Capital Raising for High-Growth Businesses

WHITEPAPER

By Jack Delosa

Janine Allis sells 65% of Boost Juice for $65 million. Sir Richard Branson invests $10 million into creating Virgin Blue only to list it on the Australian Stock Exchange three years later for $2.3 billion. Creel Price starts, builds and exits a business for $109 million in under 10 years. Dean McEvoy and Justus Hammer start and exit Spreets in 10 months for $40 million. Domenic Carosa takes his company public at the age of 25. Matt Barrie buys several businesses to create Freelancer.com, Australia's largest outsourcing platform.

What do all these entrepreneurs have in common?

In his whitepaper, Capital Raising for High-Growth Businesses, Jack Delosa draws on his experience as a Gen Y entrepreneur and investor to outline the step by step way to raising capital and building significant wealth through business. Drawing from his personal conversations with all of the entrepreneurs mentioned above, Delosa delivers an impactful punch of paradigm shifting strategies for entrepreneurs looking to get ahead in the business world.

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About The Author

JACK DELOSA

A Gen Y Entrepreneur and Investor

Jack Delosa is a Gen Y entrepreneur and investor and was recently described by Sunrise as *"The Young Aussie Millionaire That Didn't Finish Uni."*

Jack's career has spanned business, media and politics. From having his company listed in the Fastest 50 Start-Ups in Australia, to raising over $5m for his personal clients and acquiring businesses with his panel of investors, Jack Delosa is an emerging leader for future and existing entrepreneurs.

Jack's focus is educating and developing a new breed of entrepreneur through his two business education institutions, The Entourage and MBE Education that collectively talk to over 10,000 businesses every year. Educating entrepreneurs where they are needed most, he also contributed to the development of the curriculum at the Branson Centre of Entrepreneurship in South Africa.

Jack has consulted for brands such as Microsoft, Virgin and CPA on the topic of business growth and performance. Today he is a spokesperson for entrepreneurship in Australia as a regular blogger for Sydney Morning Herald, The Age, Start Up Smart, Dynamic Business Magazine and ANZ Bank. He has also been featured in BRW, Career One, Channel 7, Channel 9, Channel 10 News and Sunrise.

In recognition of his successes, Jack has been listed as one of the top 10 entrepreneurs under 30 in Australia in the Dynamic Business Young Guns, and three times in Australian Anthill's 30Under30 Publication.

Jack is also an Accredited Advisor with Succession Plus, a boutique advisory firm focused on helping SME's build value and exit.

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Playing A Bigger Game

WHY 80% OF AUSTRALIAN SMALL BUSINESS OWNERS ARE ONLY GENERATING 20% OF THE RETURN

Many Australian small business owners list access to capital as being their number one barrier to growth. Capital raising in the Australian market can be a grey area, with little education, guidance, or channels to connect with investors. Further to this, we are forever being bombarded with negative media speculation about the worsening economic climate and its effects on small business. However a recent survey done by Wholesale Investor Magazine who have 10,500 high net-worth and professional investors in their network, indicates that only 1% of investors believe now is "not a good time to invest."

Further to this, 22% of Australian business owners are aged over 60, which means almost a quarter of Australian businesses need to be sold, handed down or closed in the next 3-5 years. Tony Featherstone, former Managing Editor of Business Review Weekly (BRW), reported in the Sydney Morning Herald in September 2011 of the huge "destruction of value" created by this trend stating that "I doubt if enough politicians grasp the significance of a generation of baby boomer operators of small businesses leaving the workforce this decade and next."

This not only strengthens the need for quality guidance on how to build value and prepare a business for sale, it also represents an opportunity for entrepreneurs who understand how to raise capital and acquire complimentary companies in order to accelerate growth.

Not understanding how to raise money, buy businesses or sell a business, can place a glass ceiling on the potential of an entrepreneur.

Knowing how to successfully raise capital from investors to grow your business, purchase other businesses that have untapped potential, and prepare a business for ultimate sale, is a skill-set that not only gives you a standing in the business community, it offers a significant advantage over your competitors.

This is the skill-set that is used by high-level entrepreneurs and large organisations all over the world. The BRW Rich List comes out once a year and hosts Australia's wealthiest 200 people. Over 90% of the people listed on the Rich List have raised capital, acquired a business or sold a business to investors. Yet if these skill-sets are so important to building significant wealth through business, why are there so few small businesses adopting the same strategies?

For the first time, access to this level of information and these strategies is available to small to medium business owners who want to grow a substantial business. More and more we're seeing small businesses attract money from investors, we're seeing special funds and groups of investors develop with a sole focus on investing in start-up and early stage businesses. In 2010, Angel Investors invested over $1 billion into small businesses in Australia, right now venture capital firms throughout Australia have over $2.5 billion in investable cash. The money is out there and the deals are happening, you just need to make sure you are educated on how.

