Evaluating Early Stage Startups: An Investor's Introduction

The Entrust Group

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Agenda

1. About Entrust
2. An Overview of Early Stage Investing
3. The Investor Due Diligence Process
4. Early Stage Investing vs. Public Stocks
5. The Pros & Cons of Early Stage Investing
6. Q&A Time

Meet Your Host

Bill Neville

Business Development Manager at The Entrust Group

10 Years at Entrust

Educating investors and professionals on tax-preferred retirement accounts

B.S. in Finance from Penn State University

About Entrust

$4B

Assets Under Administration

22k

Active Accounts

40

Years of Service

1

Point of Contact

About Entrust

- Self-Directed IRA administrators
- Knowledgeable staff with CISP designations
- Nationwide offices
- In-person events and virtual webinars
- National Continuing Education program for other credentials
- Bi-annual IRA Academy

What is a Self-Directed IRA?

- A retirement account in which the individual investor is in charge of making all investment decisions
- Greater opportunity for asset diversification outside of traditional stocks, bonds, and mutual funds
- All securities and investments are held in a retirement account administered by a regulated custodian or trustee

Let's Take a Poll:

Have you ever invested in a startup / early-stage company?:

Yes: I have invested in a startup

No: I have never invested in a startup

Investing In Early Stage Companies

Presented by Verlin Gradney
Founder of Mindset Startup Academy

Mindset
Startup Academy

Background On
Verlin Gradney & Mindset

- Came to the startup ecosystem from the institutional space with intentions of building an early stage 'co-investment fund'.
- Learned very quickly that the startup ecosystem had created a far too romantic view of how the process of capital raise actually works.
- More importantly, we realized that there was no free platform in existence which teaches Founders the process of Investor Due Diligence.
- So we put off our investment fund for a few years, and began focusing on providing free education to the startup industry.
- To date, Verlin has interviewed nearly 2% of 5,000+ professional early stage investors / funds in the U.S. (VCs, Micro VCs, Angels, etc)

Our Thesis
On Early Stage Investing

- **Process of Investor Due Diligence (IDD) Is Where The Game Is Won and Lost**
- IDD is pretty much identical across the board
- Same 100+ qualitative and quantitative data points, but all are incredibly subjective
- The average IDD for most professional investors is approximately 4 to 10 meetings
- Most professional investors conduct 4 to 10 meetings, lots of data discovery, interviewing the company's customers / prospective customers, etc.
- Mindset focuses on teaching early stage Founders this grueling process, to improve their odds of success
- **And now there is a strong trend of Individual Accredited and Non Accredited Investors utilizing the same techniques of due diligence to invest in early stage companies like the pros.**

Now A Little Background On The Early Stage Startup Community

Interesting Facts...

There are roughly 5,000+ Professional Investors In The U.S.

Approximately 100k+ Companies Looking for Capital In Any Given Year

***Success Rate Of Startup Funding, Less Than 8%**

‘Early Stage’ refers to those companies and Founding Teams who are considering, preparing and/or conducting an early stage capital raise.

In the startup ecosystem, when a company goes to market to raise, the industry refers to this solicitation for capital as a ‘Round’.

By Most Professional Investor Standards, ‘Early Stage’ can be defined by the typical first 4 Rounds Which A Company Conducts To Raise Capital.

Those Initial 4 Rounds Are...

Friends & Family Round

Individual Accredited & Non Accredited Investors

Pre Seed

Individual Accredited & Non Accredited Investors

Professional Investors

Seed

Individual Accredited & Non Accredited Investors

Professional Investors

Series A

Professional Investors

These 4 Stages Of Early Stage Investing Are Directly Correlated To The Investors Risk Tolerance.

Types Of Professional Investors, Industry Tilt & Diversification

- **When we reference the term Professional Investors, we are referring to those individuals, groups, entities and funds who review, analyze and invest in early stage companies on a systematic and annual basis.**
- **This includes but not limited to:** Venture Capital firms, Micro VCs, Angels, Accelerators, Incubators, Corporate Venture Arms.
- It is not uncommon for Professional Investors to focus on one or two of the 4 types of Early Stage Rounds, in addition to have a particular industry(s) title / focus.
- Professional Investors utilize the difference in risk tolerance amongst the 4 different types of Early Stage Rounds, in addition to particular industry titles and sub industries, to build diversified portfolios no different that investor would be a diversified portfolio of listed securities and/or alternative investments.

