

Private Equities are Peachy!

Ohio TechAngel Funds Meeting
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Why are we Angels?

- ▶ 48X: Blue Rhino:
Andrew Flipowski's \$500K/\$24MM
- ▶ 260X: Amazon.com:
Tom Alberg's \$100K/\$26 MM
- ▶ 1,700X: Apple: \$91K = \$154 MM
- ▶ 3,000X: Google:
A. Bechtolsheim's \$100K/\$300MM
- ▶ 10,500X: The Body Shop:
Iain McGlinn's £4,000 / £42M

Why are we Angels?

(Ohio Exits over last 33 months)

- AtriCure (Cincinnati): \$48 MM IPO
- Northcoast PCS (Independence): Bought by Revol
- Pathlore (Columbus): \$48 MM; Bought by SumTotal
- TMW Systems (Beachwood): \$37.5 MM; Bought by Peppertree Partners
- Athersys (Cleveland): Reverse merger with BTHC VI \$65 MM
- Cadence Networks (Cincinnati): Acquired by Advantage IQ for \$37 MM
- Cohesia (Mason): Acquired by Powerway
- Endforce (Dublin): Acquired by Sophos
- Escort Radar (West Chester): LBO by Falconhead Capital
- Everstream (Cleveland): \$15 MM Bought by Concurrent Computer
- Flight Options (Cleveland): Bought by Raytheon
- Atomic Dog Publishing (Cincinnati): Bought by Thomson Corp.
- IntelliSeek (Cincinnati): Bought by BuzzMetrics
- Flashline (Cleveland): Bought by BEA Systems
- HTP (Columbus): Bought by McKesson

But: ROI is *not* our primary motivation

We are Angels Because:

- ▶ “Two thirds of angel investors report that making money isn’t their primary motivation for investing in private companies.”¹
- ▶ Learn new science & technology
- ▶ Bring a new product/service to market
- ▶ Build winning enterprises
- ▶ “Mentor capitalists” passing business acumen to next generation
- ▶ “psychic return that comes from helping build businesses in the community”¹

¹ Source: *Fool’s Gold?* by Scott Shane

We are Angels Because:

- ▶ Buffett: “I enjoy the process far more than the proceeds, although I have learned to live with those also.”
- ▶ Make a difference, not just more dollars...
AND:
- ▶ Make the biggest difference when needed most, which is *right now!*
- ▶ *WHY?* Our CEO’s weren’t managers during 1981 / 83 recession unless they’re > 55

Asset Allocation

- ▶ “Observer” Asset Classes:
 - Public Equities
 - Art/Antiquities
 - Real Estate
 - Oil & Gas Drilling Funds
 - Hedge Funds
 - Gold

- ▶ “Engaged” Asset Class: Private Equities

Public Equity Markets

Next Slide, please!

Primary Causes?

- ▶ Greed? Like gravity, it's always here
- ▶ Randomness? (Taleb's *Foiled by Randomness; The Black Swan*)
- ▶ Misplaced faith in financial wizards?
("shocked disbelief".....will replace Greenspan's "irrational exuberance.")

"Most economists are most economical about ideas.....they make the ones they learned in graduate school last a lifetime." J.M. Keynes

Causes, Clowns & Culprits

- ▶ Low interest rates
- ▶ Escalating home prices (HPA drove CMO's)
- ▶ Exploding personal indebtedness
- ▶ Fannie/Freddie (guaranteed \$1T of Sub-P)
- ▶ Financial engineers (CMO/CDO/Synthetic CDO/CPDO @ 15:1 /CDPC @ 80:1, and CDS)
- ▶ Rating Agencies
- ▶ Inept BOD's: AIG

377 Killed AIG & Cost Us \$123B

- ▶ World's largest insurer; AAA ('05); imploded as A-
- ▶ 116,000 employees in 130 countries
- ▶ '87 AIG Financial Products = 377 Londoners
- ▶ Joe Cassano invents Credit Default Swap (CDS)
- ▶ 2005: \$3.3B revenues = 18% of AIG's Op. Income
- ▶ Ave. comp = \$1 MM per FTE (\$9.5 MM over 7 yrs.)

Upton Sinclair: "It is difficult to get a man to understand something when his salary depends upon his not understanding it."

The Tooth Fairy versus:

- ▶ **Board Governance**

(@ 9-15 BR: Lehman's BOD: US Bancorp; Salomon Bros; McKinsey; IBM; Halliburton; Vodafone; Telemundo; Sotheby's)

- ▶ **Rating Agencies: \$25B Alt-A loans: AAA/junk!**

- ▶ **SEC Disclosure & SOX**

- ▶ **Regulatory Oversight: Bear Stearns D/E > 30!**

- ▶ **Value at Risk (VaR) Analysis: 1% is OK**

- ▶ **The Free Market System: Treasury's TARP**

- ▶ **"Nobody don't know nuttin"....."We're now all connected and nobody's in charge."**

In a Recession? How Long?

