

Glossary of Terminology for Venture Capitalists

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In order to successfully present your company as a valuable investment opportunity to Venture Capitalists you must first finely tune your vernacular. It is essential that one understands the unique dialect of the VC and comprehends the fundamental definitions of the terms of your target audience.

Angel Investor The first individuals to invest money in your company. For example friends, family, doctors, dentists. They do not belong to a professional venture capital firm and are therefore, not as demanding. They often believe in the Entrepreneur more than they do the actual product or business.

Anti-Dilution Protection In the event a company sells stock in the future at a lower price than the VCs paid, then an adjustment is made to the # of shares held by the VCs.

Beta Technology Technology which is complete from a development perspective but has not been fully validated against real world customer requirements.

Bridge Financing Type of financing used to fill an anticipated gap between more permanent rounds of capital investments. Usually structured so they become part of the future round if successfully raised.

Burn Rate The rate at which your company is consuming cash, usually expressed on a monthly basis.

Business Plan This is the key instrument in communicating your investment opportunity to professional venture capitalists. The quality of thought behind the business plan is used by VCs to calibrate the competency of management.

Capitalization Table A detailed schedule showing the # of shares owned by various classes owners typically broken down by common stock holders vs. preferred vs. stock option holders. This is the definitive document used by Entrepreneurs and VCs to determine who owns what percentages of the company.

Dilution As the # of investors increase the % of existing ownership decreases. However the value may not shrink due to the organization increasing in value. Many Entrepreneurs worry too much about dilution instead of increasing the value of the overall pie.

Due Diligence The process by which VCs conduct research on the market potential, competition, reference interviews, financial analysis, and technology assessment. Usually divided into business due diligence and legal due diligence.

Exit Strategy Refers to Entrepreneur's plans to provide liquidity for investors via IPO or Merger / Acquisition. Although the IPO may be the most glamorous type of exit for everyone, the most successful exits of venture investments often occur through a merger or acquisition.

"Hockey Stick" Refers to a financial projection which starts modestly for a number of months and rapidly accelerates. "How much of a hockey stick is in the plan?"

Initial / Seed Round A relatively small amount of capital provided to an entrepreneur, usually to prove a concept. It may involve product development, but rarely involves marketing.

IPO Initial Public Offering - A company's first offering of stock to the public. Viewed by VCs, founders and employees as the ultimate success for the company and the beginning of a new chapter in its evolution.

ISOs A form of stock options which does not incur taxes at the time the option is exercised. ISOs are preferred by employees because of favorable tax treatment, however, there is a ceiling on the maximum # of ISOs that can be granted to a single employee in 1 yr.

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Lead Investor Each round of Venture Capital has a lead investor who negotiates the terms of the deal and commits to 50% of the round. With a strong brand name VC Firm leading the investment, the rest of the financing usually takes care of itself.

Liquidation Preference A right in many VC deals which gives preferred shareholders the right to get their initial capital returned plus interest, before common shareholders receive any proceeds from a sale or winding up of the company.

Liquidity Event Refers to any event where by investors can cash out, typically an IPO or Acquisition of the company.

Post-Money Valuation The value of the company after VCs cash goes into the business. $\text{Pre-Money Valuation} + \text{VC Investment} = \text{Post-Money Valuation}$
 $\text{Post-Money Valuation} / \text{VC Investment} = \% \text{ of VC equity}$

Preemptive Rights Rights of existing shareholders to purchase their pro-rata share of any new shares sold by the company. VCs typically negotiate preemptive rights in order to protect their % ownership in portfolio companies.

Preferred Stock Form of equity which has rights superior to common stock holders. Most VC deals use preferred stock, which converts to common upon an IPO or Acquisition.

Pre-Money Valuation The value of the company before VCs cash goes into the business. VCs use the Pre-Money Valuation to determine what % ownership they will have in your company.

Proprietary Information Any information uniquely possessed by a company which is not generally available to the public.

Prospectus Legal document used in a public sale of stock to communicate factual & required information about the company, current status and future prospects. Information contained in a prospectus is subject to oversight by the SEC and must be the sole MKTG document.

1st Round Financing provided to companies that have exhausted personal and angel sources of capital and require further funds from serious VCs, often to initiate commercial manufacturing and sales.

2nd Round Working capital for the initial expansion of a company that typically has a product but needs funding for its initial sales rollout.

"Secret Sauce" The special attribute or function of your product differentiates your company from the competition and can not be easily duplicated.

"Shopped Deal" Any company that has been consistently denied investments from other venture capital firms.

Smart Money There are many different sources of capital ranging from friends and family to pure financial investors. The source of your financial backing and their ability to understand and add value to your business is perhaps more important than the money itself. Smart Money refers to VCs who truly understand your business.

S-1 Registration SEC filing required prior to an IPO.

Stock Options The right to acquire common stock in a company at a set price. Stock options are the driving force in attracting, motivating and retaining key employees in small technology companies.

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Strike Price The fixed price at which you can exercise a stock option. "Underwater" stock options means the current market value is less than the strike price. Conversely "In the Money" stock options means the market value is greater than the strike price.

Term Sheet Typically a 3-5 page document which outlines the fundamental business terms of a Venture Investment. This document serves to drive at the final business agreement of closing the deal. If you receive a term sheet from a VC, there is a high probability of closing & funding the deal.

Vesting Schedule The period of time over which an employee is required to stay with the company in order to earn their full economic interest in stock options; typically 4 yrs.

"Walking Dead" Refers to Companies who after 3-5yrs have neither gone public, been acquired or filed for bankruptcy.