

# Angels, Venture Capital and Entrepreneurs – Myths and Realities

Allan Martinson  
Managing Partner  
MTVP

# MTVP portfolio



- Offshore software development, Russia



- Data communications, Lithuania



- Baltic MTV franchise



- Datacenters, hosting in Lithuania



invisibleCRM

Synchronization Technologies, US/ Ukraine



- Social networking in "New Europe", Estonia



- No 2 Russian computer games publisher



apaja

- Casual games, Finland

Aeg maha! :P • Video portal, Estonia

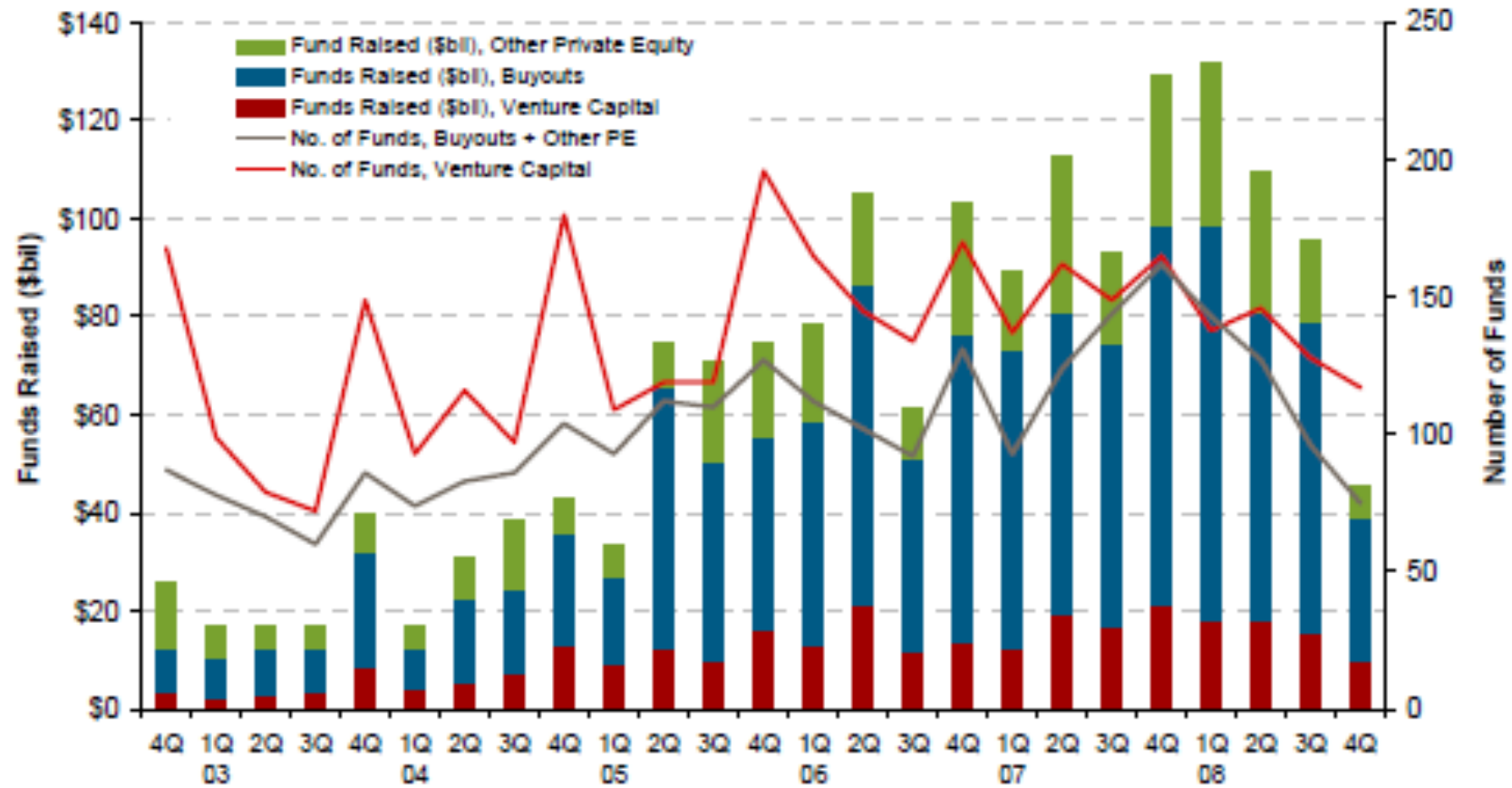
# Private Equity

- Definition: **private equity** is an asset class consisting of equity investments in companies that are not traded on a public stock exchange. Investments typically involve a transformational, value-added, active management strategy
- Categories:
  - **Venture Capital**
  - **Buy-out**
  - **Special situations**
  - **Merchant banking**
- ~\$200-400 b invested per year

