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NEED AN INVESTMENT IN YOUR COMPANY? DO YOUR HOMEWORK!

By Brian Russell

As the doors open, you step in to the elevator and discover you're now riding to the lobby with the one person who can make your new service a success with a capital investment. Barring any stops on the way down, you have roughly 30 seconds until the doors open at the ground floor. If you haven't sold the person on your dream by then, this serendipitous opportunity will be lost.

Do you have your elevator pitch—a quick and engaging description of your planned project or service—ready?

In spite of the current economy, there are opportunities on hand for startups and existing companies looking for venture capital to develop new services or products, with a handful of investors who specialize in the communications sector.

In the competitive arena of wowing venture capital investors, focusing on those few words and pertinent facts that will intrigue a potential backer can give you a strong advantage.

The call to create new revenue streams is being heard by most, if not all, small and rural local exchange carriers. In turn, they are looking to expand beyond their traditional services, while fitting these new ventures within constrained capital budgets and answering the need to improve operational cost efficiencies.

Telecom spending by many larger carriers is projected to increase in the second half of 2009, and continue through 2010.

And investors are still vigilantly looking for new opportunities, although they are as cautious as ever while they wait for signs of economic recovery.

Jim Pastoriza, managing partner of TDF (http://www.tdfund.com), sees "a slight thawing in the investment community" as the nation makes its way through the current economic storm.

"(The) bigger issue, I think, for communications services companies is the dearth of investors who are interested and have the capital to invest in this area," Pastoriza said. "It tends to be capital intensive, at least the traditional service businesses."

TDF, a venture capital firm focused on investment opportunities in the communications sector, has about $80 million under management, with investments ranging from $500,000 to $5 million.

"TDF's focus is driven by investment themes that share several qualities: large and important problems in communications, an ability to add value through management's investing and operational experience, and the Fund's location and relationships in Washington, D.C.," according to the fund's mission. "While TDF is stage agnostic, half of the Fund's investments to date are in seed and pre-revenue companies."

Good investments, according to Roy Koelbl, who is founder and managing partner of IntAlliance Partners (http://www.IntAlliance.com), will be in the companies and projects that can most clearly validate revenue growth to the traditionally capital intensive investments related to implementing new telecommunications technologies.

"Telecom is fundamental to our local and national economies," Koelbl said. "I believe that areas which fall significantly behind, also risk falling behind economically. Areas that lead in the deployment of telecom technologies and networks also have the opportunity to lead economically.

"However," Koelbl added, "telecom tends to be a very capital-intensive investment, making it a more difficult investment to obtain when the money supply is tight. The business case needs to be financially solid with demonstrated control over operating expenditures and a clear growth path. The continued development of technologies and networks and the continued consolidation of telecom companies may provide an opportunity for those still standing to become attractive investments, if they can manage their cash and have a clear growth path."

Meet the Investors

Jim Pastoriza

Managing Partner, TDF

Pastoriza joined TDF early in 2004. Pastoriza was a partner of J.P. Morgan Communications Partners, L.P. in San Francisco, Calif. He was previously a partner at AT&T Ventures, leading fund investments in Internet Security Systems (ISSX), WNP Communications (sold to Nextlink). Prior to AT&T Ventures, Pastoriza held operational positions at AT&T and Lucent Technologies. He was the product manager for AT&T's Consumer Long Distance Service, which generated $13 billion in revenue from 60 million customers. Pastoriza also served as the executive assistant to AT&T's senior vice president of corporate strategy and development. Previously, Pastoriza was a Lucent Technologies account executive, ranking in the top 1 percent of national sales. He received a B.S. from Columbia University and earned his M.S. from the Massachusetts Institute of Technology.

Roy Koelbl

Founder and Managing Partner, IntAlliance Partners

Koelbl previously served as an executive and officer of Siemens-Optisphere and Teleglobe. At Siemens, he was the senior vice president and CTO for worldwide optical networking, defining Siemens' product roadmap, technology strategy, investment opportunities, and merger and acquisition opportunities. At Teleglobe, he was the vice president of worldwide network infrastructure, simultaneously managing groups in Europe, Canada, and the U.S. He is the former director of network architecture and planning at Southern New England Telephone (SNET), and former director of access technologies for Bell Communications Research (now Telcordia). Mr. Koelbl received a B.Sc. (Applied Physics) from the University of New Brunswick and a M.Sc. (Eng) in Nuclear Physics from Queens University.

