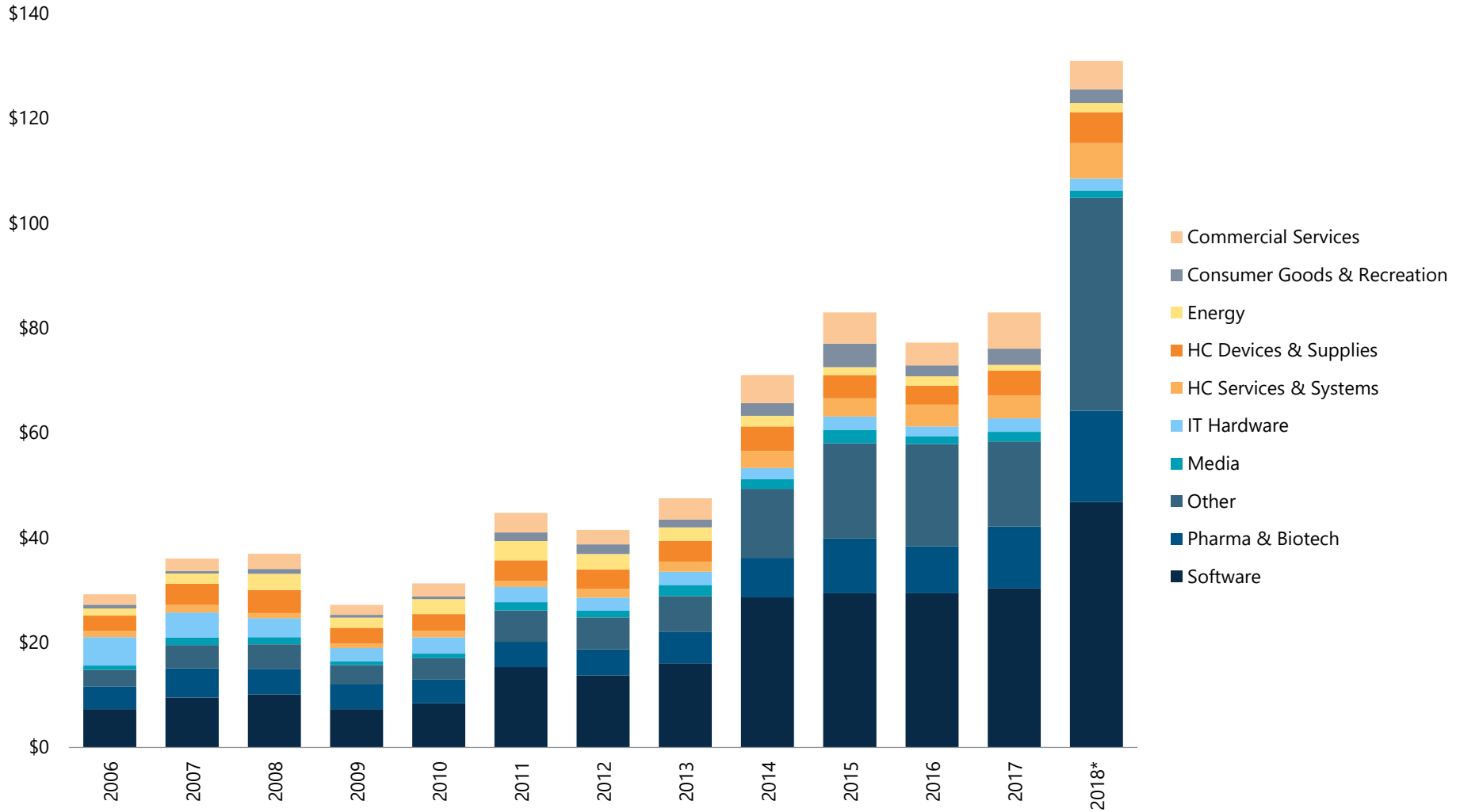
Mega-deals set new annual record by count

US VC mega-deal activity



PitchBook-NVCA Venture Monitor

Investments by Industry (\$)



