

10 Reasons Investors Pass ... And, Ways To Enhance The Odds of Raising Capital

By Andrew S. Whitman, Managing Partner – 2x Consumer Products Growth Partners
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(www.npcinstitute.com/Financing%20seminar.htm) and *BevNet Live* (www.BevNetLive.com)

Entrepreneurs often ask why investors, and more specifically institutional investors like *2x Consumer Products Growth Partners*, might choose not to invest in a given Company. While the answer is often “it depends”, the following are 10 common reasons investors pass and ways to enhance the odds of securing the investment you seek:

- 1. Dazed and Confused** A business plan consisting of 60 pages of repetitive and hard-to-follow narrative, a weak executive summary and confusing spreadsheets are unfortunately all too common. Try to tell your story in a concise and compelling way. A few pages of text (exec summary with summary financials included), 10-20 slides and an easy to follow bottoms-up excel model is often much more compelling than a 60 page Private Placement Memorandum. It takes a lot more work to be concise but it’s worth it.
- 2. Wrong Way** Seeking growth capital from the wrong sources will prove to be a frustrating endeavor. While many investors will visit with a Company that sounds interesting, don’t confuse a courtesy visit with a likely investor. In general, an institutional Private Equity investor with a \$200 million to a \$1 billion Fund, for example, will not invest \$5 million or even \$10 million in a Company, regardless of excitement for the business. These Funds generally invest much larger amounts per Company. It’s dangerous to believe that your Company will be the one exception to their investment profile. Do your homework. Make sure you’re spending time with investors who say their “sweet spot” investment (amount of capital deployed per Company) and industry focus are exactly what you’re looking for. Also, if you’re seeking capital below \$1 million or maybe \$2 million, you’re almost certainly looking for friends/family, individual angels or possibly angel groups (see list of angel groups interested in consumer products archived at www.2xPartners.com).
- 3. All Sizzle, No Steak** A pure marketing pitch doesn’t work. Remember, you’re pitching an investment in your Company not selling your product to a retailer or consumer. Make sure to buy the SPINS data if you’re a small, natural/specialty products company (or Nielsen/IRI data). For between \$500 and \$5,000, you can know everything you’d need to know about your business in a given snapshot. The same applies to financial data – demonstrate how your financials (income statement, balance sheet & cash flows) support your proposition. Provide detailed use of proceeds and show how the investor benefits from the investment. Be specific. For investors like us, the two most important metrics are gross margins and velocity (also known as same store sales or sales per point of distribution) growth. See more below.

4. Leaky Bucket Too many Companies in our industry focus on rapidly expanding distribution and proudly say they “have distribution in 3,000 doors” yet the turns per store are weak. Far more important than breadth of distribution (it’s easy to expand distribution if your velocities are compelling) is sales per point of distribution (SPP) in a retail business or repeat order data in a direct-to-consumer/online business. For example, a business with +25% sales growth sounds good. But if you dissect the consumer takeaway and there’s a -25% SPP but lots of distribution growth, we’d describe that as a leaky bucket. This situation is usually something far more fundamental than, for example, a missing management team member, having the wrong co-packer, distributor/broker issues, insufficient marketing spending, etc. Investors will be concerned. In summary, sell-in without sell-through can be more of a liability than an asset when talking to institutional investors (beyond the angel stage).
5. No Margin for Error Even when subscale, gross margins need to be sufficient to avoid significant operating losses in the early days and leave enough funds “below the line” to build a branded business from a marketing and sales perspective. Gross margin percentages in the 20s and even 30s make success unlikely for food/beverage businesses while 40s in personal care/home care raise doubts. Also, gross margins rarely increase as much as founders believe strictly due to larger volumes (e.g. scaling from 30% to 45% is rare). Invest the time early to make sure your gross margins are where they need to be.
6. Know Not Thy Business It scares the #*&@^!(%# out of investors when founders do not know (or understand) their own financials. While most investors are not expecting founders to know the finest points of their financials the way a CFO with 30 years of experience might, know your numbers and understand the pressure points of your business (e.g. break-even point and what it takes to make your business profitable if it is not). Recently, when asked a fairly basic question about his business, the founder responded “that’s really not my area or expertise.” Don’t let this be you!
7. Betting on the Come All small and even medium sized rapidly growing Companies will have parts of the business that are “yet to come” such as new products, new channels, etc. However, investors are most comfortable when most of the core offerings, SKUs, etc. are already developed so that capital is used primarily to accelerate the business (aka “step on the gas”). Simply put: less risk of the unknown. Here’s an example of a concerning situation: a business is showing excellent growth, both historically (>50% annual growth rate) and in future looking projections with growth capital (revenue of \$5 million today growing to \$30 million over 5 years). However, the \$25 million of growth is made up of \$2 million on the existing base business and \$23 million of new products not yet introduced to the market. This scenario is likely too scary for most investors.
8. Mismatched Returns An individual investor might be excited about a 10-15% annual return on an angel investment that “beat the market” (even though according to one reputable source 50% of angel investments result in a total loss of the invested capital). However, these returns are unacceptable to an institutional investor that seeks to make one to two times their money (commonly referred to as 1x-2x) per year they’re invested in an early(ish) stage Company. A private equity investment in a more mature and therefore less risky Company is likely to seek ~2.5x total return over the life of an investment. Make sure you’ve looked at the return potential from the prospective investor’s seat including assumptions of further dilution down the road if there will be additional capital raised (and there usually is!).