Koelbl first became involved in investing and merger-and-acquisition activity while working for Siemens. There, he assessed dozens of early-to-late stage companies for investment potential, performed due-diligences, as well as assessed several well-established, mature companies for potential alliances and merger-and-acquisition opportunities. After leaving Siemens, Koelbl started his own company and sought out venture investments of his own, obtaining experience from both sides of the investor fence.

When an established service provider is seeking new investment, what needs to be presented in that first meeting or talk can vary depending on the investor, say Koelbl and Pastoriza.

"Each investor has its own procedures and way of handling the first meetings," Koelbl said. "Many investors will want to see a business plan before the first meetings. Depending on the existing relationship between the investor and service provider, a slide deck may be sufficient for the first meeting if the investor is already familiar with the service provider.

"However, I would recommend that a full business plan be ready for the first meeting," Koelbl said. "The investors will want to know that the service provider has thoroughly and properly done its homework and own due-diligence before presenting."

Unsure economic times may have led to this increased interest in more answers earlier on.

"Investors are uncertain about capital budgets as well as consumer and business demand," Koelbl said. "The more the service providers can outline their projections on demand for services and impact on capital expenditures, the more comfort they will give their potential investors. The slide deck and business plan need to focus on growth and cash management."

Koelbl said the key things investors look for in a service provider before they invest depend on the specific situation and for what the investment is needed.

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When evaluating opportunities before him, Koelbl said the key questions to which he is looking for answers include:

- What supports the revenue stream?
- How can costs be held to a minimum in case the revenue is delayed?
- How can you minimize the risks with respect to the market, operations, financials and technology?

"I would add that investors not only invest in a business plan, but they invest in the people," Koelbl said. "A sound management team and management team performance will likely be a key component."

When evaluating an applicant, Pastoriza said he looks for much the same.

"Key issues are always team, technology, financing needs and market size," Pastoriza said. "These days, financing needs are a bigger hurdle than, say, 10 years ago. Service providers tend to need a lot of capital compared to other venture investments. The number of firms able to commit that capital, before the company has revenue, is very small. Most firms that have an interest in communications services are looking at post revenue opportunities, I think."

As part of TDF's process, Pastoriza suggests applicants have on-hand answers to these questions:

- What is your idea and why would a customer pay you money—how do you solve a customer pain or create an opportunity?
- Market characteristics—tell us about market size, market growth, competitive landscape.
- Competitive advantage—what is your long-term sustainable advantage?
- Who might buy your company in the future?
- Tell us about the management team and their relevant experience.
- What are your capital requirements for each stage and what are the relevant milestones that will be achieved?

But the most powerful tool, according to Pastoriza, may be what some call the elevator pitch.

Elevator pitch

A succinct overview of a product, service or project that can be delivered in the time it takes to ride an elevator. Key elements include: what the product, service or project is; what it does for the buyer, investor or sponsor (i.e. the benefits); who you are, and why you will be successful.

"Frankly, a crisp conversation on the phone is even better." Pastoriza said. "It forces the CEO to articulate, in short order, why the investment is interesting and merits further time/attention."

If the investor is interested, and progresses to the point of due diligence, Pastoriza said he'll then delve deeper into the business details.

"Service providers lend themselves to modeling, assuming they are recurring revenue companies," Pastoriza said, "so a lot of attention is paid to gross margin, market profitability, churn, adoption, cost per gross add, etc."

"Investors are looking for the right opportunities, but are still cautious," Koelbl said. "Telecom spending by several of the big carriers is currently being projected as increasing in the second half of this year.

"It is my belief that the investor community will follow or slightly lag spending until they are more confident about the economic recovery," Koelbl said.

A service provider's ability to secure stimulus funds will likely have a negligible impact on its chances of securing investor support, Koelbl said.

"I think that most investors will evaluate their potential investment into a service provider on the merits of the business case," Koelbl said. "The ability to secure or not secure stimulus funds depends on a multitude of factors and will only affect the investor's perception of the service provider based on how it impacts their potential investment."

However, a plan being solid enough to merit stimulus fund support is a positive sign that will likely support further study by investors.

"Receiving stimulus funds for capital spending has the potential to dramatically enhance a service provider's business case and therefore the investor's position," Koelbl said. "Receiving stimulus funds will tend to validate the service provider's business plan, since part of the government grant criteria is that the CapEx (capital expenses) spending in the business plan must be sustainable from an OpEx (operating expenses) perspective."

And there are still other regulatory factors that will sway the perceptions of the investment community when considering investing in service providers, Pastoriza said.

"I suspect any regulatory change that increases market opportunity and lowers regulatory risk would be helpful in attracting investment," Pastoriza said.