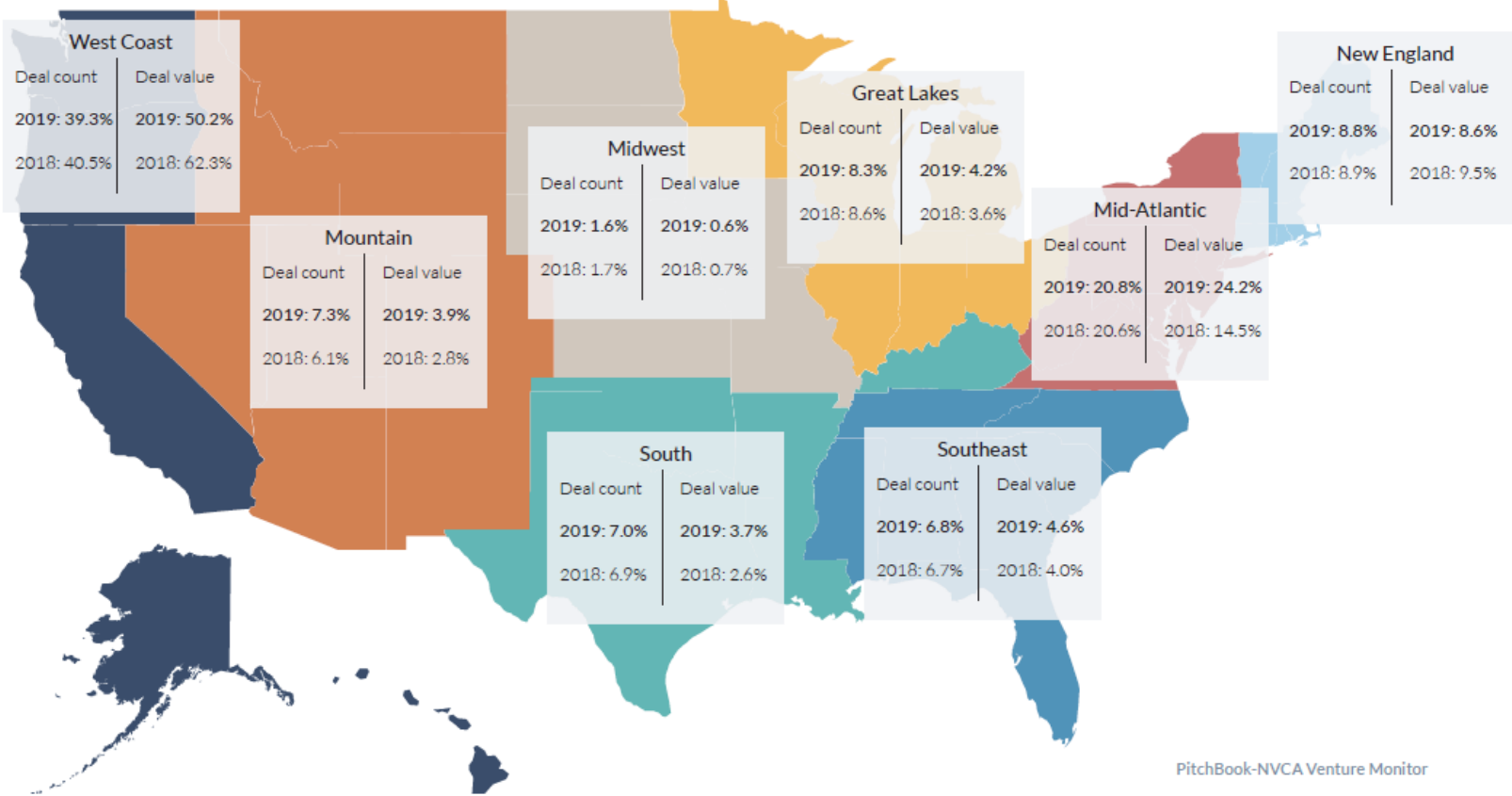
Capital Raised vs Invested



Deals by region

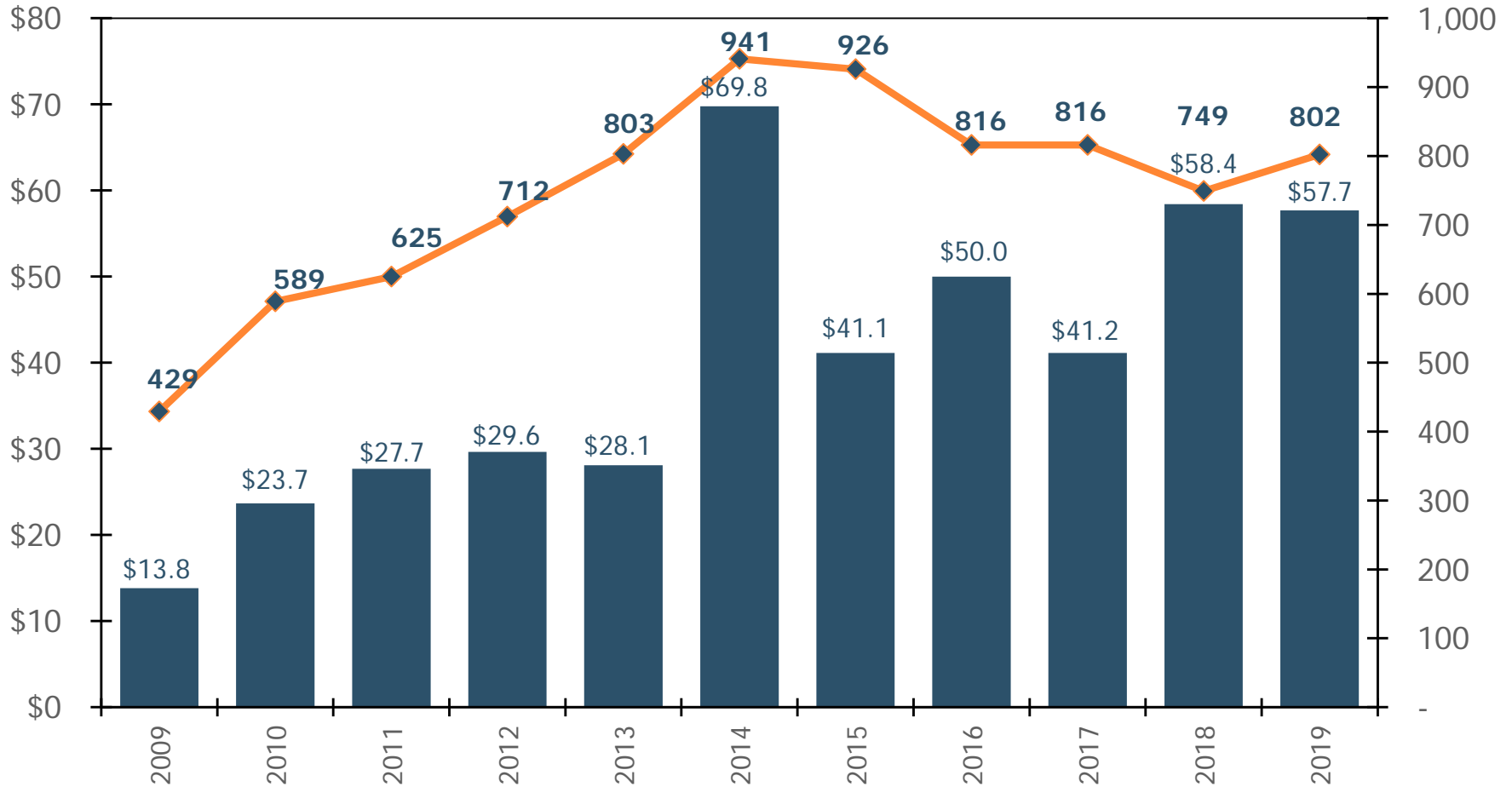
West Coast proportion of deal value falls, as share of deal count plateaus

