WPI Venture Forum
To inspire and facilitate technology-based entrepreneurship

Vantage

March 2008
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THIS MONTH'S MEETING

Tuesday, March 11, 2008

WPI, Worcester
Campus Center Odeum

Networking: 5:30 – 6:30 p.m.
Meeting: 6:30 – 9:00 p.m.

$15.00 members
$25.00 non-members

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contents

Mass. Manufacturing Goes High Tech

Yes, there is still manufacturing in Massachusetts. In fact, recent years have seen the greatest increase in valued-added dollars per manufacturing employee in state history. Manufacturing as a whole accounts for 14 percent of gross state product and continues to produce the Commonwealth's largest personal payroll.

JACK HEALY PAUL MAGUIRE JOHN GRAVELLE

Come to the WPI Venture Forum meeting on Tuesday, March 11 and learn about the survival strategies of manufacturing businesses that have transitioned to a global marketplace through market maturity and sustained profitable growth. Listen to local manufacturing business owner-experts share their mistakes and lessons learned, and how they turned adversity into opportunity. Gain valuable insights on how to survive, thrive and become a next-generation manufacturer.

The program will include interactive presentations and a panel discussion on manufacturing trends in Massachusetts today, ways to position companies for growth and highlights of how Mar-Lee Companies achieved double-digit growth and profit. Presenters will be Jack Healy, Director of Operations for the Massachusetts Manufacturing Extension Partnership (MassMEP) and the Manufacturing Advancement Center, Paul Maguire, President of IntelliSource International, and John Gravelle, President of Mar-Lee Companies.

Healy serves both MassMEP, a program supported by the National Institute of Standards and Technology and the Commonwealth of Massachusetts, and the Manufacturing Advancement Center, a separate 501(c) organization dedicated to the promotion and development of the manufacturing community in Massachusetts.

He brings many years of experience assisting manufacturing firms in improving their overall manufacturing capabilities and profitability. He served as managing partner with the Wellesley Consulting Group, president of the Presmet Corp., a manufacturer of powder metal components, and senior vice president at Lego

Continued on page 6

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LETTER FROM A COMMITTEE CHAIR

Sponsorships Nurture the WPI Venture Forum

Dick Prince

Since the WPI Venture Forum's founding in 1991, sponsors have been key contributors. Their donations of time and money have supported events, programs, business plan contests and growth over the years. The WPI Venture Forum is now on the verge of creating a new wave of programs and activities, including increasing the size of our business plan contest, reaching out to new demographics through advertising and promotion, and providing permanent staff assistance to the Department of Management at WPI.

Sponsor relations have traditionally been the responsibility of a relatively small group of devoted WPI Venture Forum members. While sponsor expectations generally range from philanthropic to seeking clients, it is important that both parties understand and benefit from the relationship between the WPI Venture Forum and the sponsors. This past year the WPI Venture Forum formed a Sponsorship Committee for the purpose of growing and managing a sponsor base while increasing funding for future programs. We have hired a Sponsorship Coordinator, developed a plan for increasing the number of sponsors, and created a sponsor database. There is also a new four-color brochure outlining sponsorship opportunities that will be used to educate and guide prospective sponsors of the WPI Venture Forum.

The WPI Venture Forum is ready to grow. To achieve this goal, we must raise the level of sponsor participation to new heights. We must rekindle old relationships and develop new ones by providing our sponsors with the maximum benefits of becoming WPI Venture Forum supporters.

If you would like more information on becoming a sponsor or otherwise supporting our efforts, come to the March 11 meeting and we can begin the conversation.

Sincerely,
Richard H. Prince
Chairman, Sponsorship Committee

Read this newsletter online and forward it to your network of business associates. New subscribers welcome.

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Common Interest Agreements in Patent Cases—Clear or Cloudy?

by BRIAN T. MORIARTY, ESQ.

HAMILTON BROOK SMITH REYNOLDS
Intellectual Property Law

Agreements to share privileged information with persons who have a "common legal interest" are generally upheld by courts. Such agreements are common in intellectual property and corporate law where they are often referred to as common interest agreements or joint defense agreements.

