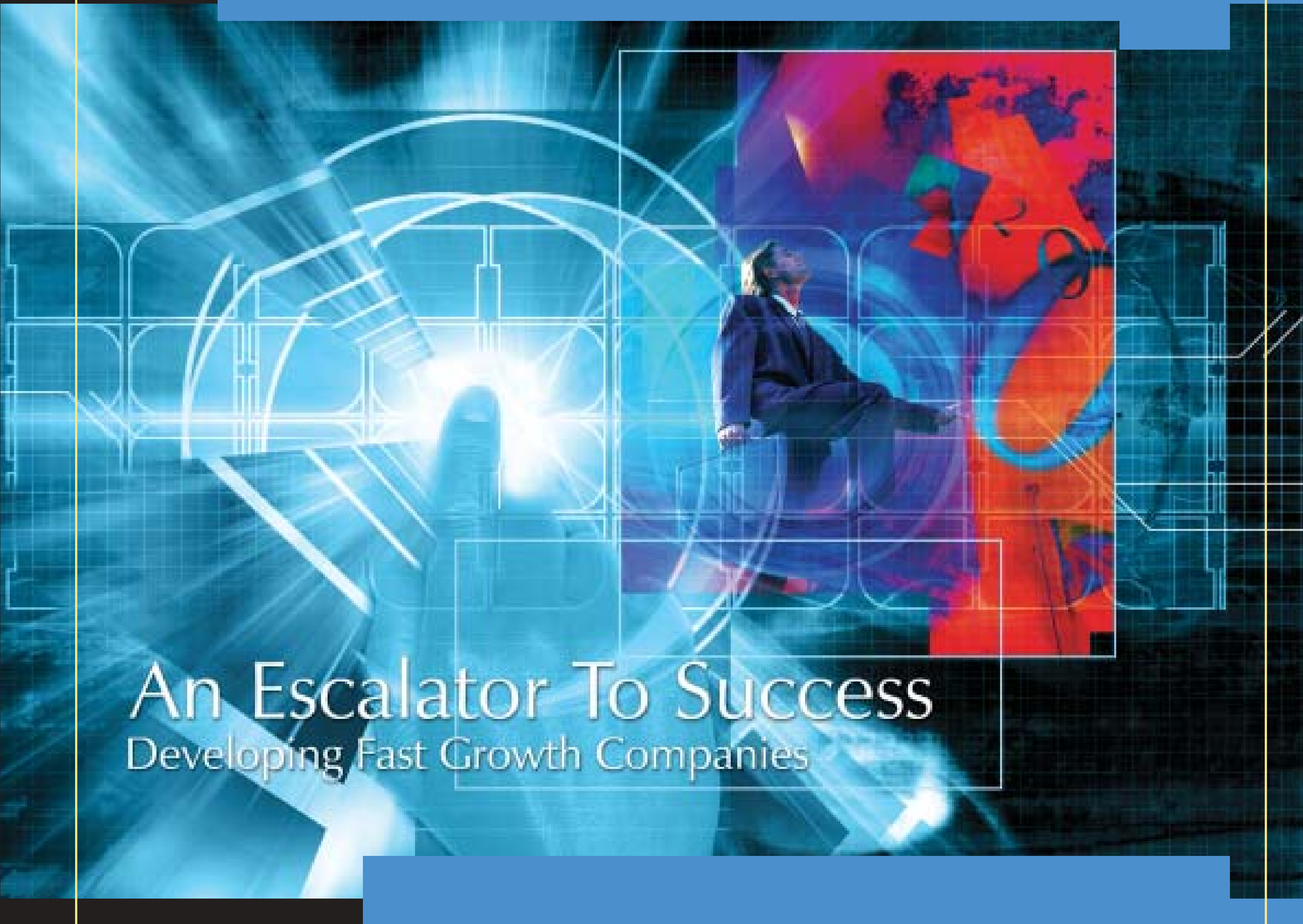
Catalyst Venture Partners



- Shaping and structuring start-up and early-stage companies for fast growth with a view to a planned exit is a complex and difficult challenge.

- Most potential fast growth companies require substantial help and support to successfully make it to a high value exit.

