

# CAPITAL UPDATE



Fall 2000

[www.thecapitalnetwork.com](http://www.thecapitalnetwork.com)

## Entrepreneurs Net Value-Add

By Emily Sopensky

**Incredible things can happen in less than a year.**

**F**or more than a few of the companies that presented at The Capital Network's conferences and angel meetings last year that can easily be said.

### Take for instance Interactive Funds

Recently, the company announced that it drew \$2.7 million in first-round funding from institutional and individual investors for help in building its MutualMinds.com money management site.

"With all the turmoil in the markets during those five months before we got funded, I can honestly say that we probably wouldn't have made it this far without the support of the investors we met as a consequence of presenting at the Texas Angel Investors January meeting," said Randy Bullard, president, Interactive Funds. "We truly feel indebted to TAI."

### Another example is Agere, Inc.

"The 1999 Southwest Venture Capital Conference was Agere's launch pad for our second round of financing, which resulted instead in our \$415M acquisition by Lucent Microelectronics," said Ford Tamer, former CEO of Agere. "It was a great opportunity to present our story to a select group of investors and get immediate feedback."

Now with many Lucent shares in their back pockets, Agere employees are part of a group of divisions being spun out into an IPO planned for first quarter 2001. Given that the company was started just 30 months ago, this is warp speed



even for technology companies creating a new marketplace, like Agere's creation of programmable network processors. Just as important for Agere is that the acquisition deal kept the company intact and allowed all 90 employees to remain in Austin.

Likewise, another presenting company, Human Code, with its 250 employees in San Rafael, Calif. and Austin, joined Sapient in

August 2000. The Cambridge, Mass. services and consulting

company offered Human Code 755,000 shares of common stock valued at more than \$100 million for the company including its employees.

Scooter Beachum, the mid-thirties founder and president of Axtive Software, announced February 4, 2000 that Remedy, Inc, a Mountain View, Calif.-firm, had acquired the intellectual property assets of Axtive for \$7.5 million and other considerations. Says Beachum "We did, however, have

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# INSTINCT VS. INFORMATION

Kevin Kimberlin, Chairman, Spencer Trask & Company

**V**irtually every Fortune 500 Company is under constant surveillance by a horde of equity analysts employed by brokerage firms, investment banks and other large financial institutions. These analysts have a massive, unending (and perhaps overwhelming) flow of information upon which to draw, generated by the companies themselves, the news media, the Internet, and other analysts. Experienced investors who follow the reports of industry analysts quickly learn two lessons.

Lesson one: although analysts have access to the exact same information, they may come to very different conclusions in regard to a company's prospects. And, lesson two: even when a consensus view exists among all the analysts who follow a certain company, that view is not infallible.

In effect, the abundance of information associated with large, visible public companies does not guarantee sound investment decisions. Imagine, then, the challenge faced by venture capital investors who are interested in extremely small, private companies where there is considerably less information. Upon what basis do we make our investment decisions?

**Very few of these issues are quantifiable. Intuition plays a major role in virtually every investment decision we make, and is an unavoidable component of venture capital investing.**



When publicly available information is sparse or nonexistent, it is incumbent upon a venture capital investor to gather information through private channels. That takes extensive legwork beyond simply reading a business plan or hearing a presentation from management. It may mean locating and talking to a company's current or potential customers, as well as speaking with existing competitors or companies that could be in a position to pose a competitive threat. As part of our due diligence, we also may interview early investors and other potential sources of capital, including prospective strategic partners. We often contact knowledgeable industry specialists, con-

sultants, academics or members of the trade media to ask their opinion on a given technology. And, as a matter of course, we spend considerable time meeting with the company's founders and their management team. Privately gathered information highlights the key issues that ultimately will influence our investment decision. We want to be convinced that a company has products and services that the market is willing to purchase — at prices that can eventually create earnings. We also want to be assured that the company can differentiate itself from the competition, and perhaps create barriers to entry. Moreover, we want a sense that later investors will be able to perceive the value of the company, and that the company's strategic vision is sustainable over time.

Very few of these issues are quantifiable. Intuition plays a major role in virtually every investment decision we make, and is an unavoidable component of

venture capital investing. That should not be surprising, inasmuch as most great ventures are themselves based on the unquantifiable visions of their founders.