US VC deal activity by region



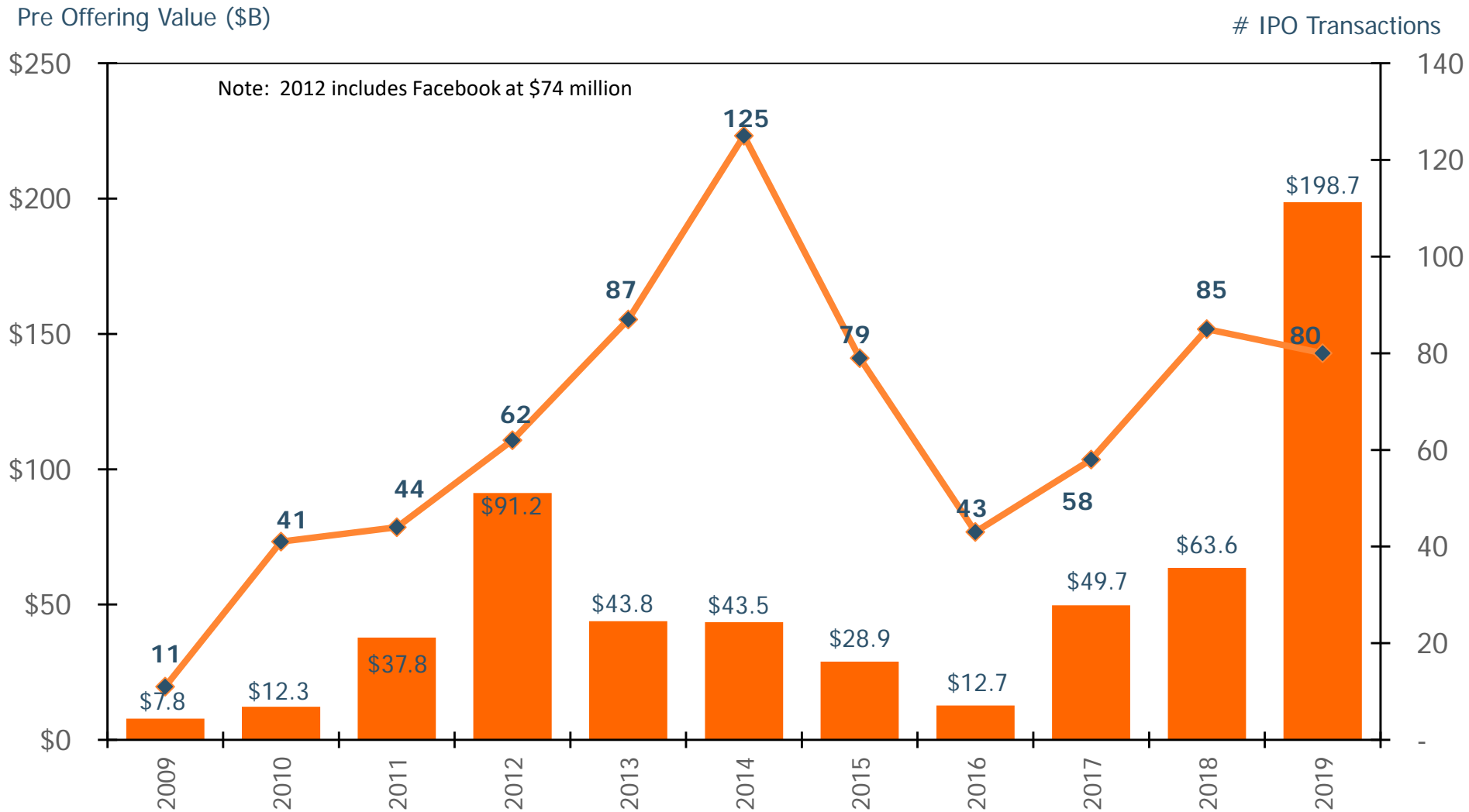
PitchBook-NVCA Venture Monitor

Venture Backed M & A

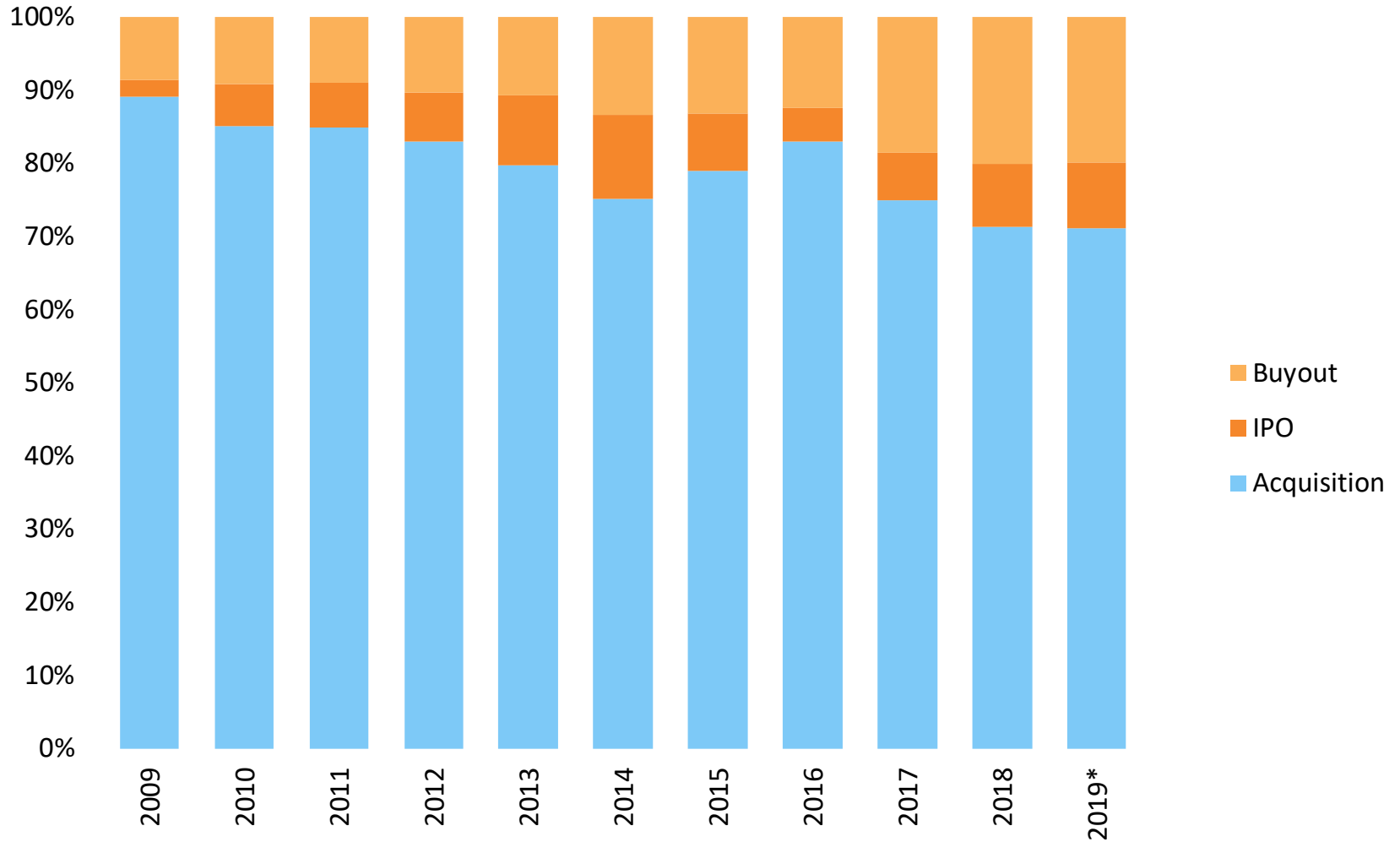


Note: 2014 includes the purchase of What's App by Facebook for \$22 billion

Venture-backed IPOs



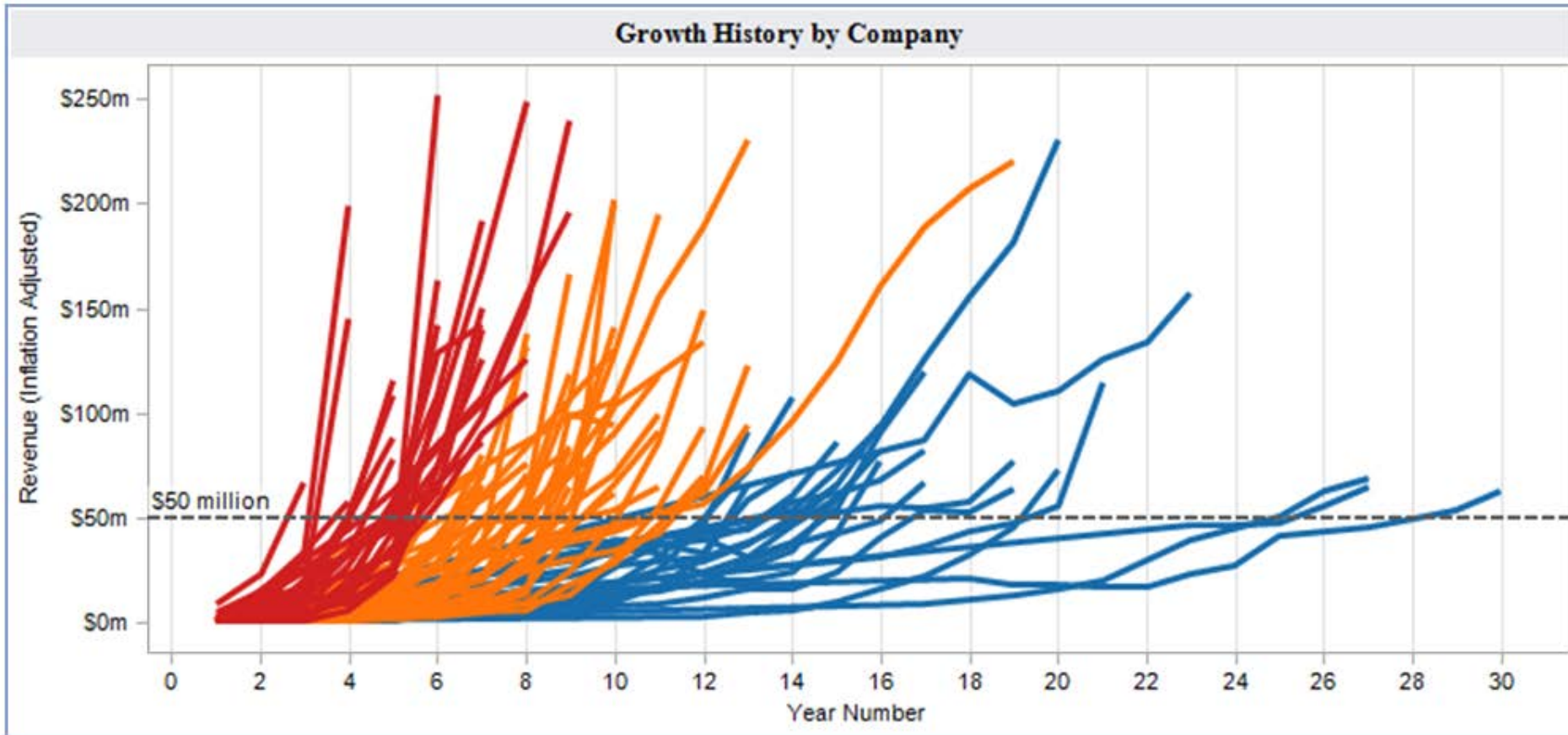
Most Exits are Acquisitions