- The foundations of success lie in identifying distinctive capabilities and strategic assets that can be exploited to generate super-normal profits.

- Taking the right strategic, tactical and operational actions relies as much on managerial and operational strength as it does on ideas and vision.

- Substantial funding is required which can only be obtained by creating strong investor appeal through the demonstration of real substance.

An Escalator To Success - White Paper
Developing Fast Growth Companies

Shaping and structuring start-up and early-stage companies for fast growth with a view to a planned exit is a complex and difficult challenge. Companies invariably need substantial help and support to achieve a high exit value. The foundations of success lie in building and sustaining a strong market position achieved by acquiring and exploiting distinctive capabilities and strategic assets. Adopting the right tactical and operational actions to achieve this depends as much on managerial and operational strength as it does on ideas and vision. There is also a strong relationship between investment and fast-track growth. Funding is crucial and the ability to attract it requires the creation of strong investor appeal through the demonstration of real substance.

The **Catalyst Accelerator Programme** helps start-up and early-stage companies achieve a high value exit strategy through fast-track growth, goal attainment and the attraction of vital external funding. Fashioned on true partnerships rather than mere consultancy, the Programme is underpinned by a well-proven method that combines hands-on, independent business development expertise with access to capital and ongoing investment funds.

The foundations of growth:
distinctive capabilities and strategic assets

Growth can be viewed in terms of how effectively companies understand and exploit the distinctive capabilities and strategic assets they already have and how they plan to acquire new ones. Distinctive capabilities and strategic assets should confer an element of exclusivity or "uniqueness". Without it, there is no real sustainable competitive advantage and the super-normal profits that put companies on the fast track will be difficult to generate. At the very least, distinctive capabilities and strategic assets should be difficult for others to copy or obtain.

But while strategic assets and distinctive capabilities are important, they are not sufficient in themselves. They must also be managed effectively and brought to bear in a timely and efficient way in order to create opportunities.

What we mean by distinctive capabilities and strategic assets

Essentially, distinctive capabilities are the skills that enable companies to operate. Typically they might include:

- An innovative culture that is able to deliver timely new products and services.
- Key human resources such as talented management and development teams.
- A network of relationships that creates an efficient supply network.
- Buying know-how.

Strategic assets, on the other hand, are the resources companies have that they can exploit. Typical strategic assets might include:

- Intellectual property such as software or design rights.
- Reputation for high quality work and/or fast delivery.
- Prime site locations.
- Operating licences in highly regulated markets.

In reality, however, the difference between distinctive capabilities and strategic assets is not always clear-cut. For example, a distinctive capability can create reputation, which is an asset.

Funding up the value curve:
phases of growth and risk/reward profiles

Business development is a continuum from idea to IPO and beyond. However, it can be characterised into distinct phases. These can be defined as:

- Pre-seed – creation and formulation of initial business ideas.
- Seed – product /service is under development and pre-sales.
- Start-up – product developed and some initial sales.
- Early-stage – pre-profit but sales growing rapidly.
- Expansion – profitable.

Development through these phases focuses on building the requisite company platform - creating management structures and systems so that the distinctive capabilities and strategic assets of the business can be exploited. It also focuses on shaping and presenting the company to appeal to investors as well as facilitating access to appropriate funding sources.

Broadly speaking, in the Pre-seed phase, companies are formulating and defining their business ideas. As companies move into the Seed phase, development of products and services are well under way and pre-sales activity has begun. With initial sales coming through in the Start-up phase, Early-stage development is characterised with sales growing rapidly, although profitability may not yet have been achieved. This comes in the Expansion phase.

Conceptually, there is a relationship between the development of a company and its value. As a company passes through each phase of development, value should increase. This relationship can be called "the value curve". In practice, however, perceived value changes and corresponding investment can only be achieved once key milestones have been reached.