# “Official” definition of the VC

- Venture capital – subset of private equity industry with the following usual characteristics:
  - Investments into **new and fast-growing** industries
  - Investments into **minority stakes**
  - Investments in **seed, early growth and growth stages**

## Global Private Equity Fundraising



Source: ThompsonReuters

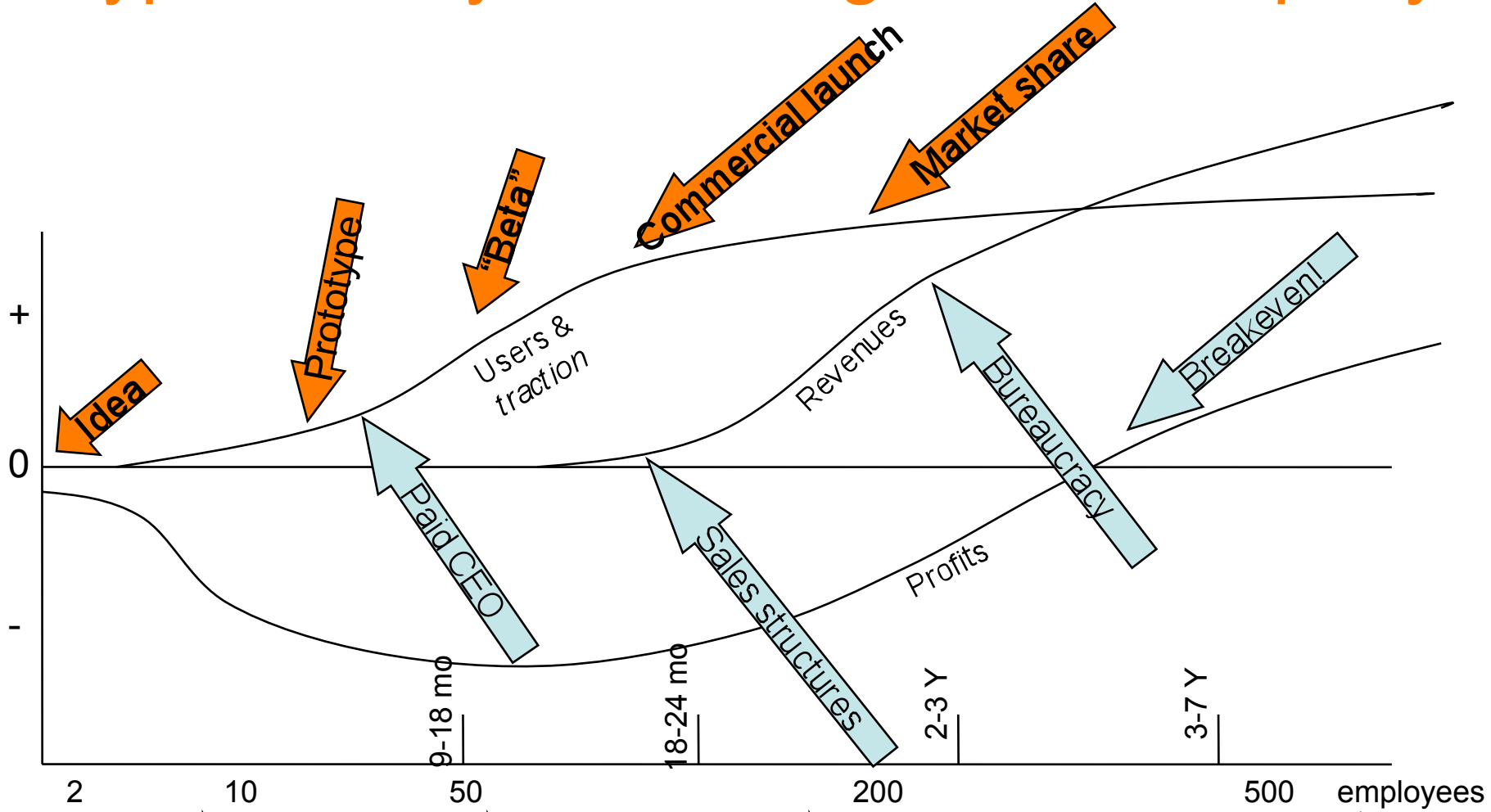
# Key figures about angel investing

- Angel investors fill the **funding gap between FFF and venture capital**
- Ticket size EUR 5000- EUR 1 m
- Average angel deal in the U.S. ~450 000 USD (2007)
- Angels provide as much capital as venture capitalists but for >10 times more companies
- ~0.5 m angels in the U.S. (equivalent ~2000 in Estonia)
- 5-10% of angels are organized into angel groups
- Average annual return 27% (2007)

# What do the angels and venture capital produce?

- VC industry produces **mature enterprises** from the raw material of young ideas and teams
- The main added value of the VC is **not financing** but know-how, experience, network and discipline
- VCs are always **people** investing into **people**
- VCs “publish” companies like book publishers publish books