How long does it take to build an empire?

Tale of 100 Entrepreneurs

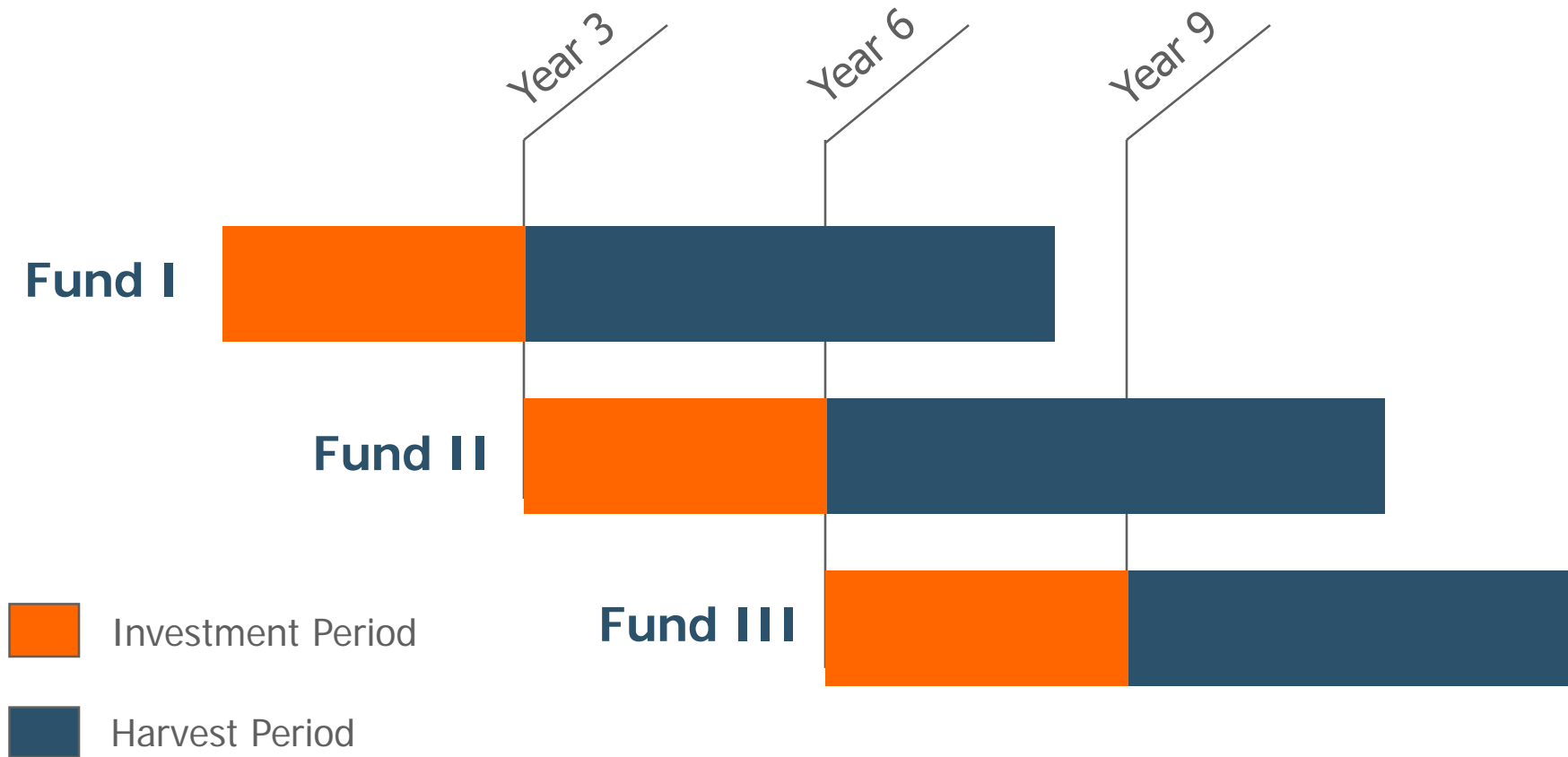
■ Rocket Ship ■ Hot Company ■ Slow Burner



Structure of a venture fund



Venture partnership life cycle



Creating wealth: the endgame

venture capital requirements

- + Great deals
 - Bad deals
 - Fees & expenses
 - VC participation (20%)
-

= 500 basis point premium to
S&P 500

Economics of a venture fund

Investment	Outcome	Distributed
\$10	Home Run	100
\$10	Home Run	80
\$10	Triple	50
\$10	Double	30
\$10	Single	15
\$10	Single	15
\$10	Bunt	5
\$10	Pop-Up	5
\$10	Living Dead	0
\$10	Total Loss	0
\$100		\$300

Summary

Distribution: \$300

Expenses: (25)

Carry: (40)