Despite the general acceptance of the so-called joint defense privilege or the common interest doctrine, the specific legal requirements for these agreements are far from clear.

For example, courts often require that the parties have "identical," not merely "common" legal interests. Courts often find that the information was shared for "business" purposes and not "legal" purposes, and do not uphold the privilege.

New clarity under Massachusetts law

A recent Massachusetts Supreme Judicial Court case addressed the topic of these agreements.

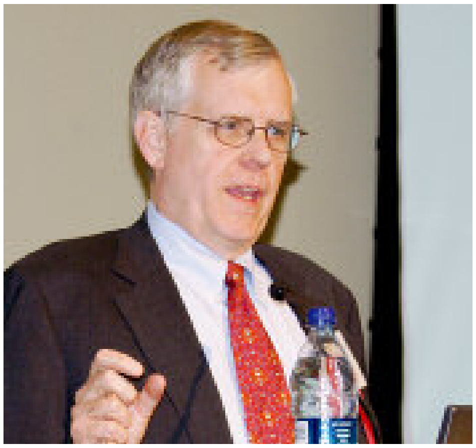
The court "formally recognize[d] the longstanding use and validity of joint defense agreements" and enunciated the law in Massachusetts by stating that "we adopt the principle of Restatement (Third) of the Law Governing Lawyers § 76(1) as the law of the Commonwealth."

The court's acceptance of the Restatement view means that common interest agreements may be valid regardless of whether a matter is litigated. Corporations, the court said, should be encouraged to seek legal advice in planning their affairs to avoid litigation.

CONTINUED ON PAGE 6

A Look at February's Meeting

Valuation, Funding, Scaling



Alan Cody spoke on valuation

Mort Rosenberg, co-moderator

by ARM AZAD, PHD

John Hession gave a lively presentation

On Tuesday, February 12, the WPI Venture Forum focused on the financial lifespan of a business, from valuation and funding to scaling up and then exiting the business. An exciting four-part lesson for entrepreneurs, the meeting was co-moderated by Mort Rosenberg, CFO Resources and Sherry Handel, Center for Women & Enterprise.

Alan Cody, Managing Director of Boston's Duff & Phelps LLC, drew on his 20 years' experience to present the methodology used to **value a business,** depending upon its stage: seed (idea), stages one to four with actual product development, management, revenue, or IPO-ready.

- The enterprise value of a business, less debt and other liabilities, is the fair value of the equity. Pre-money plus new cash is the post-money value. The relative amounts determine dilution of pre-existing shareholder ownership. Selling shares at a pre-money equity value below the post-money value of the last round will cause ownership dilution.
- Valuation is determined by the quality and experience of the management team, business strategy and opportunity, product risk, operations risk and market risk. These factors give a business the capacity to attract funding and grow.
- Estimated value is present value of free cash flow and IPO value at a risk-adjusted discounted rate. The discount rate ranges used are for start-ups (50 to 70 percent), first stage (40 to 60 percent), second stage (30 to 50 percent), third stage (25 to 35 percent) and IPO at public market rate, all determined by specific risks and rewards.
- Founders get common stock, with investors getting convertible preferred stock with the option to convert to common stock.
- For science and technology companies, ideally with patents, valuation is determined by the amount required for R&D, where the technology fits in, verification of target market customers, and by market size.

How to fund a business was the topic for John Hession, Managing Partner, Cooley Godward Kronish. A member of the Boston firm's Venture Capital Financing and Emerging Companies practice group, Hession discussed winning deal terms and structures often unknown to CEOs, including preferred, ratchet, and participating preferred.

- Deal terms generally include a contract on valuation, pricing and economics, monitoring and preserving the investment, board membership and representation as the investment's steward, with board control and investor protection rights to maintain investor ownership and grow the investment for later liquidation.
- Only five to eight percent ever make it to the IPO stage, while 90 percent of the companies are bought out, typically at a multiple of revenue (ranging from 1.5 to three times sales) to multiples of EBITDA, (ranging from four to eight times sales).
- Funding for medical devices comes after 510(k) filing or approval.