WHY 80% OF AUSTRALIAN SMALL BUSINESS OWNERS ARE ONLY GENERATING 20% OF THE RETURN

Raise Capital	Buy Businesses	Sell your Business
Expand your team and spend less time in your business	Acquire a large customer base that you can cross-pollinate with	Sell your business for a multiple of its profits – this is where many high net-worth entrepreneurs have made their money
Spend more on marketing, expand into new regions & product lines to accelerate the growth of your business	Synergise with an existing business through new staff, customers, partners and systems. Enjoy the cost-cutting that comes from these synergies	Leave a legacy for yourself and your staff that lives on without you
Buy other businesses using none of your own money	Buy businesses that have not exploited their potential and develop them to a point where you can sell the business for a profit.	Enjoy more spare time, retire, or become an 'entrepreneurial investor' investing into new opportunities

it is possible – the market in Australia

Australian Venture Capital Firms have approximately **$2.5 billion in available funds** to invest into private companies. Venture Capital firms will typically invest between $1m - $10m.	In 2010, Angel Investors – investors that typically invest less than $1m – invested over **$1 billion into 5,000 Australian companies**, an average investment size of $200,000.
Only 1 % of investors say now is not a good time to invest, with the majority of investors indicating the main barrier to investing into private companies is "finding suitable opportunities".	The most common challenge investors see within businesses that are not suitable, is that **"the companies are unprepared"**. A preparation period of 3-6 months is recommended for a company to become 'investor ready'.

The Investment Landscape
KNOWING WHO TO TALK TO

Type of Investor	Description	Stage of Investment	Transaction Size
"The FFF Fund" – Friends, Family and Fools	People that you have a personal relationship with, that want to see you succeed	Seed	$0 - $100,000
Angel Investors	Private individual, investing their own money because they like the business and understand the space	Seed / Start Up / Expansion	$0 - $2m
Venture Capital (VC)	A professionally managed fund designed to invest in high-growth businesses	Expansion	$1m - $20m
Private Equity	A professionally managed fund designed to invest into mature companies, often taking a majority shareholding	Mature	$10m +
Bank Financing	A financial institution that is very risk averse, particularly when it comes to investing in small business	Expansion > Mature. Provided there is strong and stable profitability.	$1m +

When we talk about capital raising, what we're really talking about is value.

Value is all about how we can:

1. Enhance the value of the company prior to talking to investors
2. Continue to increase the value of your business to deliver a good return to your investors
3. Ensure that you as the entrepreneur, maximize the value you are able to generate through the business

Valuation

Your business is an asset. Similar to a house, your business is an asset that has a market value. This value can be enhanced or diminished depending on what you do with the business. Similar to renovating a house to add value to it, there are certain things you can implement within a business that can add significant value in a relatively short period of time.

The most common method of valuing a company is to do so at a multiple of its profits. The average private business in Australia is valued at 1.5 x profit.

So for most private businesses in Australia, if their profit is $200,000 before tax, the business may be valued at:

$200,000 (profit) x 1.5 (multiple) = $300,000 (valuation)

Although profitability is not the only factor that comes into valuation, it is a very important factor in that if you can demonstrate profitability, finding investors for your business does become easier. This is important given that our research indicates the number one place Australian small business owners go for advice is their accountant, however the first thing your accountant tells you to do is minimise profit for the sake of minimising tax.

If you're looking to build value into your business so that you can raise capital and in future potentially sell the business, stripping profits out of the business in the meantime is not commercially smart and should be advised against.