The Process Of Investor Due Diligence (IDD)

Analyzing & Investing Like Professional Early Stage Investors

IDD

Analyzing Early Stage Opportunities

- As Mindset has proven via its Mindset Investor Interview Series, all Professional Early Stage Investors from around the world follow a very similar process when it comes to analyzing early stage companies. We refer to it as Investor Due Diligence.
- **Not only do Professional Early Stage Investors 'sing from the same hymn book', but we often structure our due diligence processes in a very similar manner.**
- It's the same 11 to 12 macroeconomic topics, made up of about 100 to 150 qualitative and quantitative data points.
- The key thing to recognize however is that each and every data point is subjective, thus creating a wide set of beliefs and theories as to which combination of data points leads to the highest level of success for investors.

Deal Flow For Most Professional Early Stage Funds

- 1,500 to 2,000 Deals A Year Reviewed
- A Selection of 20-30% Of The Pipeline Gets A Meeting
- Less than 10% Of The Pipeline Ever Reach IDD
- 1-2% Of The Pipeline Actually Receives Investment

Individual Accredited & Non Accredited Investors Utilizing The Same Principles To Analyze Early Stage Companies

Similar To An Actual Venture Capital Firm, Individual Investors Can Follow An Investor Due Diligence (IDD) Process As Well.

- IDD Processes are typically comprised of about 5 to 6 individual meetings, with plenty of email communications back and forth in between.
- Before or after each meeting, a professional investor is typically sending the company a 'data request'. This is a request to review materials / data which relates to the particular 11 or 12 macroeconomic topics discussed in the current / previous engagement together. The Professional Investor will build up their data requests over time to prevent themselves from being 'fire hosed' with information right away.

Brief Overview Of
What A Typical IDD Process Entails...

- Assessing The Leadership Team
- Market Size & Opportunity
- Who is the Ideal Client Profile
- Product Roadmap, Value Proposition and Differentiation
- The Ability to Create True ‘Customer Pul’
- Competitive Landscape
- Market Strategies
- Investor Risks
- Sales Assumptions
- Revenue Forecasts
- Valuation & Capitalization Structure
- Deal Terms

Investing In Early Stage vs. Public Stocks

- Reviewing Early Stage Private Companies differs from due diligence on larger public or established companies in the fact that there is no revenue or previous track record to review. Early Stage companies are a 'collection of hypotheses', and thus your IDD Process is designed for you to generate a likelihood of success.
- This where early stage investing becomes a bit more of an 'art' than a 'science'.
- Successful Early Stage investors are often very good judges of human qualitative skill sets. Understanding what we are refer to as 'Founder-Market Fit'.
- Thus, Early Stage investing can require more personal 1-on-1 review as opposed to simply reviewing statistical and historical data points such as 'Technical' or 'Fundamental' analysis.

Why Take The Risk & The Statistical Averages Of Early Stage Investing

Interesting Facts...

Most Professional Investors Need Approx 25 Holdings To Get One Large Exit.

Average Return On An Ideal Investment = 20-30X Return Over 7 to 10 Yrs.

In The U.S. Professional Early Stage Investors Contribute Billions Of Dollars A Year To Early Stage Rounds

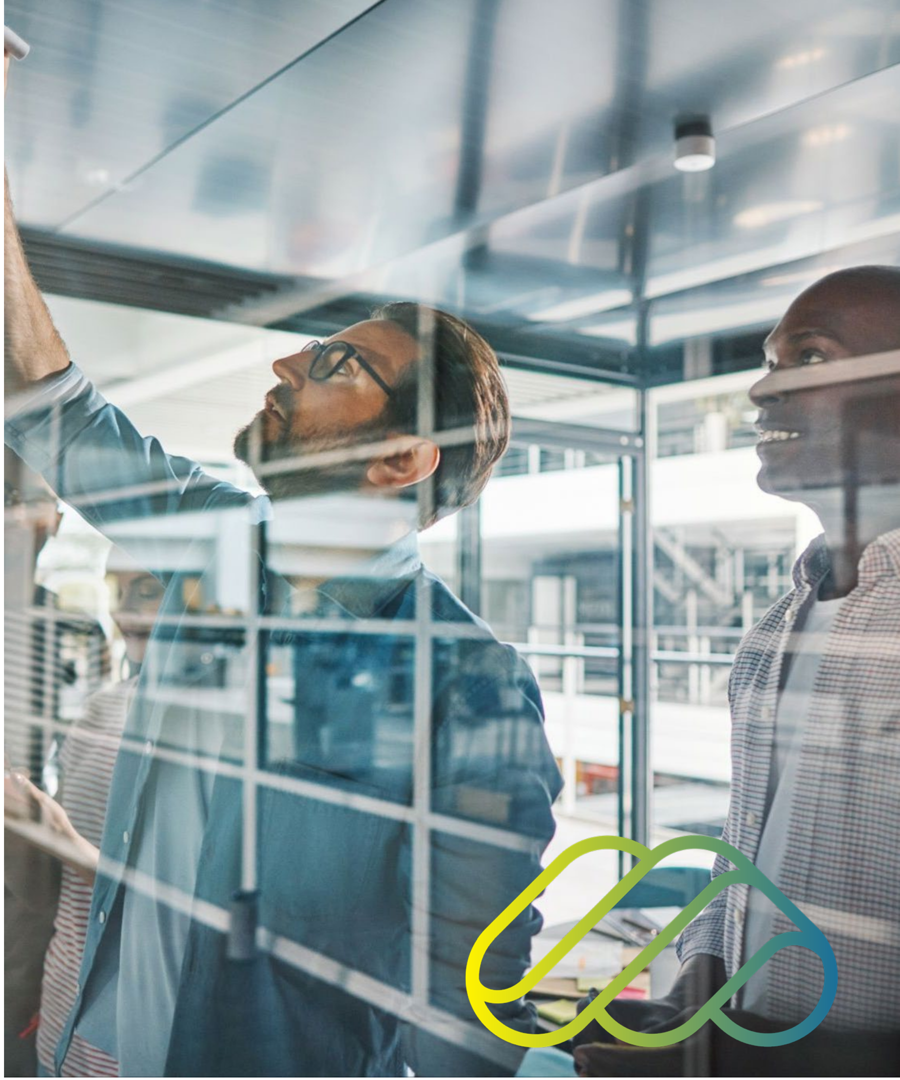
- In The U.S. We Fund Approximately 10,000+ Venture Capital Deals A Year
- The Largest Segment Of Which Is Further Down The Capital Ladder