# Typical lifecycle of a high-tech company



FFF  
\$10-500K

A-round  
\$1-10m

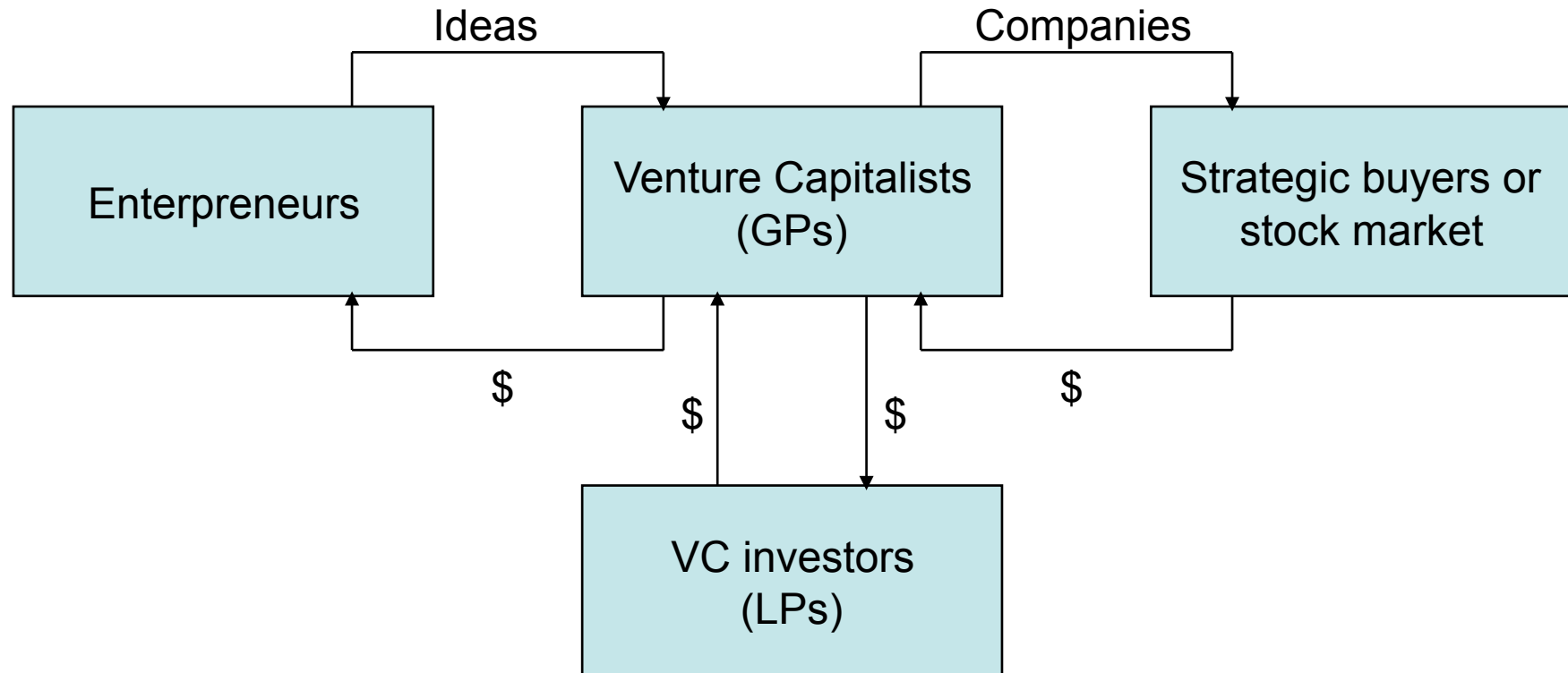
B-round  
\$5-50m

IPO or  
exit

# Typical life cycle in figures

Year	1	2	3	4	5	6
Phase	Startup	Early growth		Growth		Exit
Revenues (\$m)	0	1	4	10	20	30
Growth %			300%	150%	100%	50%
Investment phase	Angel	A-round		B-round		
Pre-money / exit valuation (\$m)	0,5	3		40		<b>150</b>
Investment (\$m)	0,4	2,5		25		
Post-money valuation (\$m)	0,9	5,5		65		150
Post-money ownership of founders	56%	30%		19%		19%
Value of founders' stake (\$m)	0,5	1,7		12,1		28,0
IRR to angel investors	124%			Money-back, angel	56	times
IRR to A-round investors	102%			Money-back, A-round	17	times
IRR to B-round investors	52%			Money-back, B-round	2,3	times

# Stakeholders of the VC industry



## GP incentives:

- 2% annual management fee
- 20% success fee (carry) after achieving 8% IRR (hurdle rate)

# Magic X and IRR

- Money-back (X) – the main benchmark of VC industry
  - IRR is secondary
- Link between X and IRR
  - 3X = 17% IRR in 7 years      – OK
  - 4X = 22% IRR in 7 years      – good
  - 5X = 26% IRR in 7 years      – very good
  - >10X = >39% in 7 years      – from excellent to magic
- Individual expected IRRs of portfolio investments shall be 2X bigger to compensate for
  - failures
  - Fund manager's costs
  - Time and money lost on entry and exit
- **VCs expect the investee companies to deliver minimum 50% IRR over 5 years**

The Regents of the University of California  
Alternative Investments as of September 30, 2005