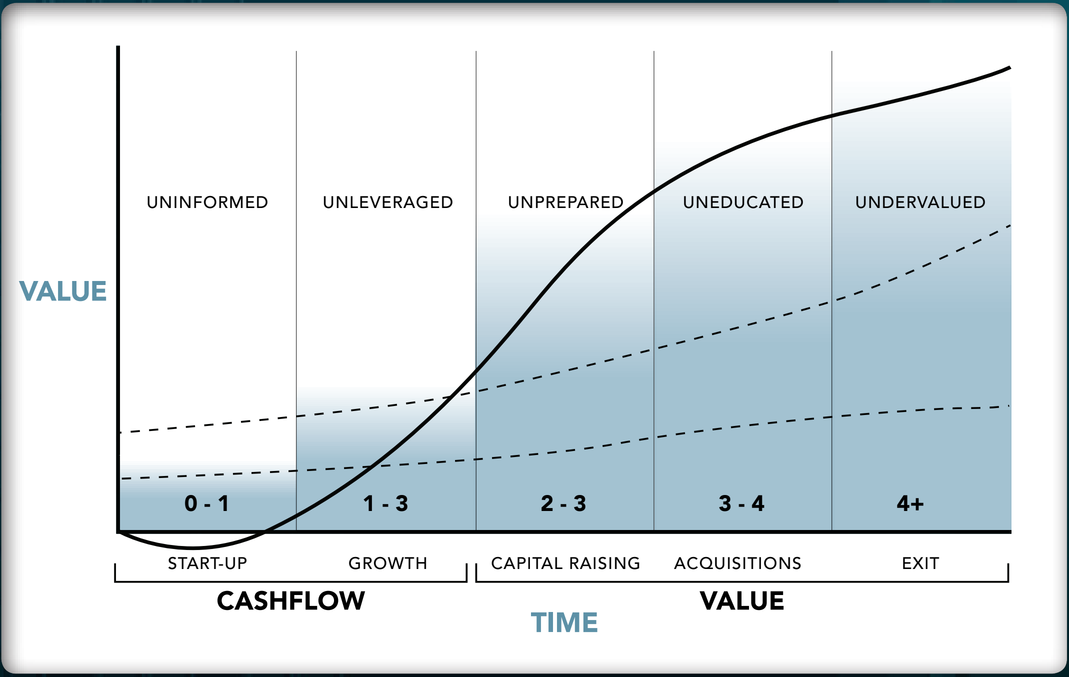
Whether you are profitable at the moment or not, you can still raise money from investors. When Facebook was losing approximately $1m each month, Microsoft invested $240 million for 1.6% of Facebook, valuing the company at over $15 billion. Facebook were able to achieve that valuation not on the back of their profitability, but due to the assets and I.P they had in the business.

Profitability is not the only factor. If you can demonstrate that you have built something worthwhile that has proof of concept, a good market opportunity and a team that can be trusted to execute well, there are investors that are happy to look at your opportunity.

The Business Lifecycle

BUILDING SIGNIFICANT WEALTH THROUGH BUSINESS

"The proper man understands equity, the small man profits." – Confucius



*Most business owners never venture beyond Stage 2 to realise the value they have already built. This means the vast majority of business owners are doing 80% of the work and only ever seeing 20% of the return.

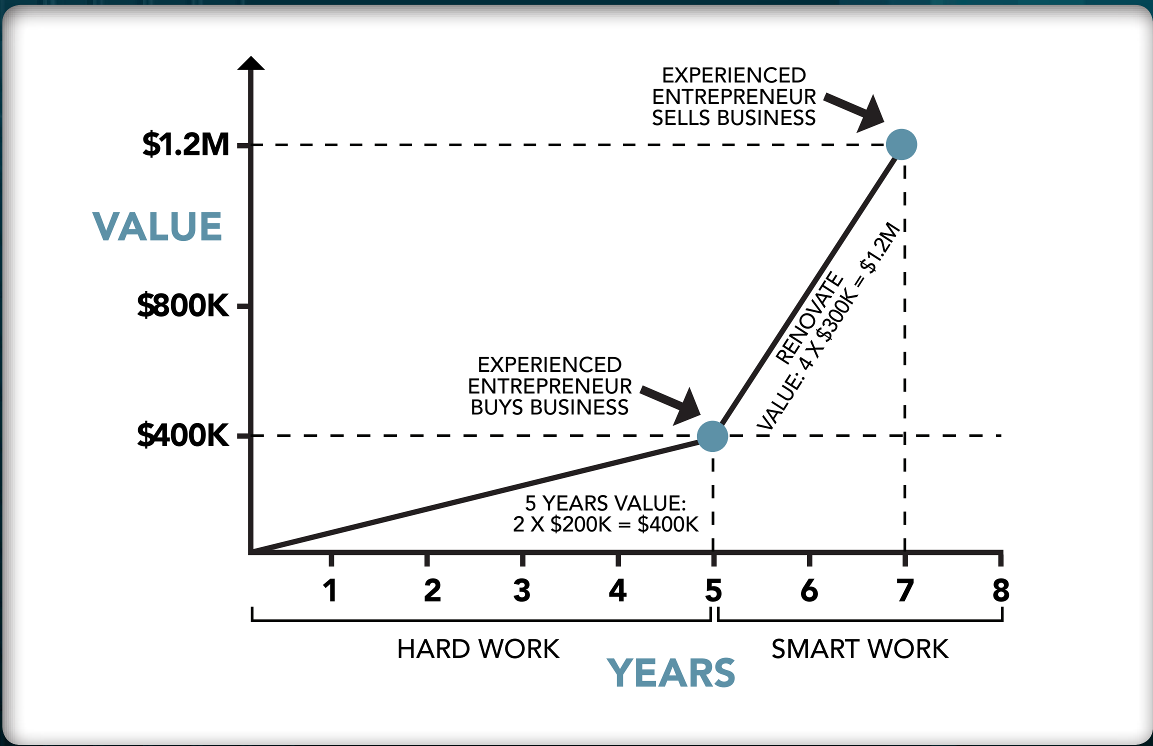
As a business goes through it's lifecycle it's value increases significantly. As demonstrated by the diagram, most of this value is not created until the business ventures beyond Stage 2 – The Growth Stage. As a business becomes larger and more profitable, by virtue of its size it is considered to be less risky and therefore will typically attract a higher value.