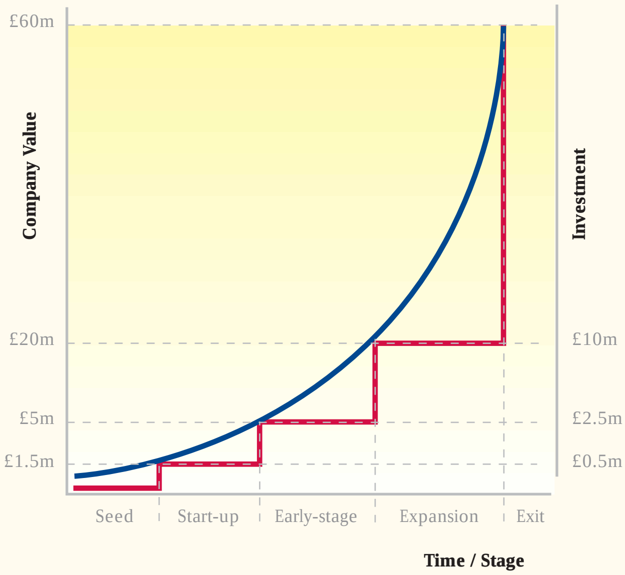
The Value Curve/Investment Step Relationship – an indicative example

Softco Ltd is a fast growth business that has had three rounds of investment:
Series A - £0.5 million at a valuation of £1.5 million; Series B - £2.5 million at £5 million; Series C - £10 million at £20 million. The business was sold for £60 million.

The investments were secured when the following milestones were reached:

Series A: Product was fully developed and about six "blue chip" customers had been secured.
Series B: Revenue was on track to achieve about £1 million in the investment year, the management team had been strengthened and a strong pipeline had been developed.
Series C: Forecast revenue had grown to £10 million in the investment year. The company was profitable and was on track to achieve net earnings in excess of £5 million the next year and a target exit.

Throughout the growth process, the value of the company has grown and can be seen as notionally rising in a curve. However, in practice this valuation can only be realised and investment obtained on optimum terms once thresholds or milestones have been reached.



Moving up the curve:
a multi-faceted approach

So how can a company move up the curve? The Catalyst Company Accelerator Programme is a well-developed and well-proven approach to the challenge that is designed to put companies on the fast track for growth.

The Programme is underpinned by a series of exercises and tasks that enable companies to move up the value curve and pass key milestones. In practice, many of these tasks run in parallel with one another and can be undertaken either as pre-funding or post-funding exercises.

Developing an operating business plan: The operating business plan is a working document that serves to highlight the strengths and weaknesses of a company. It provides a guide to the action needed to develop the proposition to a point where it is attractive to investors. Typically, the process of creating the operating business plan throws up a variety of issues that require addressing.

- Is the management team up to the job of creating and managing a fast growth business? Are the weaknesses recognised or are people deluding themselves? This can be one of the most difficult issues facing a new, entrepreneurial management team. Often, bringing in professional managers to supplement the founders during the later stages of development can finesse the problem.

- Is the intellectual property sufficiently well developed and protected? The ownership of intellectual property is a minefield. There are numerous horror stories of start-up companies having asked friends to do some software coding for them only to discover that this friend now owns the intellectual property. Developing products at work on employer's time and their equipment with a view to starting your own enterprise can mean your employer owns the intellectual property. We help companies find their way through this maze, bringing in intellectual property lawyers where necessary.

- Is there a coherent market strategy? Does the company know who will buy and why? This knowledge forms the basis for both the sales and the marketing strategies and, if it is wrong, can lead to company failure.

- Is the product ready for launch? Is there really a sellable product or is it merely an advanced beta version that still needs extensive de-bugging and testing.

- Is there a compelling "must-have value proposition"? It is simply not enough for company to offer "nice-to-have" technology. It must solve a real business problem where there is a demonstrable return on investment.

- Is the revenue model structured correctly and pitched at the appropriate price point? Getting this right is absolutely essential, as companies often don't get a second chance. There are also various potential options to factor in – buy, rent, lease, licence etc.