Entrepreneur Manny Villafaña (interviewed in this issue's Top Access, <http://www.angelinvestor-magazine.com/>) was certain that he could develop improved and commercially viable pacemakers and heart valves. The list of people who doubted him was far longer than the list of believers. Several times, he had to make an "end run" around the consensus opinion of the medical technology establishment. The result: Manny has fathered four successful companies and created products that continue to save the lives of thousands of people around the globe.

When it is time to make an investment decision, numbers alone are not sufficient. We seek to combine our rigorous review of the venture's business model with the information we have privately gathered, and filter that through intuition built up over many years of experience. In the end, a deal has to "feel right" and "sound right" before we first will invest our money and later our clients' money.

There is implicit risk in the many unknowns associated with emerging ventures. As venture capital investors, we don't see that as a deterrent, but as an opportunity. 

*Spencer Trask & Company, a comprehensive private equity firm dedicated to the needs of angel investors. The company publishes Angel Investor Magazine.*

# Monitoring and Mentoring

Every day, entrepreneurs with a dream are presenting their business plans to investors in hopes of becoming the next Michael Dell.

Unfortunately, too many entrepreneurs and investors think that the deal is done on the day of closing of funding. Expectations are high, and the company is a "home run," the "next Tivoli."

Everyone around the closing table can picture that new chalet in Aspen. The wealth has been created and spent within an hour of closing. I know of what I speak - I've done it at one closing or another in twenty seven years of investing.

For that brief moment, Newco is a home run and it is the next Tivoli, so everyone needs to enjoy it for what it is - a brief moment of excitement. The reality is that on the day of closing, the real work begins. Both the entrepreneur(s) and the investor(s) have to be ready to participate in a process of monitoring and mentoring to actually turn Newco into a successful venture.

The investors have to be willing to give a good deal of time and energy to the enterprise to monitor the progress of the company and its products.

They also have to mentor the management team to advise, teach and lead them down a path that will build and inspire the team as it grows.

This takes a further investment of precious time over and above the dollars they have already committed to the venture. But this investment of time is equally, if not more, important that the money invested. An investor cannot simply write a check and walk away, expecting a big pay-off without further concern or effort.

For the entrepreneurs, they have to be willing to view their investors as a valuable addition

and use their skills, knowledge and contacts.

If the entrepreneurs are doing a good job, the last thing an investor wants to do is get in the way and impede progress. On the other hand, if things are not going well, the investors will have to make whatever changes are necessary for the benefit of the company.

The wise entrepreneur will realize that the operative word is "cooperation" at every stage of the process and he/she should do whatever is necessary for the well-being of the company, including ceding the CEO role to someone more experienced.

This same cooperative spirit has to pervade the investors' psyche as well. They have to work with the entrepreneurs one way or another. I have seen too many ventures go awry when investors and entrepreneurs were working at cross purposes.

The very best ventures have a spirit of cooperation from the very start. There are problems and thorny issues to overcome, but people seem to put their egos aside for the betterment of the enterprise. With this marriage of money, talent and energy, there is a wonderful future out there for everyone involved in an entrepreneurial effort and the celebration in Aspen upon successful completion of a sale or IPO, is really when you hit a "home run." 

*Dennis E. Murphree is the Managing General Partner of Murphree Venture Partners, an early-stage venture capital firm with offices in Houston, Austin, Albuquerque and Boulder. He is also Adjunct Professor of Entrepreneurship in the Jones Graduate School of Rice University. He can be reached at [dmurphree@murphreeventures.com](mailto:dmurphree@murphreeventures.com).*

## Message from the President

As the first year of the millennium draws to a close, The Capital Network has seen a continued expansion in entrepreneurial activity. While April's market correction brought a sense of reality back to the Internet venture marketplace, many entrepreneurs have continued to develop viable business models and have gotten their deals funded through



TCN's various activities, including our monthly angel programs and larger venture conferences. We are also seeing a number of ventures for which we helped raise seed capital go on to raise funding for series A and B venture rounds.