Up and Exiting Your Business

- There are plenty of venture capital dollars in the marketplace, but how to unlock them? Angel investors who fund early-stage companies outspend VCs eight to ten times over. While valuations are up, cost and efficiency of capital are receiving greater scrutiny.
- Big funds that raise $800 million to $1 billion can no longer invest in the sub-$10 million dollar space. A risk-averse biopharma company cannot build a business without $25 million and later-stage financing, with a mostly complete management team.
- Current angel pre-money average is $3.5 million. Average time for liquidity from Series A VC funding was 1.8 years in 1999 to 2002, and we are now back to the historical norm.
- Multiple rounds of financing are typical to reach breakeven or achieve a liquidity event. Some 20 clean energy deals had pre-money valuation of $15 million. After three rounds of financing, the founder typically owns about 10 percent, and the option pool for the non-founder management team is another 10 to 15 percent.

Jeff Bentley, CEO of CellTech Power, LLC, a start up fuel cell company, presented the challenges involved in **scaling up the business.** Bentley has more than 15 years of leadership experience in the fuel cell industry, and some 30 years with military and high technology products.

As a case study, Westborough-based CellTech Power started in 2006, is angel-financed, with eight employees currently raising institutional and strategic funding. The fuel cell industry challenge is meeting expectations generated from the past 10 years' high-profile publicity. Despite significant promise, there has been no commercial success yet, at least in the automobile industry. Challenges are the complexity of the traditional fuel cell,

Jeff Bentley addressed scaling up issues

expensive platinum, and unproven durability. Yet markets exist for portable power, and stationary power for buildings and automobiles.

- Fuel cell commercialization is slow, and investors are weary. At issue: timing of scale up and positive cash flow.
- CellTech Power solution — solid oxide fuel cell — a special fuel cell with a very high efficiency running on real fuels like coal, natural gas and diesel. Does not require an infrastructure change like hydrogen would.
- Key theme: efficiency and simplicity reduce costs by about 30 percent. Great commercialization potential of technology in a wide variety of markets. Can potentially convert coal to electricity at twice the efficiency of a regular coal-fired power plant, but not until 2020.
- With nine people, CellTech Power is able to be cash flow positive on customer-funded R&D in terms of preserving equity.
- Challenge: fuel cell is not an end item, like a car with a fuel cell in it, and many moving parts are needed to integrate the whole system. True commercial success involves a lot of resources.

Continued on page 7

Mass. Manufacturing Goes High Tech

CONTINUED FROM FRONT PAGE

Systems, where he co-founded the US division of the toy company. Prior to Lego, Healy held a succession of positions at Squibb Beech-Nut, Inc., starting as a sales representative and rising to vice president of sales in several operating divisions.

He serves as a board member or trustee for a number of local businesses, schools and non-profit organizations.

At Intellisource International, Maguire looks through the lens of the customer and investor to help executives broaden their perspective to see new growth opportunities and to help them make better and faster decisions. Over a 20-year period in the software industry, he participated in seven start-up companies, all of which achieved their exit strategies. He has been through the IPO process twice and has participated in more than 15 mergers and acquisitions.

Before founding IntelliSource, Maguire served as Chairman and CEO of Infotriever, a Toronto-based software company backed by Brightspark Ventures. In addition to his role as CEO, he also served as Brightspark's Business Development Strategist for eight start-up companies in their investment portfolio.

President and CEO of Mar-Lee Companies in Leominster, Massachusetts, John Gravelle is a successful entrepreneur who has directed the operations of Mar-Lee Companies for more than 25 years. Under his direction, Mar-Lee has grown to become one of the area's leading plastics manufacturers and mold makers whose business focus is the medical and consumer products markets.

Mar-Lee has successfully transformed itself from a traditional custom injection molder and mold maker into a successful contract manufacturer specializing in medical applications and high-volume, highly automated packaging products. With annual growth of 15 to 20 percent, Mar-Lee has generated double digit profits, while investing an average of 10 percent of annual sales into automation and technology.

An active community member in Leominster, Gravelle is a member of the Massachusetts Medical Device Industry Council, the Society of Plastics Industries, the Society of Manufacturing Engineers, and the Society of Plastics Engineers.