Implementing change: Companies often need independent advice and help in addressing the key implementation issues that arise from developing the operational business plan. These can be quite diverse but typically involve:

- Identifying and helping to recruit key members of the management team. We have a substantial network of highly experienced individuals who are looking for "opportunities" as opposed to jobs and are often willing to become investor directors.
- Assisting with the development of a market strategy. Using both analytical and market research techniques, we can help focus the strategy that forms the basis for the marketing and sales efforts.
- Providing contacts in organisations that could become strategic partners. We do this through our relationships with a wide range of companies from corporate venturers to smaller client investors. We use our reputation as a way to open the door for early-stage businesses.
- Helping to clarify roles. We work with each member of the team to identify their respective roles, assessing both their strengths and their weaknesses.
- Developing sales plans. Our sales plan generates both target customers and target outcomes. It is based on a disciplined sales process that anyone can follow and leads to rigorous pipeline analysis and revenue forecasts.
- Carrying out team building exercises. Frequently with new teams created to exploit intellectual property, there are communication difficulties and it can take some time for teams to become a coherent entity. Our team building exercises use questionnaires and discussion techniques to identify key issues and develop possible solutions.

Reference and trophy customers: One of our most important roles is helping companies win trophy and reference customers in key markets. A reference customer is one that is willing to publicly support a company's product or service. A trophy client is one that gives potential customers and investors confidence that the product or service on offer is cutting edge, reliable and well supported.

Reference and trophy customers are essential for the development of a fast growth company. We spend a lot of time working with portfolio companies to create a wish list of customers, identify suitable contacts and develop a strategy for penetration. We then help them negotiate appropriate terms and conditions.

Raising funding: We adopt a very strategic approach to fund raising - matching funds to the stage of development of the company. For seed and start-up companies, we seek to access funds from a variety of sources including:

- Government grants under such schemes as the "Smart" programme and the National Endowment for Sciences, Technology, and the Arts (Nesta).
- Government small firm loan guarantee schemes supported by many of the major banks.
- Factoring and invoice discounting.

For later stage companies, we typically aim to raise a combination of debt and equity from such sources as:

- Private investors.
- Mezzanine loan finance from banks.
- Institutional investors such as venture capital organisations.
- Government grants under the European Union regional funds programme.
- Corporate venturers who will often combine finance with other forms of support.

However, whatever stage a company is in, the same processes are required:

- Preparing a business plan suitable for investors that helps sell the vision as well as the reality.
- Providing contacts into the funding community.
- Developing presentations to ensure that the appropriate messages get across.
- Assisting in the negotiation process to ensure that the funding is injected on the best possible terms.

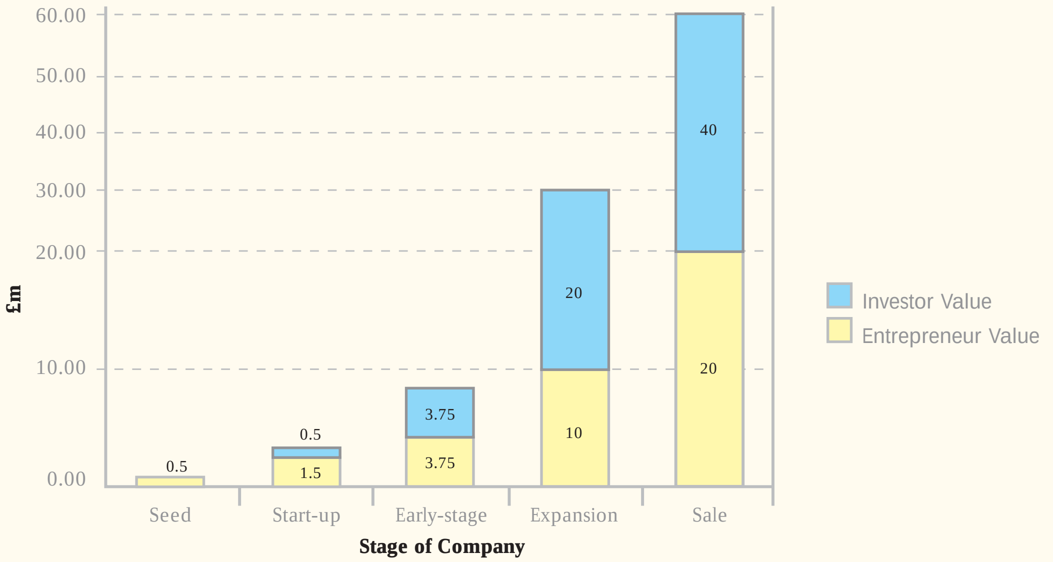
Post-funding support: Raising funds is not an end in itself. It should be viewed as a beginning. The next step is to help manage the post-funding process to ensure that it is effectively applied, further funding is obtained (as necessary) and a successful exit is realised. This often involves:

- Taking a seat on the board to help the founders manage investor relations.
- Helping recruit additional senior staff to manage the process of fast growth.
- Mentoring the CEO and other senior managers to help them deal with the stress of managing fast growth.
- Developing future funding strategies.
- Identifying potential acquisition targets.