TCN itself has seen a record year for venture programs that are designed to bring together early stage tech ventures and interested investors. Our monthly angel programs continue to attract early stage companies seeking \$500 thousand to \$2 million as well as a regular group of sophisticated angels and boutique venture funds. Our venture conferences, which feature companies raising \$2 million

to \$200 million, have expanded to venues in northern California and the Midwest. We've added new annual industry events focused on NewMedia and BioTech.

While capital is critical, business smarts is one of the most important ingredients in helping ventures grow to their potential. Leveraging TCN's strong relationships with angel investors and service

providers, TCN now actively brings together entrepreneurs with mentors -- experienced business people, who can assist early stage ventures in defining their business model and business plans can help them prepare for raising capital.

The Capital Network's programs continue to grow and we are pleased to be able to play a role in helping prepare companies and then introduce them to early stage investors including venture capitalists, angels and corporate investors.

For more information on how TCN might be able to assist you or ventures you are working with, please contact me directly at [david@thecapitalnetwork.com](mailto:david@thecapitalnetwork.com) or (512) 305-0826.

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numerous ...opportunities of interest' as a result of the SWVCC. So we were faced with that darn we-want-to-buy-your-IP-hire-your-people-and-give-you-a-bunch-of-money-problem. We had a "Best Deal Pageant" and Remedy won."

Another dazzling success story was Chorum Technologies, which attracted a hard-to-beat total of \$42 million third-round funding in December 1999.

In May 2000, Netier Technologies was labeled one of Dallas' fastest growing companies by the Dallas Business Journal.

## Growth in Both Funds and IPO Skepticism

But since last year, venture capital funds have grown and so has skepticism about taking companies to IPO. While the money is there, startups in search of funding are receiving much more scrutiny. As a result, the process of providing promising entrepreneurs with early guidance and insight becomes even more important.

What TCN's venture capital conferences and monthly angel programs have to offer is not just a few intense minutes in front of multiple investors. It is the process that goes on behind the scenes that is as important if not more so.

"While the ultimate goal may seem to be to get in front of an investor to pitch a deal, what's far more important is that the entrepreneur and company be ready for that moment," asserts David

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Gerhardt, president of The Capital Network.

According to Jay Campian, Managing Director, Access Venture Partners, knowing your business and knowing how to present your business go hand in hand.

"Obviously we are first attracted to a company that has a large marketplace and a technology that tackles it. But as important are the people and the approach to tackling that marketplace that holds our attention," he says.

## Be Prepared—TCN Mentors Young Firms

Whether a company presents at one of TCN's venture capital conferences or seeks early stage funding at a Texas Angel Investors meeting, the process of grooming a company for its presentation is the real secret to ensuring the best opportunities for funding and for learning what it takes to go to the next level.

SchoolPeople, newly accepted into the Austin Technology Incubator, is working with The Capital Network to hone its pitch for finishing its seed round of financing and to go after \$10 million for its first-round financing as well as institutional support. An

application service provider with products for K-12 school management, School People anticipates making many pitches not only for funding but to the many institutions in a highly fragmented but huge marketplace.

Director of Business Development Nikolas White says TCN guided his company's pitch by re-ordering and slimming the presentation and by helping them refine their sales strategy, market definition and opportunities.

"We're excited about this market because of its potential, and we're thankful for the superb help that

The Capital Network has given us," says White.

As most successful business persons will tell you, the big wins are built on small incremental stages of growth. Just knowing about those stages is not the same as experiencing them. But observing and learning is usually the first stage in any successful venture.

Whether participating in or simply observing the process, The Capital Network's venture conferences, angel meetings and mentoring assistance are valuable resources to help early-stage ventures.