9. Failure of Confidence Most founders I know don't intentionally set forth unachievable and unrealistic growth projections just to attract investors. However, when looking back with the benefit of hindsight most projections turn out to be considerably too aggressive despite claims of "conservative projections" and investors know this. Whether projections are conservative or not, be careful what you claim. Being credible (in all ways) is critical for an investor to back a CEO and a Company.
10. Too Messy Friends & family or angel investments are the lifeblood of getting great businesses off the ground. However, they're often structured in unusual ways, with unrealistically high valuations or with restrictive terms and agreements that make the company unattractive to new investors. It's important to take the time to clean up your cap table, get prior debt holders to convert to equity or simplify any "out there" terms to make your Company "investment friendly". It's worth the effort.

Finally, regardless of what stake an investor has in a Company, it changes the way a founder operates even if in very minor ways. Don't skimp in taking all the time you need to get to know a prospective investor and growth partner if they're bringing more than just money. This is critical. But, conversely, don't over think the terms/structuring of an investment. The investor and the Company are either quickly on the same page or not. Founders that go around and around trying to get "a better deal" will likely end up without an investment. Deal momentum is important to capitalize on and deal fatigue often proves fatal.

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I hope this information is helpful and you successfully raise your growth capital en route to building a wildly successful business. Good luck!



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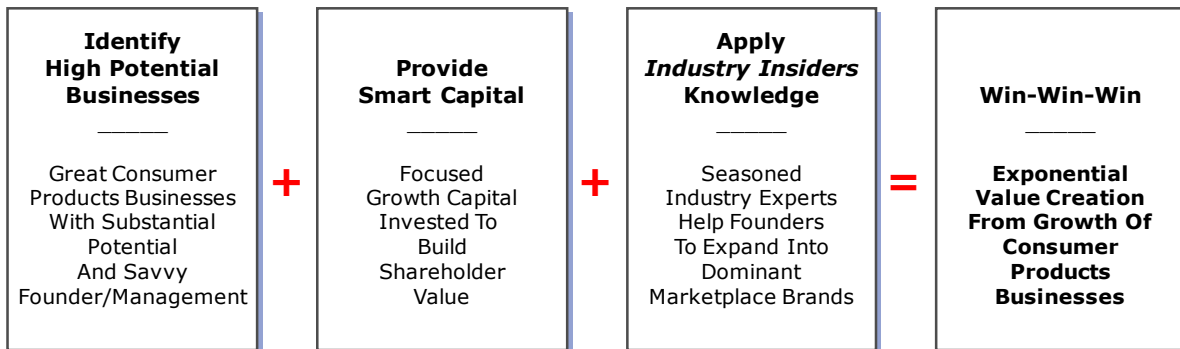
2x Consumer Products Growth Partners joins with founders and management in emerging consumer products businesses capable of growing exponentially via an infusion of capital and management expertise. Focus areas include food, beverage, personal care, home care and pet care – particularly in the organic/natural, specialty/gourmet and ethnic sectors. Businesses are primarily within the \$1-15 million revenue range. Sorry, no pre-revenue businesses.

OVERVIEW

2x Consumer Products Growth Partners joins with founders and management of emerging consumer products businesses capable of growing exponentially via an infusion of capital and management expertise.

Focus:	Categories:	Due To Our Growth Perspective, Businesses Are Likely To Have Characteristics Of:
	<ul style="list-style-type: none"> ✓ Food ✓ Beverage ✓ Personal Care ✓ Home Care ✓ Pet Care ✓ Other Branded Consumer Products 	<ul style="list-style-type: none"> ✓ Natural ✓ Organic ✓ Ethnic ✓ Specialty ✓ Gourmet
Revenue:	Primarily within the \$1 million to \$15 million revenue range; Never pre-revenue businesses	
Ownership:	Minority ownership stake as part of a partnership most common; Majority interest or complete buyout not atypical	
Investment Criteria:	<ul style="list-style-type: none"> ✓ Founders/management team seeking a partner, not just an investor ✓ Powerful consumer-driven positioning with exceptional product fulfillment ✓ Strong sense of “proven-ness” based on in-market performance ✓ Exponential growth potential to at least \$30+ million in revenue within 3 to 5 years ✓ Categories that immediately leverage our expertise ✓ Attractive go-to-market approach leading to sound long-term financial proposition 	

FORMULA FOR SUCCESS



VALUE-ADDED RESOURCES

2x Consumer Products Growth Partners bring more than 250 years of directly relevant expertise to complement and support founders/management. We leverage our industry expertise, contacts and connections for the benefit of the companies. Our experience and operating approach is the main attraction for entrepreneurs.

“The unparalleled depth of experience in the industry is helping gDiapers achieve our goals ... business, social and environmental.”

– Jason Graham-Nye, CEO/dad and co-founder, gDiapers

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