Fund Name	Type	Vintage Year	UC Commitment	Cash In	Current NAV	Cash Out	Cash Out + Current NAV	Investment Multiple <sup>2</sup>	note	Net IRR <sup>1,2,3</sup>	note
VENTURE CAPITAL <span style="float: right;">Dollars in Thousands</span>											
Brentwood Associates II, L.P.	Venture Capital	1978	\$3,000	(\$3,000)	\$0	\$4,254	\$4,254	1.42x		5.5%	
InterWest Partners I, L.P.	Venture Capital	1979	\$3,000	(\$3,000)	\$0	\$6,681	\$6,681	2.23x		18.5%	
Alta Company	Venture Capital	1980	\$3,000	(\$3,000)	\$0	\$6,655	\$6,655	2.22x		13.8%	
Kleiner Perkins Caufield & Byers II	Venture Capital	1980	\$7,500	(\$7,500)	\$721	\$31,521	\$32,242	4.30x		50.6%	
Golder, Thoma Fund I	Venture Capital	1980	\$5,000	(\$5,000)	\$0	\$59,349	\$59,349	11.87x		32.1%	
Welsh, Carson, Anderson & Stowe II	Venture Capital	1980	\$4,000	(\$4,000)	\$0	\$8,670	\$8,670	2.17x		14.2%	
Mayfield IV, L.P.	Venture Capital	1981	\$5,000	(\$5,000)	\$0	\$13,158	\$13,158	2.63x		26.1%	
Sequoia Capital III	Venture Capital	1981	\$4,000	(\$4,000)	\$30	\$7,232	\$7,261	1.82x		11.3%	
Alta II, L.P.	Venture Capital	1981	\$3,000	(\$3,000)	\$0	\$5,300	\$5,300	1.77x		7.0%	
InterWest Partners II, L.P.	Venture Capital	1982	\$4,000	(\$4,009)	\$0	\$6,972	\$6,972	1.74x		8.4%	
Technology Venture Investors - 2, L.P.	Venture Capital	1982	\$4,000	(\$4,000)	\$0	\$6,744	\$6,744	1.69x		9.2%	
Kleiner Perkins Caufield & Byers III	Venture Capital	1982	\$7,832	(\$7,832)	\$0	\$13,596	\$13,596	1.74x		10.2%	
Welsh, Carson, Anderson & Stowe III	Venture Capital	1983	\$5,000	(\$5,000)	\$0	\$9,067	\$9,067	1.81x		8.4%	
Brentwood Associates IV, L.P.	Venture Capital	1983	\$5,000	(\$5,000)	\$0	\$10,863	\$10,863	2.17x		10.9%	
Mayfield V, L.P.	Venture Capital	1983	\$6,300	(\$6,300)	\$0	\$8,208	\$8,208	1.30x		4.5%	
Sequoia Capital IV	Venture Capital	1984	\$4,000	(\$4,000)	\$0	\$9,698	\$9,698	2.42x		18.7%	
Golder, Thoma, Cressey Fund II	Venture Capital	1984	\$3,000	(\$3,000)	\$0	\$11,048	\$11,048	3.68x		18.3%	
Technology Venture Investors - 3, L.P.	Venture Capital	1984	\$8,000	(\$8,000)	\$0	\$17,278	\$17,278	2.16x		13.1%	
Kleiner Perkins Caufield & Byers II Annex Fund	Venture Capital	1984	\$1,500	(\$1,500)	\$41	\$2,975	\$3,016	2.01x		12.6%	
Institutional Venture Partners III, L.P.	Venture Capital	1985	\$8,000	(\$8,000)	\$0	\$17,169	\$17,169	2.15x		13.9%	
InterWest Partners III, L.P.	Venture Capital	1985	\$7,000	(\$7,000)	\$0	\$20,308	\$20,308	2.90x		19.9%	
Kleiner Perkins Caufield & Byers IV	Venture Capital	1986	\$10,000	(\$10,000)	\$0	\$18,342	\$18,342	1.83x		11.0%	
Sequoia Capital Growth Fund	Venture Capital	1987	\$10,000	(\$9,579)	\$473	\$38,536	\$39,010	4.07x		23.8%	
Mayfield VI, L.P.	Venture Capital	1987	\$15,000	(\$15,000)	\$0	\$58,894	\$58,894	3.93x		27.1%	