- ▶ Average U.S. recession = 10 months
- ▶ 1971 /73 and 1982 /83 recessions = 18 months
- ▶ 18 months = May 1, 2010.....BUT:
- ▶ '83 Financial Services = 15.8% of corporate profits.....versus >30% today
- ▶ “On September 29, 1929, the booming stock market reached a peak that would not be attained again for another twenty-five years. By the time the market reached its all-time low in 1932, most blue chip stocks had lost 95% of their value.” William A. Sherden
- ▶ Buffett: “If history books were the key to riches, the Forbes 400 would consist of librarians.”

Keynesian Beauty Contest

When buying public equities, picking great companies is not enough.....you must pick stocks the stock pickers think are gorgeous*

* John Maynard Keynes: The General Theory of Employment, Interest, and Money (1936); also “a convergence to Nash Equilibrium.”

Private Equities are Pulchritudinous!

We focus on building great companies, not guessing what the stock pickers think are great companies

Private Equities' Beauty

- ▶ No security analysts/stock pickers/rating agencies
- ▶ No swaps/derivatives/counter parties
- ▶ No obfuscating footnotes
- ▶ No regulators/SEC/Treasury intervention
- ▶ No FX/foreign government risk
- ▶ We look over this storm to our exit horizon

Just build a great company!

OTA's Portfolio Companies

- ▶ Triage: Five categories
- ▶ “Months to Fumes”
- ▶ Runway Calculator (capital to achieve CFBE)
- ▶ Decrease Burn to Extend Runway
- ▶ Consider:
 - Wealth creation, not income creation
 - Relationship & Communications
 - Co-investors' support

OTA's 5 BUCKETS

Zebramobile
Exacter

CFBE

PreEmptive
ClearSaleing
InsightETE
AircraftLogs
Caster

CFBE w/ cuts

NanoStatics
CleveX
SageQuest
MID

CFBE w/
<50% raise

AssureRx
Aquablok
MMD

CFBE w/
>50% raise

VenJuvo
GLP
I3

Need New \$
ohio

CEO Action Steps

- ▶ Track competitors (“Last one standing”)
- ▶ Complete the Berkus “Attraction Grid”
- ▶ Calculate MTF & runway to CFBE
- ▶ Weigh pain today vs. remorse later
- ▶ Prepare a “To Don’t” List
- ▶ Seek help from advisors/investors (>55)

Need Capital before 5-1-10?

- ▶ Reward diminished cash burn
- ▶ Over-communicate with current investors
- ▶ Update ES & BP
- ▶ Videotape pitch/BP on protected website page
- ▶ “Sell” your fiscal discipline vs. competitors

CEO Opportunities

- ▶ Intensify focus against weakest competitor
- ▶ Cull average employees
- ▶ Attract competitors' best talent
- ▶ Acquire IP from dying ventures
- ▶ Acquire complimentary ventures
- ▶ Battle-hardened team & fewer competitors

SUMMARY: Memorable Times!

- ▶ “Business is relative, not absolute”
- ▶ Ohio’s chance to really pull ahead!
- ▶ Immune to the IPO market
- ▶ Valuations will compress
- ▶ Fewer down rounds in the future
- ▶ Syndication skills rewarded
- ▶ “Real source of all growth is human creativity and entrepreneurship.” (G. Gilder)
- ▶ Tales for our next generation!

SUMMARY: We'll Be Fine!

- ▶ Theory of Relativity: Where would you rather invest? (US \$)
- ▶ 2003–7: U.S economy grew one China!
- ▶ De-couple results from stock price, especially for non-financial entities, and public equity bargains could arise.....but
- ▶ Private equities will be exceptionally alluring for those with liquidity and conviction!

Discussion/ Questions?

Musings

- ▶ “I’m close to a raging bull on private equities!” Steve Schwarzman (Blackstone)
- ▶ “Being first to market doesn’t matter if you’re not still standing”
- ▶ “Be financially cautious and entrepreneurially optimistic” James Geshwiler
- ▶ “Capital Efficiency will be more revered.”
- ▶ “The fact that people will be full of greed, fear or folly is predictable. The sequence is not predictable.” W. Buffett

Musings

- ▶ Buffett: “In the end, alchemy, whether it is metallurgical or financial, fails. A base business cannot be transformed into a golden business by tricks of accounting or capital structure.”
- ▶ “The illusion of knowing what’s going to happen is worse than not knowing.” James Utterback of MIT
- ▶ “It is not the strongest of the species that survives, not the most intelligent, but the one most responsive to change.” Chas. Darwin
- ▶ “Let us remember that economists are evaluated on how intelligent they sound, not on a scientific measure of their knowledge of reality.” N. N. Taleb
- ▶ “You eventually get the shareholders you deserve.” W. Buffett
- ▶ “Calculus...(gives) speculation the deceptive guise of investments.” Ben Graham *The Intelligent Investor* (1949)