FINANCE ▪ ACCOUNTING ▪ HR

Charles River CFO

Start-up Best Practices

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INTRODUCTIONS

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FORMATION AND STRUCTURE
Type of Entity

Two considerations

- **Limitation of liability**
- **Tax efficiency**

Limitation of liability

- **Limited Liability Company (LLC)**
- **Corporation**

Tax status

- **C corporation (if taking outside investment, rarely a S corporation)**

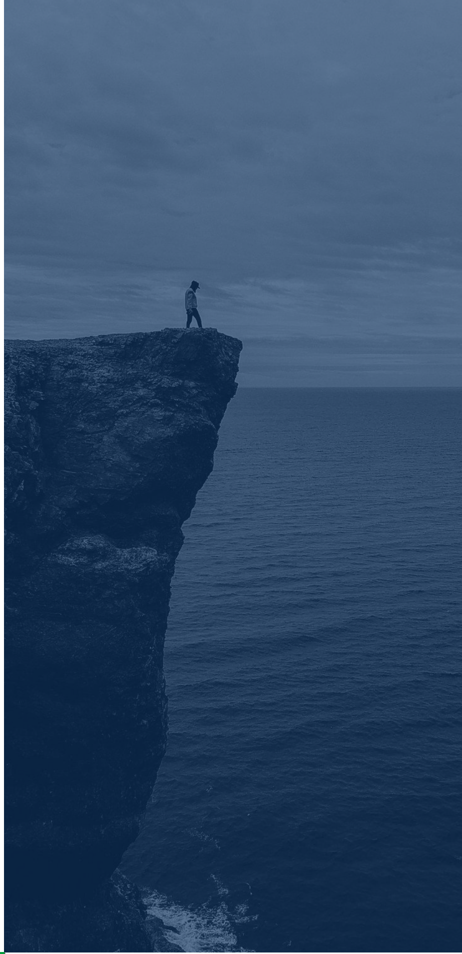
FORMATION AND STRUCTURE
Qualified Small Business Stock

- Qualified Small Business Stock (QSBS)
- Available for product companies with assets < $50M
- First $10M OR 10X the basis in the stock of capital gain
- Capital gain > $10M
- But, investment gain must be rolled over

MORSE

VESTING SCHEDULES

- Risk: highest attrition occurs in first 12-15 months
- Tie vesting to the risk
- Exceptions to consider
- Market metrics



“SINGLE TRIGGER”

- Risk: Buyers undervalue targets where employees are receiving 100% acceleration
- Market Norm: Buyer assumes target’s stock plan, optionees receive carry-over tax treatment
- If Buyer does not assume target’s plan, then options are “cashed out” at deal value

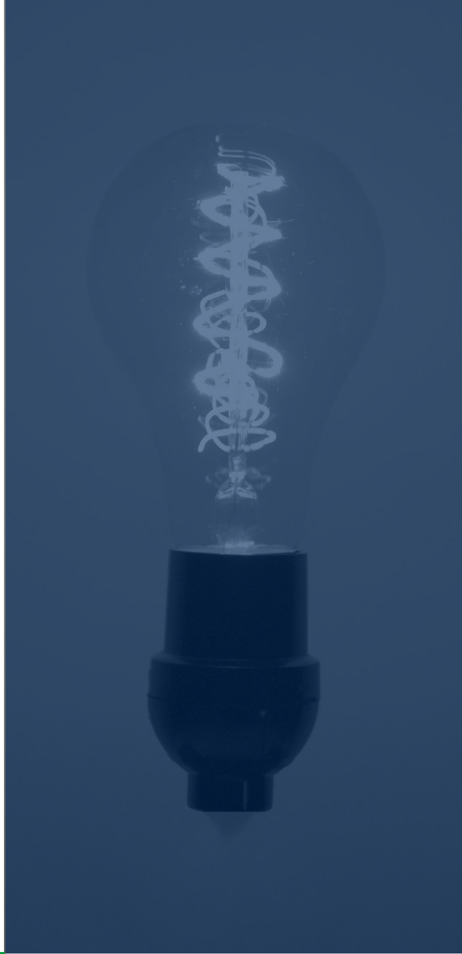
“DOUBLE TRIGGER”

- Unvested stock or options vest on “double trigger” event occurring following sale
- For cause
- For good reason
- Final terms can be subject of intense negotiation.