## Presenters at TCN Events 1999-Aug 2000

Accelerator Technology Corp	EquipmentAuction.com, Inc.	OnGoingInternet
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Comercis	JoeAuto.Com	SpecialtyStoresOnline.com
Commerciant	Journee Software	SpeedGate
Comparisons Corp	Journyx	SplitSecondSales, Inc.
CompleteBook.com	JSE	Stellar Semiconductor Inc
Computer Moms Intl	Just 4 Biz	Studio Solutions
Concur System Technologies	Ki-Soft	Taensa
CopperFoot	KnowItAll.com	talenthill.com
Core Intellect	M&C Systems	Tantau Software
CourseNotes	Media Excel	TexasTea.com
CyberRhythm Communication	MediaPrise	The LNZ Company
Cymbia.com	MediaPrise, Inc.	TheEdgeSports.com
DeepLeap Inc	MetaFirm Technologies, Inc.	thePerk.com
eCertain	MicroDisplay	Tornado Alley
EcoLife	Morningstar Dianostics (sic)	U.S. Creative Directory
eEconomy	MossBeach Technologies	Ubundle
Egg Innovations	NeKtar Worldwide	USA Voice.com
e-Insurance	NetBotz	Vante Technologies
EnerGenetics International	NetCertification	viewon.com
eNetica Solutions, Inc.	Netier Technologies	webSerguros
	Netilla	WebTaggers
	NextCare	WellGen
	NORDview	WHAM
		Wish Doctor Software
		Wizer Systems
		XTRA On-Line
		ZeopniX

As most successful business persons will tell you, the big wins are built on small incremental stages of growth. Just knowing about those stages is not the same as experiencing them.

# Building Your Company's Financial Infrastructure: The Top 10 Things to Remember

Joseph H. Koelzer, Jr. Executive VP and COO, Virtualcfo Inc.

**T**hinking of starting your own business, but worried that you don't know enough about business finances?

Virtualcfo has helped more than 200 early-stage high tech companies build their financial infrastructure. We know from experience that from the start "getting it right" is crucial. Here's our Top 10 Financial Issues that you should consider as you launch your business.

## 1. Understand what you want from your company.

Know your personal goals. What do you really want from this business? wealth, personal growth, career satisfaction, control? or something else? How will you achieve these goals? The answers to these questions will drive everything else.

## 2. Match your objectives to those of your funding sources.

There are many types of funding available? yourself, friends, family, angel investors, venture capitalists and strategic partners. Make sure you match the type of funding to your business goals. Remember? this is probably not the place for your parents' retirement funds!

## 3. Be cautious using stock for transactions.

Don't sell common stock! Why? Because it sets a value on the shares and a potential floor on the price of the incentive stock options you may want to issue to recruit employees. Use convertible debt or preferred stock for any sale of equity. The equity funds you raise are the most expensive money that you will obtain.

## 4. Leverage your equity investment.

Equity dollars are only one funding option. Your equity investment can help

picture, not just the valuation number, when evaluating a potential investment.

## 6. Financial forecasts are important.

Provide a realistic assessment of your company's potential. Use benchmarking against similar companies. If these are unavailable, try to provide independent research supporting your numbers. Forecasts are one of the many factors affecting valuation and that you may be held to the numbers you present. Pay careful attention to your cash requirements and make sure that the

**Know your personal goals. What do you really want from this business? wealth, personal growth, career satisfaction, control? or something else? How will you achieve these goals? The answers to these questions will drive everything else.**

you raise other sources of financing that may be less expensive. Examples include a bank line, leasing lines, vendor credit and strategic alliances.

## 5. Valuations are not just about the numbers.

Valuation is based on many things; the quality of the idea, the size of market, the experience of the team, board members & advisors and the team's ability to execute the plan. Look at the entire

assumptions are reasonable and achievable.

## 7. External resources are long-term relationships.

Your professional service providers (e.g. legal, accounting, insurance, real estate) can be valuable resources. They can introduce you to potential partners, provide specialized resources and help you tackle difficult problems as you grow and change. Think of them as long-term relationships.

## 8. Establish and use financial controls, policies and procedures.

Operational and financial controls are crucial for early-stage companies. Policies and procedures and an efficient financial accounting system are important!

## 9. Avoid potential tax problems — outsource your payroll.

All due taxes must be paid on time. Employers are liable for all payroll taxes, which must be withheld and paid to the IRS. Non-payment means you may be personally liable. The best way to ensure taxes are paid is to outsource your payroll processing.

## 10. Prepare for your exit.

Actions and decisions you take today can affect your exit strategy, particularly equity transactions and how you prepare your infrastructure. Always be ready to acquire and/or be acquired! 

