From Seed to Series B

Mike Miller
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Liquid 2 Ventures
My Background

• Particle Physics

• Y Combinator (S08), Cloudant, IBM

• Liquid 2 Ventures
“Universal” startup trajectory?
“Our job is to help you keep your startup alive long enough to realize its potential”

–Graham from Cendana Capital
“Universal” startup trajectory?

Data taken from Pitchbook
Industry Trends

U.S. Startup Funding Rounds
2005 to 2015

- Seed/Angel
- Series A
- Series B
- Series C

Number of Rounds


Sources include AngelList, Crunchbase, MatterMark Research
Industry Trends

In truth, graduation rates vary wildly on starting population. Who did the seed, how big, when?
“We find 65-70% get Series A funding, 40-45% get to Series B.”

–Anon (Top 5 seed fund MD)
Why deals really get done

3 Types of Investors

- "Coverage" (aka FOMO)
- Market, Team
- Quantitative
“What do I have to do to get funded?”
What you cannot control

• Your competitors

• Geopolitics and macro-trends

• VC dogma

• The outcome of any given deal (highly stochastic)
What you can control

• Product

• Team

• Revenue

• NPS

• Messaging around raise (pre-seed, seed, seed’, seed+…)

• Timing

• Optimizing the raise:
  • Establish the market
  • Who you pitch first, what feedback you get, etc
Aside: Why investors care so much about Marketing

- Measure twice, cut once

- Have you really identified the core business problem that you solve?

- How easy is your sale

- Is your sale repeatable

- Cloudant example: it’s not the tech, or scaling, its the time time market. => make it faster to build new revenue
Series A: SaaS

- Pre-A Funding: $2.5MM-$3.5MM
- MRR: $100k - $250k
- ARR: $1.2MM-$2MM
- 15-20% MoM,
- **12 months in the market**
- Wide range, dependent on the actual GP
Series A: Infra

- Pre-A funding: $4MM-$5MM

- "Prepare yourself for a seed prime/seed extension/seed plus/seed convertible raise..."

- $1MM - $3MM ARR

- 3-5 "marquee" customers: "thought leaders associated with New IT, devops, digital transformation and the like"

- "Beefy ACV to demonstrate you’re solving an important problem"
Series B

• Estimates vary even more wildly.

• “5x your A numbers in <2 years”

• “Be like Gitlab!”

• MRR: $500k - $1.2MM

• ARR: $6MM - $9MM

• Quantify: churn, CAC, LTV

• Team size 40-60, significant non-eng

• 2-3X YoY strong B (*)

• 5-10% MoM rev growth

(*) Hmm, where does that come from?
IMHO: To achieve Series B, prove you are going to be a “meaningful exit” for your VCs.

https://medium.com/jme-venture-capital/meaningful-vc-exits-2bb5702776e2#.usqs1a7h6
A Typical Early Stage VC Fund

• 2/20 Fund Structure

• ~20 core investments per fund

• Goal: 3x gross returns

• Expected outcomes:
  • 7 zeros, 7 money backs, 6 wins
  • 5 “meaningful exits” and one “home run”
What’s “meaningful”?

\[
\frac{\text{Returns}}{\text{Company}} = \frac{3 - 1 - \frac{1}{3}}{5}
\]

Meaningful Return = 1/3 of Fund Size

https://medium.com/jme-venture-capital/meaningful-vc-exits-2bb5702776e2#.usqs1a7h6
What’s “meaningful”?

<table>
<thead>
<tr>
<th>Fund Size</th>
<th>Meaningful Exit</th>
<th>Home Run</th>
<th>VC ownership</th>
<th>Exit Size for Meaningful Exit</th>
<th>Exit Size for Home Run</th>
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<td>50</td>
<td>17</td>
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<td>20%</td>
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<td>333</td>
<td>1000</td>
<td>20%</td>
<td>1667</td>
<td>5000</td>
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</tbody>
</table>

Assumes 20% ownership (Series A goal)
Larger funds do have more GPs, but this is LP math
Revenue Requirements