Net to LPs: \$235

Venture returns:

the time value of money

Years to return

	X	1	2	3	4	5	6	7	8	9	10
Multiple	1	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	2	100%	41%	26%	19%	15%	12%	10%	9%	8%	7%
	3	200%	73%	44%	32%	25%	20%	17%	15%	13%	12%
	4	300%	100%	59%	41%	32%	26%	22%	19%	17%	15%
	5	400%	124%	71%	50%	38%	31%	26%	22%	20%	17%
	6	500%	145%	82%	57%	43%	35%	29%	25%	22%	20%
	7	600%	165%	91%	63%	48%	38%	32%	28%	24%	21%
	8	700%	183%	100%	68%	52%	41%	35%	30%	26%	23%
	9	800%	200%	108%	73%	55%	44%	37%	32%	28%	25%
	10	900%	216%	115%	78%	58%	47%	39%	33%	29%	26%
	20	1900%	347%	171%	111%	82%	65%	53%	45%	39%	35%
	100	9900%	9000%	364%	216%	151%	115%	93%	78%	67%	58%

Company IRR calculations

exited company

Quarterly of Cash Flow (000s)

Mar-99	\$0
May-99	\$0
Sep-99	\$0
Nov-99	(\$1,700)
Feb-00	\$0
May-00	\$0
Aug-00	\$14,937
Residual Value 12-00	\$1,170

Exit Mechanism	SALE
Write up	\$14,407
Annual IRR	1804.30%

202,733 Total SHS received

\$99.69 Date of distr value

\$20,209,946 Gross

(\$1,700,000) Basis

\$18,509,946 Gain

Venture fund IRR calculations: ISP IV

quarterly cash flows net to limited partners

		Cash flows to (from) Limited Partners		
		Capital Contributions	Distributions	IRR Calculation
1998	Q1	(2,527,500)		(2,527,500)
	Q2	(2,259,375)		(2,259,375)
	Q3	(4,786,875)		(4,786,875)
	Q4			0
1999	Q1	(7,978,125)		(7,978,125)
	Q2	(6,382,500)		(6,382,500)
	Q3			0
	Q4	(6,382,500)		(6,382,500)
2000	Q1	(6,382,500)		(6,382,500)
	Q2	(6,382,500)		(6,382,500)
	Q3	(6,382,500)	61,708,387	55,325,887
	Q4	(2,553,000)	6,005,247	3,452,247
2001	Q1	(6,382,500)	14,332,611	7,950,111
	Q2		10,687,647	10,687,647
	Q3			0
	Q4	(3,191,250)	43,501,709	40,310,459
IRR		(61,591,125)	136,235,601	76.83%

The private equity investment:

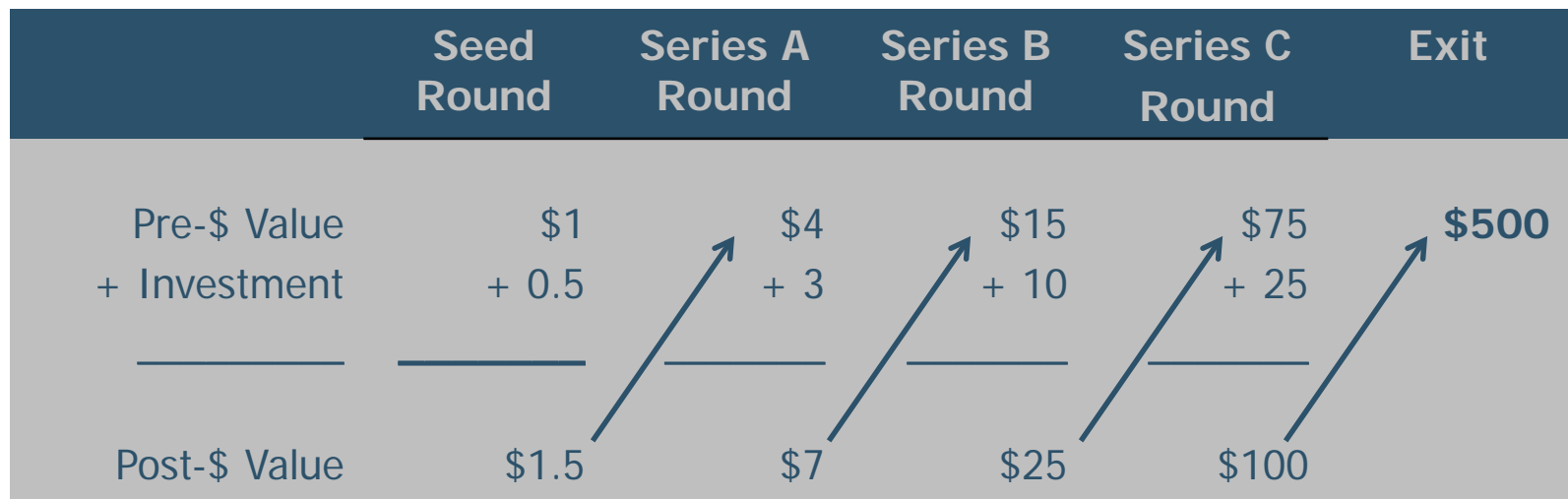
how ownership is determined

$$\begin{array}{l} \% \text{ Equity Acquired} \\ \text{by Venture Capital} \end{array} = \frac{\text{Cash Invested}}{\text{Negotiated Premoney Value} + \text{Cash Invested}}$$