Institutional Venture Partners IV, L.P.	Venture Capital	1988	\$12,000	(\$12,000)	\$2,120	\$17,309	\$19,429	1.62x		9.2%	
Alta IV, L.P.	Venture Capital	1988	\$5,000	(\$5,000)	\$0	\$15,546	\$15,546	3.11x		22.4%	
Technology Venture Investors - 4, L.P.	Venture Capital	1988	\$12,000	(\$12,000)	\$1,082	\$41,317	\$42,400	3.53x		27.7%	
Kleiner Perkins Caufield & Byers V	Venture Capital	1989	\$15,000	(\$15,000)	\$0	\$60,176	\$60,176	4.01x		35.7%	
InterWest Partners IV, L.P.	Venture Capital	1989	\$10,000	(\$10,000)	\$6	\$16,485	\$16,491	1.65x		10.0%	
Sequoia Capital V	Venture Capital	1989	\$6,000	(\$6,000)	\$421	\$31,391	\$31,812	5.30x		39.6%	
Merrill, Pickard, Anderson & Eyre V, L.P.	Venture Capital	1989	\$10,000	(\$9,658)	\$0	\$53,067	\$53,067	5.49x		46.1%	
Institutional Venture Partners V, L.P.	Venture Capital	1991	\$12,000	(\$12,000)	\$48	\$35,896	\$35,944	3.00x		28.2%	
Kleiner Perkins Caufield & Byers VI	Venture Capital	1992	\$15,000	(\$15,000)	\$677	\$49,266	\$49,943	3.33x		39.0%	
Mayfield VII, L.P.	Venture Capital	1992	\$15,000	(\$15,000)	\$0	\$42,875	\$42,875	2.86x		24.8%	
Sequoia Capital VI	Venture Capital	1992	\$8,500	(\$8,500)	\$1,262	\$131,973	\$133,234	15.67x		110.4%	
InterWest Partners V, L.P.	Venture Capital	1993	\$17,000	(\$17,000)	\$1,263	\$73,377	\$74,640	4.39x		61.5%	
Institutional Venture Partners VI, L.P.	Venture Capital	1994	\$12,000	(\$12,000)	\$1,174	\$69,090	\$70,264	5.86x		64.6%	
Kleiner Perkins Caufield & Byers VII	Venture Capital	1994	\$20,000	(\$15,000)	\$4,674	\$482,985	\$487,658	32.51x		121.7%	
Mayfield VIII, L.P.	Venture Capital	1995	\$12,000	(\$12,000)	\$1,936	\$35,188	\$37,124	3.09x		48.4%	
Sequoia Capital VII	Venture Capital	1995	\$13,000	(\$13,000)	\$16,308	\$196,750	\$213,058	16.39x		174.5%	
Institutional Venture Partners VII, L.P.	Venture Capital	1996	\$18,000	(\$18,000)	\$8,220	\$114,108	\$122,328	6.80x		96.3%	
Kleiner Perkins Caufield & Byers VIII	Venture Capital	1996	\$20,000	(\$20,000)	\$10,074	\$329,915	\$339,989	17.00x		286.6%	
InterWest Partners VI, L.P.	Venture Capital	1996	\$15,000	(\$15,000)	\$2,858	\$39,862	\$42,719	2.85x		49.1%	
Hummer Winblad Venture Partners III, L.P.	Venture Capital	1997	\$10,000	(\$10,000)	\$1,010	\$7,479	\$8,489	0.85x		-5.4%	
Sequoia Capital VIII	Venture Capital	1998	\$16,000	(\$16,000)	\$7,019	\$33,530	\$40,549	2.53x		90.4%	
Institutional Venture Partners VIII, L.P.	Venture Capital	1998	\$30,000	(\$30,000)	\$6,651	\$20,807	\$27,458	0.92x		-3.0%	
InterWest Partners VII, L.P.	Venture Capital	1999	\$15,000	(\$15,000)	\$7,691	\$1,920	\$9,611	0.64x		-9.9%	
Sequoia Capital Franchise Fund	Venture Capital	1999	\$22,000	(\$16,280)	\$5,633	\$5,966	\$11,598	0.71x		-17.0%	