INTELLECTUAL PROPERTY ISSUES

Basic Issues - Recurring Problem Areas

- Owners never assign IP to company
- Consultants never assign IP to company
- Owners fail to timely file a patent application
- Joint ownership of inventions
- Rights of sponsors of non-commercial research



EQUITY COMPENSATION

Typical US stock plans provide

- Restricted stock
- Incentive stock options (ISOs)
- Nonqualified stock options (NQSOs)

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FUNDRAISING

- Priced equity rounds versus SAFE financings and convertible notes
- Majority of pre-priced rounds are SAFEs
- Valuation caps and discounts present in both SAFEs and convertible notes
- Most SAFEs are “post-money” SAFEs while most convertible notes are “pre-money”

MORSE

DISCUSSION

WHAT'S NEXT?

Risk Management

- Investment Risk
- Insurance Risk – D&O, Cyber, Clinical Trial

The **Audit** – planning for the future

- What type of audit

A Future **IPO?**

- Different flavors
- Timeline

INVESTMENT RISK

- Capital preservation
- Liquidity
- Risk return rates

LIQUIDITY

- Schedule maturities before forecasted cash needs
- Allow for variability in cash forecasts
- Interest rate volatility: within the limits defined by cash forecasts, lengthen or shorten average maturities as appropriate given Fed rate expectations
- Massachusetts Security Corporation

MASSACHUSETTS SECURITY CORPORATION

MSC Analysis

$10 million equity raise/cash infusion.

Without MSC

- Excise tax .26% in Mass on "net worth"
- Non-income measure of excise $26,000

With MSC

- Non-income measure of excise eliminated
- Minimum tax at $456

HOT SPOTS/RISK AREAS

- Consider cost/benefit to create and maintain MSC
- Movement of funds
- Separate legal entity
- Accounting issues
- Federal tax issues

INSURANCE RISK

- Directors and Officers insurance
- Clinical trials insurance
- Cyber insurance

DIRECTORS AND OFFICERS INSURANCE

- Market trends (pre 2019 vs post 2020) ($$$)
  - Supply and demand - 2024 see some reductions - Allianz
- Public vs. private (range)
- Purchase of tail insurance – why, what is it cost estimates

CLINICAL TRIALS INSURANCE

- Overseas trials
- Product transit insurance to clinical sites
- Importance of working with experts

CYBER INSURANCE

- What is it?
- Key coverage sections for emerging growth firms
- Reasonable limit to consider
- What has changed in last three years - $$$$

AUDITS

- What is an audit?
- Two types

  - *PCAOB audit = public company audit*

  - *AICPA Audit = private company financials*
- Why are they required?
- Who requires the audit?

AUDIT CONSIDERATIONS

- Equity recording / Cap table recording
  Use cloud-based software - work smart, affordable, some offer valuations.
- 409a valuations
  Annual, plan in advance - take a least a month to prepare.
- Pre-audit
  Reconcile, Think quarterly, Document control systems.
- Technical memos
  Get ready, identify technical areas with accounting estimates and prepare or outsource memos to support position estimates .
- Segregation of departments
  Payroll. Split into G&A and R&D.
- Have a forecast
  Reconcile. Consider runway, reconsider runway and look at runway again.

GOING PUBLIC - THE BUFFET

TRADITIONAL IPO

REVERSE MERGER

FORM 10

SPAC

THE TIMELINE - "Be Ready"

- 12 – 18 Months before filing S-1 with SEC
  Audit of 2 years of GAAP financials and footnotes.
- 3 – 12 Months
  Select bankers. Listing application. Draft S-1.
- 1 – 3 Months
  File S-1 with SEC. Updates. Roadshow.
- Go Public
  Post filing. Reporting requirements.
- Are you ready ? - really are you ready?
  Considerations besides timeline

ARE YOU REALLY READY?

- News announcement timeline?
- Do you have?
  - stock coverage post IPO
  - employee training on being public
  - controls around stock trading
  - 10B-5 plans
  - board charters/governance
  - fraud hotline
  - robust D&O insurance
- Consider part time solutions to get you public

DISCUSSION

ALTERNATIVE FUNDING

- Cash flow is the life blood of small businesses

- 61% of small businesses around the world struggle with it *(Intuit)*

DEBT VS EQUITY FUNDING

- Traditional business loans require history
- Equity financing can often be received sooner
- And allows for a healthy ratio of debt vs equity
- Consider alternative funding options

ALTERNATIVE SOURCES

- Personal financing and credit lines
- Friends and family
- Crowdfunding
- Startup incubators
- Angel investors
- Government loans and grants
- Venture capitalists
- Equity free financing