Example:

$$25\% = \frac{\$1 \text{ Million}}{\$3 \text{ Million} + \$1 \text{ Million}}$$

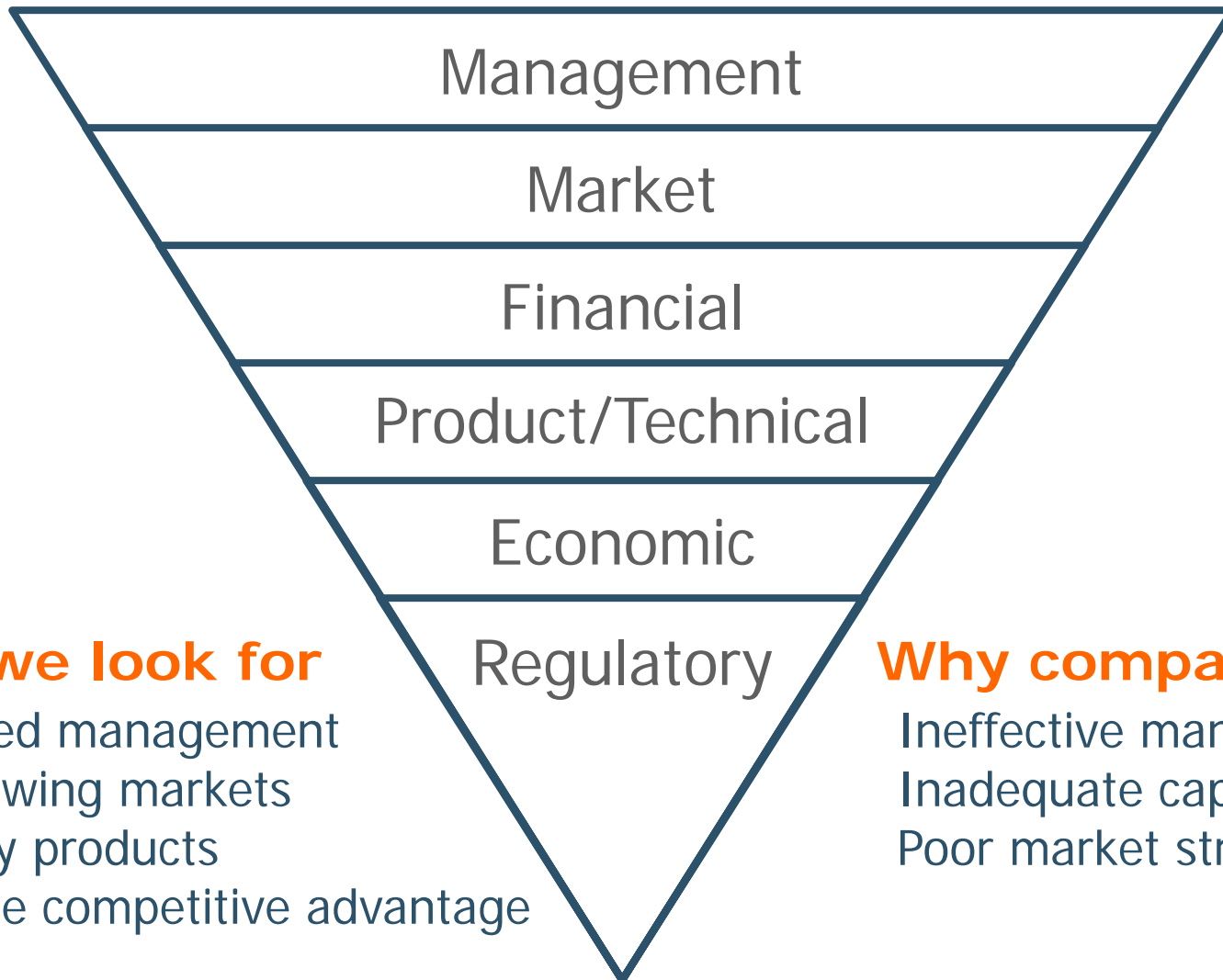
Capital requirements & endpoints



Sample capitalization chart

Round	Seed		A		B		C		Proceeds	Multiple
	\$	%	\$	%	\$	%	\$	%		
Founders	-	67%	-	38%		27%		20%	102,040,816	N/A
Seed Investors	500,000	33%		19%		14%		10%	51,020,408	102.0
A Investors			3,000,000	43%		31%		23%	114,795,918	38.3
B Investors					10,000,000	29%		21%	107,142,857	10.7
C Investors							25,000,000	25%	125,000,000	5.0
	500,000	100%	3,000,000	100%	10,000,000	100%	25,000,000	100%	500,000,000	13.0
Pre-money value	1,000,000		4,000,000		25,000,000		75,000,000			
Post-money value	1,500,000		7,000,000		35,000,000		100,000,000		500,000,000	
Dilution	33%		43%		29%		25%			
Founders' value	1,000,000		2,666,667		6,802,721		20,408,163		102,040,816	
Increase in value	n/a		2.7		3.6		2.1		102	

Evaluating opportunities



What we look for

Experienced management
Large, growing markets
Proprietary products
Sustainable competitive advantage

Why companies fail

Ineffective management
Inadequate capitalization
Poor market strategy

The private equity investment:

how ownership is determined

$$\begin{array}{l} \% \text{ Equity Acquired} \\ \text{by Venture Capital} \end{array} = \frac{\text{Cash Invested}}{\text{Negotiated Premoney Value} + \text{Cash Invested}}$$