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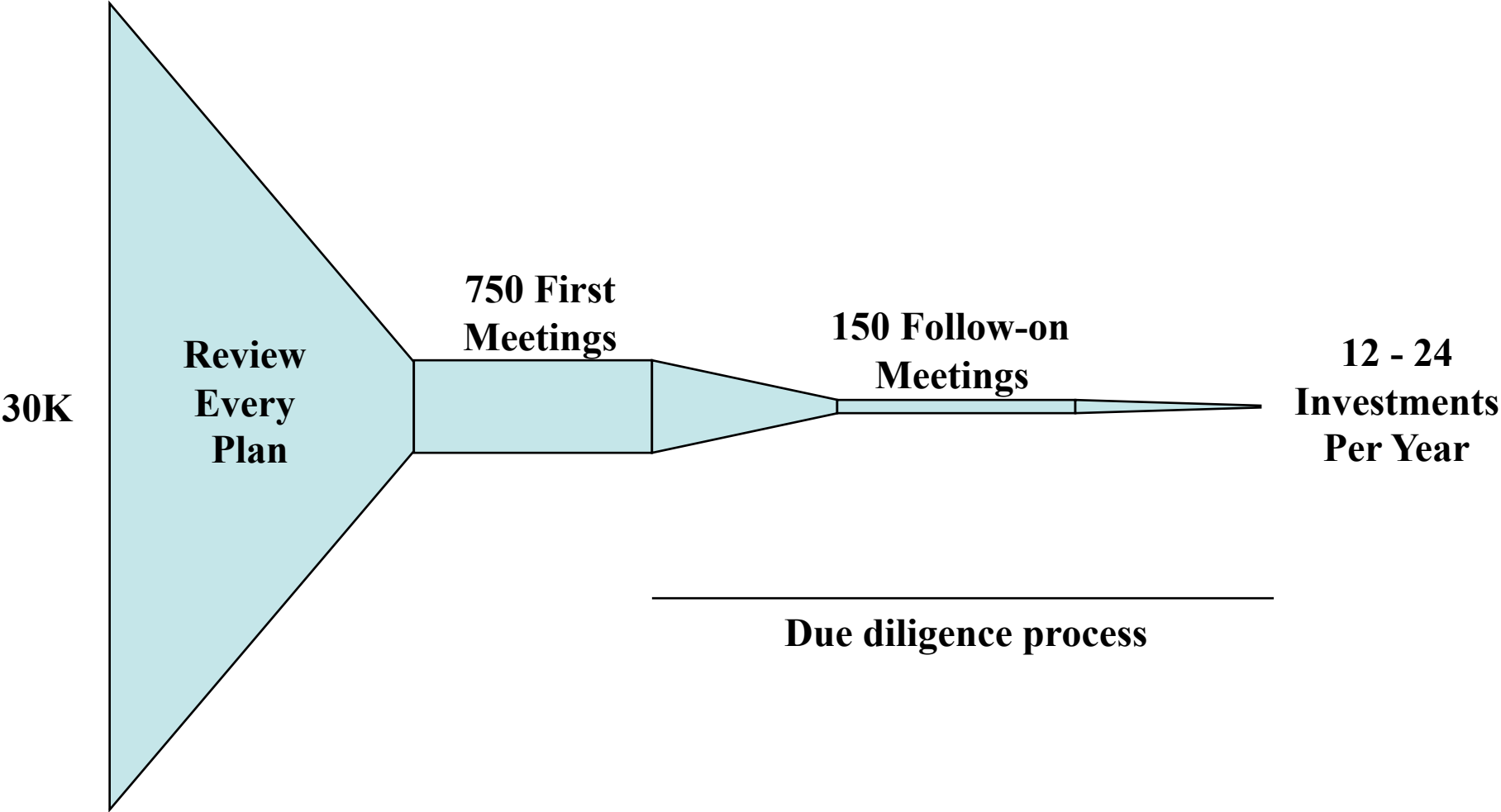
# Venture Capital process