Statistical Averages
With Early Stage Investing

- **Statistics show that an average Professional Early Stage Investor needs 25 portfolio holdings to have 1 investment which is capable of reaching 1B valuation.**
- These odds of success aren't great when compared to other investment alternatives. So why do investors engage such a risky model?
    - Most Professional Early Stage Investors look for a 20-30+ times return on their money.
    - Therefore if you diversify your capital, conduct good due diligence, and pay close attention to the percentage of equity you own in each company, it can be quite lucrative.
    - But risks are high, and such investing for most individual investors should be seen as a way to simply complement an already well diversified portfolio.

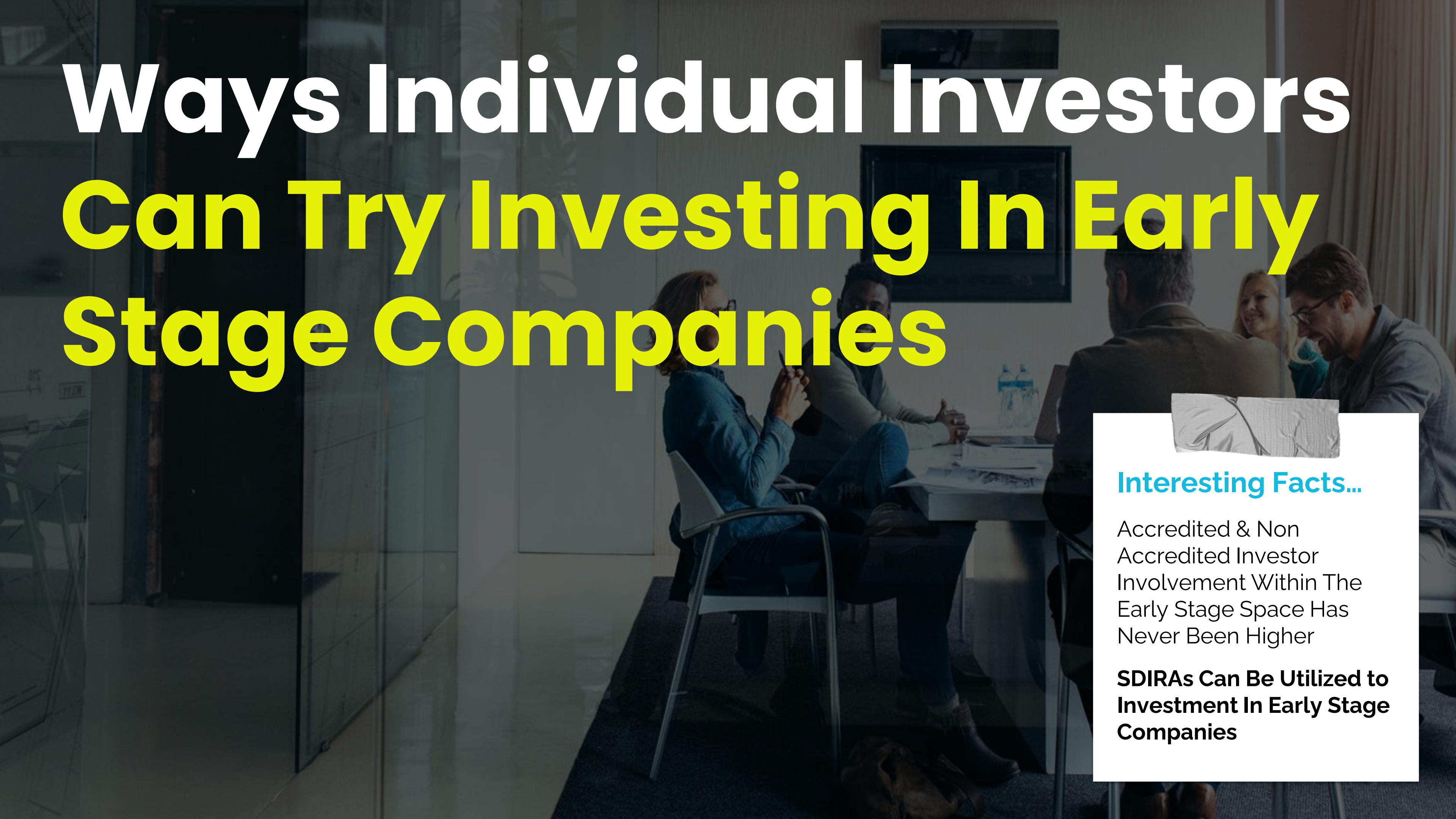
The Pros & Cons
Of Early Stage Investing