Example:

$$25\% = \frac{\$1 \text{ Million}}{\$3 \text{ Million} + \$1 \text{ Million}}$$

Some helpful math

$$\text{PRE} + \text{Cash Investment} = \text{POST}$$

$$\text{PRE} = \text{POST} - \text{Cash Investment}$$

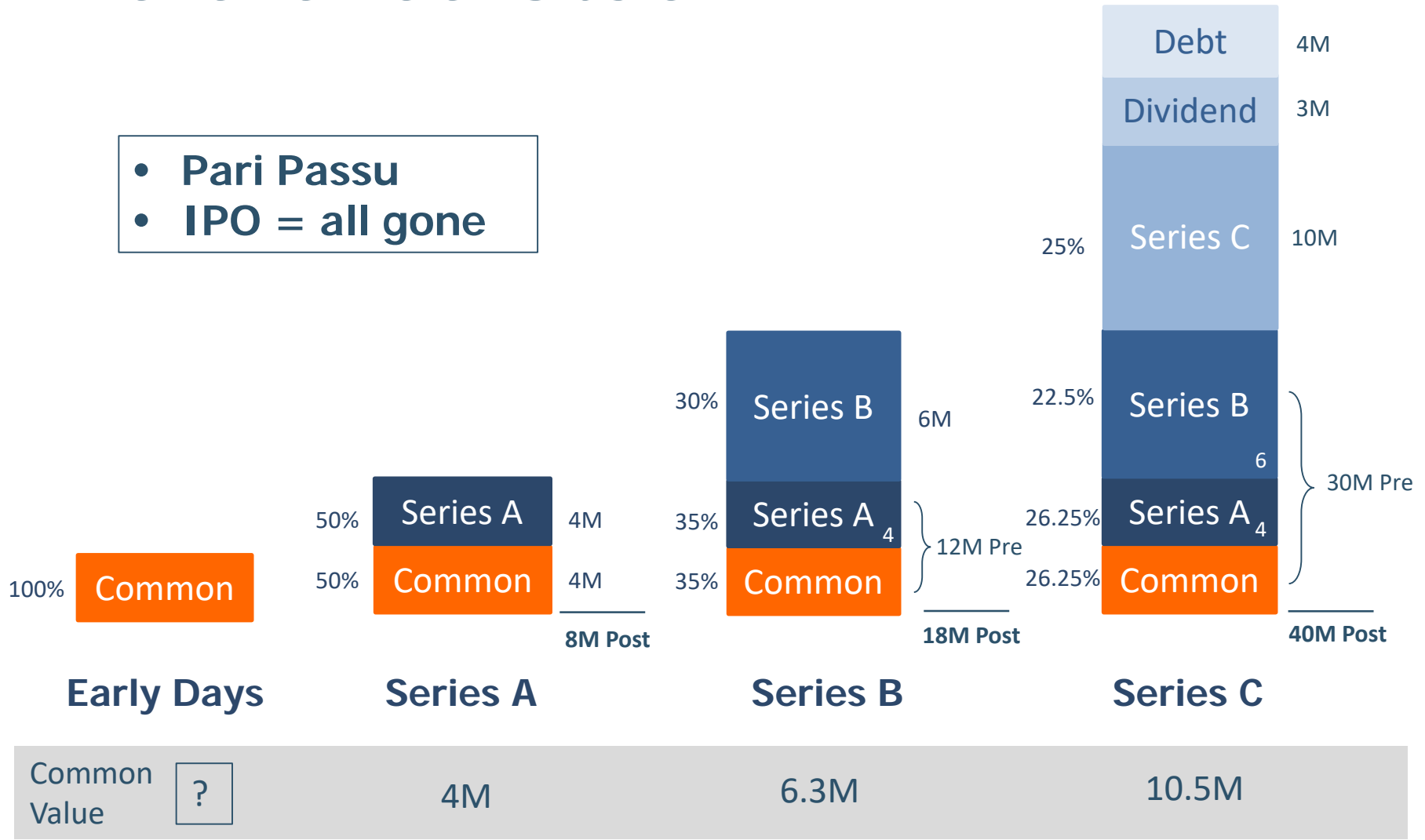
$$\frac{\text{Cash Investment}}{\text{POST}} = \% \text{ OWN}$$

$$\text{Cash Investment} = \text{POST} \times \% \text{ OWN} \quad \text{Multiply X POST}$$

$$\frac{\text{Cash Investment}}{\% \text{ OWN}} = \text{POST} \quad \text{DIV by \% OWN}$$

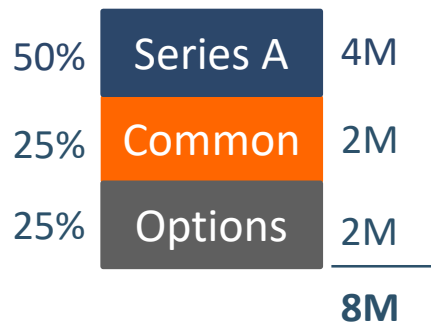
Preference Stack

- **Pari Passu**
- **IPO = all gone**

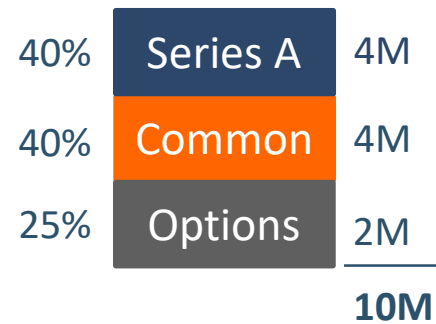


Fully Diluted vs. Not Fully Diluted

Fully Diluted



Not Fully Diluted



- Option pool
- Convertible Debt
- Warrants

Preferences

Liquidation Preference

Sales Price	4	6	8	20
Series A ₄ 50% (CSE)	4	4	4	10
Common 50% (CSE)	0	2	4	10

"Participating" Preferred

Series A gets money back + participates in remaining proceeds based on CSE %

Sales Price	4	6	8	20
Series A ₄ 50% (CSE)	4	5	6	12
Common 50% (CSE)	0	1	2	8
Series A % of Proceeds	100%	83.3%	75%	60%
Effective Pre Money Value		800K	1.3M	2.7M