What's unfortunate about this is that the vast majority of businesses never go beyond The Growth Stage due to a lack of knowledge around the Capital Raising, Acquisition and Exit Stages. All too often we see a small business owner spend five years working day and night to get the business to a point where it is profitable only to have an experienced entrepreneur or investor come along and buy the business for 2 x profit.

In the next 24 months, the experienced entrepreneur will essentially 'renovate' the business. They will increase the marketing activities, adopt a smarter sales strategy, tighten the systems, put in a CEO to manage the business and typically enhance the value of the business using far less time and effort than the previous owner.

The experienced entrepreneur has not only been able to increase profitability but they have also managed to justify a higher 'multiple' for the business, now selling the business for 4 x profit to another investor who wants to pick up the business.

Hard Work Vs. Smart Work



Here the experienced entrepreneur has done three things:

1. A capital raising – to fund the purchase of the business at the 5 year mark
2. An acquisition – the actual purchase of the business at the 5 year mark
3. An exit – the sale of the business at the 7 year mark

Understanding these three "transactions" is the key to mastering business and building significant wealth for yourself and your partners.

Start-Up

The first two years of the business are always the hardest. Long hours, no holidays, tight cash-flow, few customers and if that wasn't enough a high turnover of staff due to a high pressure environment. A start-up business is often an excitable teenager that doesn't know what it wants to be when it grows up, but is determined to find out.

A start-up business is a temporary organism designed to find a viable business model. In the start-up phase, what you think you're going to look like in six months, you won't.

Growth

Once you have navigated the start-up phase and have a relatively proven business model, you enter the growth stage. This stage is where the model is somewhat determined, a customer base is in place, staff know what they're doing, there is a message to market fit and it's time to scale. Although this stage can be a bumpy ride due to rapid growth, this is where a business grows into itself and begins to realise its value.

The growth phase is where most businesses stop evolving due to a lack of knowledge of Stages 3 – 5.

Although this is where the business will begin to generate good cash-flow, there is a much larger opportunity for those who understand how to venture into Stage 3.

Capital Raising

It is almost inevitable than any business looking to grow beyond a certain point will need to raise external money from investors or the bank. In the current economic climate it is very difficult for small businesses to borrow money from the bank and therefore more and more business owners are turning to private investors to fuel the growth of their business.

Typically we see businesses look to raise capital for one of two main reasons:

1 To **create demand.**
Companies will look to fuel growth by funding:
- a. Marketing strategy
- b. More production
- c. Sales staff
- d. Web strategy
- e. Management team
- f. Opportune buying moments

2 To **service existing demand.**
Companies, already growing at a rapid rate, will look to fund this growth by investing in:
- a. More staff
- b. A Bigger warehouse / office
- c. An upgrade of the website
- d. Management team
- e. Cash-flow
- f. Purchase more product

Half the value investors bring is not their money. It's their experience, their knowledge and sometimes most importantly their network. When raising money from private investors, it is always beneficial to bring on 'smart money'.

Acquisitions

Often prior to selling a business, an experienced entrepreneur will acquire other businesses to boost the value of the head company. As demonstrated in the Value Model on Page [6], generally the larger a company the higher the multiple it will reach.

The larger a company is, generally the higher the multiple it will attract, so where a company doing $200,000 profit may be valued at 2 x profit, a company doing $1m profit, may be valued at 4 x profit. This is simply because by virtue of its size it is considered to be less risky. They have good cash-flows, a large client base, an established brand, a broader staff base and a higher profit. These factors will insulate the business should anything go wrong with the business itself or any external factors such as the economy.