*Virtualcfo Inc. was formed in 1996 to assist early-stage companies in building their financial, administrative, human resource and marketing infrastructure. [www.virtualcfo.com](http://www.virtualcfo.com) 512.345.9441.*

# Microsoft Opens Technology Center for E-Commerce Development in Austin, TX

In early October, Microsoft Corporation will launch an E-Commerce Technology Center in Austin, TX for customers and partners located in the central and south regions of the United States. The Microsoft Technology Center (MTC) is targeted at assisting start-up, established and brick-and-mortar dot-coms design, develop, tune and test E-Commerce applications. Through engagements ranging in length from two to eight weeks, the MTC offers customers wishing to capitalize on cornerstone Microsoft.NET technologies an opportunity to leverage technical skills, a development environment and an infrastructure designed from the ground up to accelerate their projects and reduce their risk.

The Austin MTC supplies technical skills, Microsoft and third-party software and infrastructure to remove common barriers in deploying E-Commerce sites and services built using Windows 2000 Advanced and Data Center Servers, SQL Server 2000, Commerce Server 2000, BizTalk Server 2000, XML and COM+. A permanent staff of Microsoft Consulting Services consultants provides expertise such as Windows 2000 web farm architecture design; SQL Server 2000 performance tuning; Internet Information Services (IIS), Active Server Pages (ASP) and COM+



application development; and the integration of .NET Enterprise Servers. Common engagement scenarios include performance/scalability testing and capacity planning; Windows 2000 and SQL Server 2000 migrations and pilots; Commerce Server 2000 and BizTalk Server 2000 migrations, pilots and boot camps; and Windows Media Technology integration. These engagements are designed to fit into high-risk stages of customer, solution provider or incubator project life-cycles.

In addition to access to a full-time consulting team, customers receive a private development lab equipped with five dual-processor Dell Precision 220 Workstations on a private Fast Ethernet network connected to a

dedicated rack of Dell PowerEdge (PE) Servers. Each customer rack includes two eight-processor PE8450 servers, two four-processor PE6450 servers and four two-processor PE2450 servers with 90GB of PowerVault storage on a Gigaset system area network. Twenty Dell PowerApp 100 web servers are also available for load generation or for testing scale-out scenarios. The software environment will be configured to match each customer's deployment environment coupled with Microsoft and Dell best practices. Common configurations will include a two-node fail-over SQL Server 2000 cluster, two application servers and a four-node Network Load Balancing Services (NLBS) cluster. In addition to Dell Computer Corp., Gigaset Corp., APC Corp.,

BMC Software, Epicenter Corp., Rainbow Technologies, Interwoven Inc, Symantec Corp. and others are partnering with Microsoft as sponsors of the Austin MTC by providing hardware, software and expertise for joint dot-com customers.

A Microsoft Technology Center was recently opened in Waltham, MA to support the east region of the U.S. while Chicago, IL and Mountain View, CA locations are targeted to come on-line during the next six months to support the central and west regions of the U.S. 

*For more information, please contact Bob Laskey at [laskey@microsoft.com](mailto:laskey@microsoft.com) or (512) 795 5354*

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# Texas Venture Capital Conference 2000



*Kick-off Reception at the Governor's Mansion*



*TCN Chairman George Watson, Lt. Governor Rick Perry, IC2 Institute Director Dr. Robert Ronstadt, TCN President David Gerhardt*



*MoneyHunt Live's Tad Jones preps a potential contestant for the TV show*



*Financing Entrepreneurial Ventures Workshop, May 3, 2000, Four Seasons Hotel, Austin*

## Calendar of Events

**Financing Entrepreneurial Ventures**  
September 19, 2000  
Four Seasons, Austin

**[4-part finance seminar]**  
September 20, October 19,  
November 16, December 14, 2000  
(with Austin Software Council)  
MCC Building Austin

**Venture Capital Forum**  
October 2 - 3, 2000  
Rio de Janeiro

**Educational Workshop**  
October 25, 2000  
The Westin Park Central, Dallas

**Southwest Venture Capital Conference**  
December 26, 2000  
The Westin Park Central, Dallas

**Southwest Bio Venture Conference**  
December 6-7, 2000  
Moody Gardens Convention Center,  
Galveston

**NewMedia Venture Capital Conference**  
March, 2001  
The Four Seasons, Austin

**Texas Venture Capital Conference**  
May, 2001  
The Four Seasons, Austin

**Texas Angel Investors...Call for dates**

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# THE CAPITAL NETWORK

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