- **Pros**
  - Great way to support local, regional and national entrepreneurship
  - Should you choose, an opportunity to advise / mentor younger generations of business owners
  - High potential returns which can dramatically outperform the public markets
  - Opportunity to work together with other like-minded investors
  - Ability to create your own deal terms, and carve a deal which makes sense for you
  - Broader diversification and market exposure opportunities to complement a currently well balanced portfolio



The Pros & Cons
Of Early Stage Investing

- **Cons**
  - Early Stage investing is high risk
  - Requires lots of due diligence
  - You have to engage 1-on-1 with the Founding Team
  - No strong empirical and/or historical data to reference
  - Hi failure rate of investments between Friends and Family and Series A
  - Requires a lot of follow up and review of performance throughout the year
  - You have request your data for review, not like the public markets were all data is at your fingertips
  - You need a diversified portfolio of Early Stage investments to statistically reach a large exit



Ways Individual Investors Can Try Investing In Early Stage Companies

Interesting Facts…

Accredited & Non Accredited Investor Involvement Within The Early Stage Space Has Never Been Higher

SDIRAs Can Be Utilized to Investment In Early Stage Companies

How To Invest In Startups Utilizing Your SDIRA

- Once Your Your Preferred Early Stage Round Based Upon Risk Tolerance, As Well As Your Preferred Industry(s), You Then Begin To Conduct Your IDD
- Once You've Identified & Vetted An Investment, You Place Your Equity / Debt Investment Utilizing Your SDIRA
- Within Their SDIRAs, Many Individual Investors Utilize One Of The Following Instruments To Make Their Early Stage Investments:
    - SAFE Notes
    - Convertible Notes
    - Stock Purchase Agreements
    - Private Placement Memorandums (PPM)

How To Get Engaged With Early Stage Investing

- Angel Groups vs Angel Networks
- New Forms of Crowdfunding Platforms
- Entrust Connect Marketplace
- Angellist Syndicates
- Create Your Own Local Investment Club
- **The Entrust Connect Marketplace**

How To Get Engaged With Early Stage Investing

- A good rule of thumb is to stick with what you know. Meaning, if you've worked within the medical device industry for many years and you understand the in's and out's of the industry, try starting with early stage medical device investing. Find an angel or investment group which aggregates deal opportunities within the medical device space, and work with other individual investors who share your same passion and knowledge. Start with what you know best.
- Get familiar with tools like Crunchbase and Pitchbook.
- It's predicted that over the next ten years new opportunities and tools will enter the market which will make it much easier for accredited and non accredited investors to invest alongside large scale Professional Early Stage Investors.

Investing In **Early Stage Companies**

Thank You For Listening.

And Good Luck In You Early Stage Ventures.

Mindset
Startup Academy

What's Next?

Upcoming Webinar: *How to Invest in Commercial Real Estate With Private Debt Funds*

➔ Register today & join us March 23!

Want to learn something new?

➔ Let us know in the survey as you leave

Need more information on SDIRAs?

➔ Visit our website and Learning Center

Follow us on social media for updates

Time for Questions

?

Stay Connected

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Learning gives CREATIVITY

Creativity leads to THINKING

Thinking provides KNOWLEDGE

Knowledge makes you **GREAT**

- Abdul Kalam