An example of why a business would look to acquire a complimentary or competitive business:

Mother Ship Company Pty Ltd is doing $1m profit and therefore is confident it can sell for 4 x profit, giving it a value today of:

4 (multiple) x $1m (profit) = $4m (valuation)

Mother Ship Company Pty Ltd identifies that they can purchase Small Fish Company Pty Ltd, which is doing $200,000 profit, for 2 x profit.

Therefore Mother Ship Company buys Small Fish Company for:

2 (multiple) x $200,000 (profit) = $400,000 (valuation)

However, given that Mother Ship Company is valued at 4 x profit, when they "tuck in" Small Fish Company to the Mother Ship it is instantly worth:

4 (multiple) x $200,000 (profit) = $800,000 (valuation)

This means that Mother Ship Company have just made a profit of $400,000 simply by acquiring a smaller company, and tucking it in to a larger company. Now when it comes to sell Mother Ship Company, instead of an exit price of $4m, the exit price will be $4.8m, and it has only cost them $400,000.

The end result for Mother Ship Company Pty Ltd is:

4 (multiple) x $1.2m (new profit) = $4,800,000 (valuation)

Exit

The exit stage is where many high-level entrepreneurs have built most of their wealth. The exit point is where you as the entrepreneur will essentially cash in on your hard work.

A friend and mentor of mine, Creel Price, started his business in 1998 with $5,000 and a business partner. From day one it was Creel's intention to build the business to a point of sale. Over the next ten years Creel built his company with an amazing culture to over 1,000 staff and ultimately sold in 2008, just 10 years later for $109 million. An avid adventurer and mountain climber, Creel reflects on his journey "Building a successful is very much like climbing a mountain, many people think it's about getting to the top. It's not. It's about getting to the top and back down safely. Selling your business is about getting back down safely."

Pareto's Principle – The 80 – 20 Rule

In 1941, a 20th century management consultant Joseph Juran stubled across the work of Vilfredo Pareto. Pareto, an Italian economist noticed that 80% of Italy's land was owned by 20% of the population. He then carried out surveys on a variety of other countries and found to his surprise that a similar distribution applied.

As result Pareto created what we today know as the 80-20 Rule. The 80-20 Rule suggests that 80% of our results, come from 20% of our effort.

The 80 – 20 Rule can be applied across many contexts:

- 80% of your sales come from 20% of your clients
- 80% of your complaints come from 20% of your customers
- 80% of your profits come from 20% of the time you spend
- 80% of your sales are made by 20% of your sales staff
- 1992 United Nations Development Program Report: The richest 20% of the world's population controlling 82.7% of the world's income
- You wear 20% of your clothes, 80% of the time

It has been our experience at MBE Education, through speaking to over 10,000 businesses every year, that that the vast majority of Australian business owners are doing 80% of the work and generating 20% of the return.

Stage 1 and 2 of the Business Life Cycle are by far the most difficult and time consuming. Stages 3 – 5 although they require less effort than Stages 1 & 2, generate 80% of the return. Unfortunately we rarely see small business owners venturing beyond Stage 2.

To understand how to build value into a business, and more importantly to understand how to extract value, is the key skill-set of any high-level entrepreneur and one that must be mastered if you want to push beyond the previously existing glass ceilings.

Jack Delosa, Managing Director of MBE Education

MBE Education is a boutique education firm that educates small to medium business owners on capital raising, acquisitions and exit strategies. Through dealing with over 10,000 small businesses every year, MBE Education is the leading business education provider in Australia.

To contact MBE Education:

1 Give us a call on 1300 858 418

2 Email us at **team@mbeeducation.com.au**

MBE Clients

"Anyone who joins MBE will get incredible value! Renay and I joined six months ago and since becoming a part of Corporate Finance Course, the financial situation of our group has improved by over $5,000,000. Yes Five million dollars!

The hardcore business knowledge available to us as participants has directly contributed to this result. So thanks for keeping this thing going as long as you have, however you are managing to do it. The dollars we have paid for the program is well worth it! Use that as a testimonial for anyone who is half assed about their business future!
Robert Homoki – Cataport Group

"Through MBE and the connections that I've made, I am now working as an advisor on two separate capital raising transactions and the strategic sale of an online retailing group.

Having been a small business owner I thought I had a good understanding, however, from a corporate perspective I was no-where near the level I am now. The knowledge that you will gain, whether you want to be an advisor or use it in your own business is invaluable."
Brett Dickinson – Infinite Capital Group

"Although I've got extensive business experience, you don't know how to utilise your experience unless you go through MBE. It has allowed me to put a structure around my years of experience and deliver it to the Client. In the 4 months since I've started the course I've got 9 clients including one acquisition of about $6mill and a number of capital raisings from $500k to $2million."
Paul Sassine – Corporate Advisor - Business Growers Australia