- A SaaS company with 75% gross margin can be sold for 5x ARR
- A marketplace company with 15% take rate can be sold for 1x the last twelve months (LTM) gross merchandise value (GMV)
- An e-commerce company with 30% gross margin can be sold for 2x the LTM revenues
- In all cases, Net Debt (debt minus cash) at the time of exit equals zero, so Enterprise Value (EV) = Equity Value
- In all cases, the same growth rate is assumed

Know your asymptote. I didn’t.
### Revenue Requirements

You’ve got 5-7 years to hit ~$20MM ARR

<table>
<thead>
<tr>
<th>Fund Size</th>
<th>Exit Size for Meaningful Exit</th>
<th>SaaS Target ARR (5x)</th>
<th>Marketplace Target GMV (1x)</th>
<th>E-Commerce Target Revenues (2x)</th>
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<tr>
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Growth Requirements: t2d3

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<th>3</th>
<th>4</th>
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<tr>
<td><strong>ARR Growth Target</strong></td>
<td>Triple</td>
<td>Triple</td>
<td>Double</td>
<td>Double</td>
<td>Double</td>
<td>Double</td>
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<tr>
<td><strong>ARR Target for Meaningful Exit</strong></td>
<td>0,2</td>
<td>0,7</td>
<td>2,1</td>
<td>4,3</td>
<td>8,5</td>
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<tr>
<td><strong>ARR Target for Home-Run</strong></td>
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<td>2,1</td>
<td>6,3</td>
<td>12,5</td>
<td>25,0</td>
<td>50</td>
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</table>

Triple: 10% MoM
Double: 6% MoM
What to do if your round isn’t happening

• Be honest with yourself and investors

• Grow both revenue & margin

• Extend runway: (Burn <$100k month)

• The dirty secret of the bridge round, and how to do it

• Venture debt (Banks & Funds)
How bridge rounds really work

• Almost everyone has to do a bridge rounds.

• Bridge rounds are always insider rounds.

• Try to secure 50% commitment from your anchor investors before picking up the phone.

• Don’t expect much/any bump in terms.

• If you are executing extremely well, you may be able to do an uncapped note with 20% discount to the next round.
**Venture Debt**

- **Debt is complicated:** CFO territory
- **Banks:** WSJ’ + 1.25-2.25%
- **Funds:** ~11% fixed
- **Interest, warrants, right of first refusal**
- **Amortization, prepayment, fees, collateral, covenants, breakup charge...**
Venture Debt (Funds)

"Post Seed: Typically more conservative debt ratios, 25-40% of equity raised (so if company raises $3mm, we do $750k - $1.25). In high end of range, we would use milestones to get there. At this stage, very dependent on team, product, market. Would want growth to unlock milestones.

A: Typically 35-45% of the equity raised. Key here is wanting to see the origins of standard SaaS metrics, that company has acquired customers in a process that can be replicated. That TCV supports CAC, and low churn. Product should be in a good place and ready to ramp, feedback from early customers is strong (possibly with renewals). Also want to understand the ROI as perceived by users, to ensure product is ripe for market and not just purpose built for POCs.

B: Typically 50-60% of equity raised. Want to see true SaaS metrics – LTV, CAC, Churn, Sales cycle, ASP, etc. Want to see that company has successfully built sales organization and has strong process for onboarding and ramping new salespersons.

In general, we are typically trying to buy companies 6-10 months, where we can be comfortable that our capital is adding value. Revenue growth rates are hard, because it will depend on the ASPs. But 100% y-o-y is good rule of thumb. Higher growth may give us comfort to do more debt, and vice versa."

-Top 5 venture debt partner

25-40%
Venture Debt (Banks)

“A little all over the map, but if a company has raised a true series A or B VC round with a few VCs, they can probably get anywhere from $2.0-$5.0MM of debt from someone like us. What the revenue scale is, what the customer contracts look like, growth rate, margins, burn, and SaaS metrics all play into it.”

-Top 5 venture bank
Conclusion

• Focus on what you can control
• Revenue growth is your #1 measure of success
• If your round isn’t happening, know your options
• Lean on your existing investors for advice