- Fundraising
- Screening of pipeline, making right bets
- Negotiating the investments & entry conditions
- Adding value
- Exiting at right time and valuation

# MTVP's pipeline process

- ~200 companies and ideas reviewed each year
  - In average, one per day
- Sources:
  - Personal contact network
  - Fairs, conferences, seminars
  - Investment banks, other investors
  - Unsolicited calls from companies to investors
  - Unsolicited calls from investors to companies
- 25-40% reaches the stage of 1st meeting and analysis of the businssplan and financials
- 5-10 companies reach due diligence stage
- ~5 reach investment stage
- Growth in “thesis-based investing” (synthesis vs analysis)

# DFJ Annual Deal Funnel



Ladies and Gentlemen,

I've a patent that **drastically increases** internet security.

For the realization of the system I need 200 million USD's investment capital.

With this amount of money you can buy **20%** of a new company.

You'll earn 600 million USD's per year.

A video – presentation is available: <http://www.youtube.com/watch?v=U4UWUG5RShE>

Thank you for your efforts in advance  
sincerely

Csaba Bona

**PS: Please forward this email to every known Billionaires, investor.**

**In case of realization for 1 % comission.**

**Your answer is appreciated.**

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**FIRM OVERVIEW:** Medium Private VC founded in 1993 based out of Palo Alto, USA (US West)

**FIRM DESCRIPTION:** IT-centric stage-agnostic and geography-agnostic fund with deep sector expertise and hands-on approach to helping entrepreneurs build great businesses

**TEAM MEMBERS:** [Arneek Multani](#), [Bonnie N. Kennedy](#), [Donald R. Dixon](#), [Evangelos Simoudis](#), [Howard S. Zeprun](#), [John H. Moragne](#), [Matt Chagan](#), [Michael Biggee](#), [Nick Bellomo](#), [Peter T. Meekin](#), [Robert C. Mc Cormack](#), [Rockwell A. Schnabel](#), [Venetia Kontogouris](#),

sort by date

by agree

by disagree

# Entering investments

- Reasonable pre-money valuation
- Shareholders Agreements:
  - Preferred convertible or straight equity
  - Liquidation preference (1X or more)
  - Valuation adjustments
  - Drag-along, tag-along. ROFR, forced exit
  - Veto & information rights
  - Representations & warranties
  - IP rights
  - etc

# Adding value

- Good VC = smart money
  - Extensive experience and good instincts
  - Coaching & directing
  - Recruiting top management
  - Finding partners
  - Assistance with M&A and exit
  - etc
- Attention of VCs focuses on mediocre performers
  - Misperformers = “no money, no time”
  - Top performers take often care themselves

# Exits

- Exit is the “sale” in venture capital’s production process
- All companies in portfolio which are not exited are “work in progress” or “stock”, however good their performance might be
- VC returns are largely dependant on exit markets which are outside VCs’ control
- **Making investment = buying raw material.  
Exiting investment = selling the final product**