Fast growth businesses will have various different stakeholders - founders, management and investors. All the stakeholders must believe that they will achieve a fair return on exit. If the returns are perceived as being unbalanced, then there is a danger that potential will not be fulfilled. Future investment may not be forthcoming and quality management may not be attracted.

Investor/Entrepreneur Share of Exit Value

Using our illustrative company, SoftCo, the figure below shows how returns to key stakeholders change through the investment/exit cycle.



As investment is drawn into the business and the business value grows, entrepreneur value increases from £0.5 million at the seed stage to £20 million on exit. However, entrepreneur shareholdings fall from 100% at the seed stage to 33% on exit. This is illustrated below.

Investor/Entrepreneur Share of Exit Value (£millions)

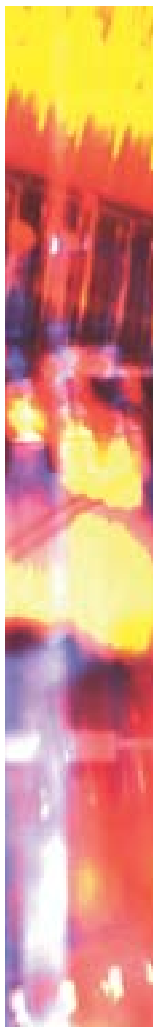
	Seed	Start-up		Early-stage		Expansion		Exit	Exit Multiple
Pre-Money Value	0.5	1.5		5		20		60	
Investment	0.0	0.5		2.5		10			
Post-Money Value	0.5	2		7.5		30			
Entrepreneur Value	0.5	1.5	75%	3.75	50%	10	33%	20	
Investor 1 Value	0	**0.5**	25%	1.25	17%	3.3	11%	6.7	**13.3**
Investor 2 Value	0			**2.5**	33%	6.7	22%	13.3	**5.3**
Investor 3 Value	0					**10**	33%	20	**2.0**
Total Investor Value	0	0.5		3.75		20		40	

In the example above investors at the start-up stage (Investor1) achieve 13 times their initial investment. Investors at the early stage get back 5 times their investment. Investors at the expansion stage (pre exit) achieve twice their initial investment.

The returns to investors reflect the different risk/reward profiles of the company development cycle. In the early stage of a company, risk of failure is very high. But, as the company becomes more established and is able to attract better quality management, the risk declines. Accordingly, investors need to match their returns to their appetite for risk.

Clearly, managing a fast growth company is a difficult, complex challenge and companies need substantial support. A company's development is generally resource intensive and invariably requires external funding. Inward investment is based on a company achieving key milestones. The return to stakeholders needs to reflect the inherent risks in a company passing through the various stages of development. The Catalyst Company Accelerator Programme is designed to help companies achieve key milestones in order to obtain necessary funding.

	Characteristics	Type of advice and help	Funding
Pre-seed	Pre-establishment of ideas.	General business education. Networking. Basic concepts.	Low.
Seed	Product under development. Pre sales. Embryonic management. Capital required to prove the product.	Start up education. Networking. Company formation. Business plan preparation. IP protection.	Self-funding. Friends and family. Grants.
Start-up	Product available. Initial sales. Weak management. Capital required to develop company structure/ management team.	Strategic marketing. Funding. Recruitment. Trophy clients. Deal making.	Friends and family. Bank. Early stage. Angels. VCs.
Early-stage	Some revenues. Core management team in place. Fast growing. Trophy clients. Capital required to finance sales and marketing.	Tactical marketing. Positioning. Strategic funding. Recruitment. Fast growth.	Bank. Angels. VCs. Factoring. Invoice discounting.
Expansion	Regular revenues. Developed management team. Fast growing. Diversified client base. Capital required to expand into new markets/marketing.	Market strategy. Investment ahead of the curve. Mentoring.	VCs.



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