TRADITIONAL INITIAL FUNDING

Personal financing and credit lines / from 401K

- Access to cash quickly for everyday operation
- Require timely minimum payments with interest

Friends and Family

- Potentially lower interest rates than bank
- Conflicts can arise with loans

CROWDFUNDING CAMPAIGNS

- 41% of campaigns are successful
- Successful campaigns in 2023

- GPD Win 4	Gaming	$3.9m
- Petsnowy	Petcare	$1.9m
- Mirror Hotels	Camping	$1.9m
- Hover X1	Aerial Photography	$1.6m
- Niostem	Hair replacement	$1.3m

- Pick the right platform
- Know your target investors
- Promote the campaign

STARTUP INCUBATORS

- Pre-seed startups
- Collaborative environment
- Offer multiple resources
- Physical facilities
- Consulting services
- Legal and accounting assistance

ANGEL INVESTORS

- High net worth individuals who fund riskier startups
- Often take active role strategically
- Usually have expertise or experience in industry
- Access to business connections
- Offer advice and other support

GOVERNMENT LOANS AND GRANTS

Small Business Administration 7(a) loans

- Loans in the amount of $500,000 to $5,000,000
- Other programs can offer larger loans

Targeted business loans and small business grants

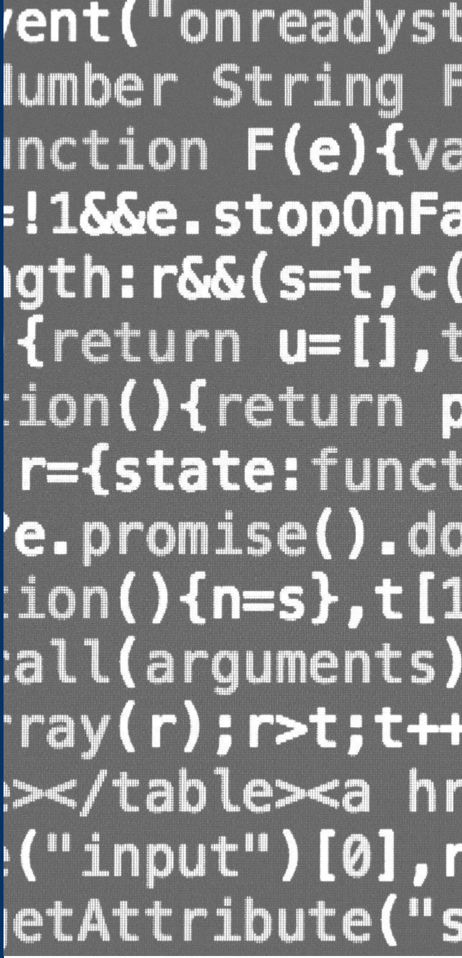
- Science, technology, health
- Specific demographics
- Programs for minority and women-owned startups
- Enterprise zones

VENTURE CAPITALISTS

- Private investors working in a firm that often consult with other investment managers
- Investees are ready to launch their product
- Focus is on the market and the product's benefit
- Business has identified key team members

EQUITY FREE FINANCING

- Pipe & Pike (2 similar companies)
- Advances on recurring revenue
- SaaS companies are targeted
- Borrowing is online and quick
- Repayment is based on a % of revenue



DISCUSSION

FINANCIAL PLANNING BEST PRACTICES

- The ability to identify and plan for cash shortages is critical
- Financial analysts spend
  - 47% of their time collecting data
  - 30% administering the process and
  - only 23% of their time providing value-added analysis (*APQC*)
- Measure financial impact of strategic objectives
- 60% of organizations do not link operation plans to strategy
- Implement a rolling forecast

BEST PRACTICES

- Focus on business drivers not details
- Relevant: Direct relation between driver & result
- Actionable: Results influence actions
- Anticipate reporting changes
- Use the proper reporting technology

FINANCIAL PLANNING BEST PRACTICES

- Mitigate risk and uncertainty
- Link human resource & capital allocation plans
- Ask not what do you need to be successful
- Ask **who** do you need to be successful

DISCUSSION

The Charles River CFO Advantage

- 20+ years experience
- Industry depth
- Variable resource model
- Flexible contract
- Team approach
- Key relationships with leaders in their fields, like Morse (Thank you Dan)

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Charles River CFO

CFO, Accounting, Tax & HR Services

We are smart, nimble, and flexible.

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