# Reality bites



# Venture-backed exits 2002-08

Quarter/ Year	Total M&A Deals	M&A Deals with Disclosed Values	*Total Disclosed M&A Value (\$M)	*Average M&A Deal Size (\$M)	**Number of IPO's	Total Offer Amount (\$M)	Average IPO Offer Amount (\$M)
2002	319	154	7,586.7	49.3	22	2,109.1	95.9
2003	284	119	7,460.1	62.7	29	2,022.7	69.8
2004	346	187	15,919.6	85.1	94	11,378.0	121.0
2005-1	81	45	4,351.9	96.7	10	720.7	72.1
2005-2	81	34	4,725.0	139.0	10	714.1	71.4
2005-3	102	48	5,739.5	119.6	19	1,458.1	76.7
2005-4	87	39	2,594.0	66.5	18	1,592.1	88.5
2005	351	166	17,410.6	104.9	57	4,485.0	78.7
2006-1	107	52	5,607.5	107.8	10	540.8	54.1
2006-2	106	40	4,018.5	100.5	19	2,011.0	105.8
2006-3	94	42	3,450.8	82.2	8	934.2	116.8
2006-4	63	26	5,616.8	216.0	20	1,631.1	81.6
2006	370	160	18,693.6	116.8	57	5,117.1	89.8
2007-1	83	29	4,540.3	156.6	18	2,190.6	121.7
2007-2	86	36	3,972.3	110.3	25	4,146.8	165.9
2007-3	103	52	10,810.0	207.9	12	945.2	78.8
2007-4	88	43	9,084.1	211.3	31	3,043.8	98.2
2007	360	160	28,406.7	177.5	66	10,326.3	120.1
2008-1	73	30	3,929.4	131.0	5	282.7	56.6
2008-2	72	22	4,154.0	188.8	0	0.0	0.0
2008-3	78	29	3,741.1	129.0	1	187.5	187.5
2008-4	37	15	2,090.9	139.4	0	0.0	0.0
2008	260	96	13,915.4	145.0	6	470.2	78.4

Thomson Reuters & National Venture Capital Association

\*Only accounts for deals with disclosed values

\*\*Includes all companies with at least one U.S. VC investor that trade on U.S. exchanges, regardless of domicile.

# Is Venture Capital Dead?



On The Cover/Top Stories

## Venture Capital's Coming Collapse

Rebecca Buckman 01.12.09, 12:00 AM ET



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## The VC model is broken

MATT MARSHALL | NOVEMBER 12TH, 2008



# The reasons for VC crisis

- IPO market is dead & M&A valuations are depressed
- LPs wary of alternative assets and have “denominator problem”
- Too much capital in too many VC funds
- Fundamental problem: IT and marketing has become so cheap that VCs may not be needed any more

# VC is changing, not dead

- Tim Draper: *The venture capital business is the best-known method for job and wealth creation there is*
- Companies funded by VCs in 1970-2005 produce 17% of America's GDP and employ 10% of workforce
- Winds of change:
  - Less VCs with less capital in the U.S.
  - More VCs on all emerging markets
  - Angels to take care of earlier stage, VCs move back to later stage
  - Average exit size will be many times smaller
  - More focus from technology to business model invention

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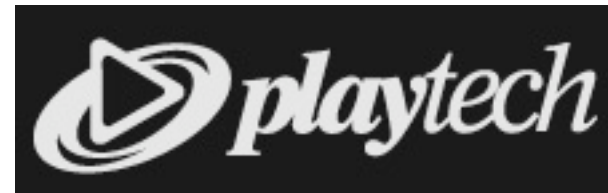
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Skype: allan\_martinson



# VC landscape in the Baltics

- **Estonia:**
  - **New Economy Ventures (NEV, Gild Bankers) – 1999-...**
    - 3 m EUR, The first real VC fund in the region
    - ~10 companies
    - ~30% IRR
  - **MTVP – 2005-...**
    - 17 m EUR
    - 9 companies
  - **Ambient Sound Investments (ASI) – 2006-...**
    - Funded by Estonian Skype co-founders
    - Strategy between angel & VC investing
    - Up to 100 m EUR of funds available
    - ~20 companies
  - **Estonian Development Fund – 2007-...**
    - Funded by the government
    - 35 m EUR
    - 4 companies
- **Latvia: 3-state sponsored private funds**
  - ZGI
  - Ekoinvestors
  - TechVentures
- **EIF JEREMIE projects in Latvia, Lithuania**



Jne...