Common Interest Agreements in Patent Cases

CONTINUED FROM PAGE 3

In addition, the court loosened the standard of what constitutes a common legal interest by not requiring "identical" legal interests and rejected the requirement that such agreements be in writing.

Despite the clarity of this opinion, it may have only limited applicability to patent matters because most patent privilege questions are governed by Federal Circuit or regional federal circuit standards, not state law.

What law applies?

Procedural issues in patent cases, such as the law of attorney-client privilege, are governed by Federal Circuit law if an issue "bears an essential relationship" to patent law. This standard is almost impossible to apply. The rule seems to say that if the Federal Circuit thinks it's important to apply its own law to an issue, then it will do so.

In recent years, the Federal Circuit has shown an increasing tendency to find questions of privilege in the patent context to be sufficiently important to warrant the application of Federal Circuit law, as opposed to regional circuit or state law.

For example, the court recently upheld the privilege for an invention disclosure record prepared by a non-attorney for the corporation's "patent committee." The court noted that its "own law" applied to the issue.

The Federal Circuit and Massachusetts courts accept the common interest doctrine, but the scope and contours of the law as applied to patent matters remains cloudy. Perhaps the Massachusetts Supreme Judicial Court's decision might serve as a model for a future Federal Circuit decision on the common interest doctrine for patent matters.

Brian T. Moriarty is a principal with Hamilton, Brook, Smith & Reynolds, P.C. in Concord, Mass. (www.hbsr.com). Brian is an intellectual property litigator with expertise in the areas of biotechnology and pharmaceuticals. He is one of a few registered patent attorneys in the US who also has served as an assistant US Attorney. Brian can be reached at brian.moriarty@hbsr.com or 978.341.0036.

Venture Forum 2008 Calendar of Events

March 11	Traditional Manufacturing is High Tech Today
April 8	Marketing a High Tech Enterprise
April 17	Networking Event, Worcester Art Museum
May 13	Profits Come from People
June 10	The Five-Minute Pitch Contest

Valuation, Funding, Scaling Up and Exiting Your Business

CONTINUED FROM PAGE 5

- Formed 50 percent of company with core technologists. Expanded work force meant core technologists shrank to 25 percent. Focus on core technology is crucial for growth. Add partnerships to scale up in the fuel cell industry, as they want to be in the middle of the value chain.
- With five to eight "believers," you are always resource-limited. Scale up to 35-40 employees, a distinct break point. At 100 people, you run into bureaucracy, but it's a necessary transition in terms of scale up. Each transition is a culture issue.
- Establish a local manufacturing base – often a dilemma for Massachusetts companies.

Exiting the business and preparing for a liquidity event was the topic for Greg Erman, a serial entrepreneur focused on commercializing technology to decentralize the delivery of healthcare. The exit process is very complex, he explained, but professional help is available from a number of boutique investment banks.

- Exit means a merger, acquisition, IPO or LBO has occurred, perhaps with private equity involved. Opportunity happens when one prepares. Pick a specific market segment with a huge unmet need and timing opportunity. Create a situation where you have the most exit alternatives and can win in a negotiation.
- For a medical device company, the exit is between $100 million and $200 million. If there's not much perceived risk and a mature market, public market is a possibility, but if a lot of risk, then an acquisition approach may be more appropriate.
- Private equity is compelling when there is cash flow, with key operational and inflexion points. Focus on income and cash flow statements.
- Average M&A deals have doubled this decade over the last decade, but have been flat since the peak days of 2000; dramatic reduction in the IPO landscape. Exit is a very arduous process, and each of Erman's companies sold to big public companies. Start with 50 investors simultaneously and narrow it down to a few term sheets.
- If IPO market is bad, M&A market looks better, investors seek quicker liquidity, acquisition faster way to get the money.
- Key challenges: sizable appreciation, elimination of acquirers, especially in the tech industry. Medical device space is more vibrant with more acquirers now than five years ago. Buyers are looking for later and later stages of companies. Exit is between 1.5 to three times revenue. Transaction value has dramatically dropped because of all the challenges.
- Hurdle rate has increased for companies that want to go public — revenue rate has increased from $80 million to $100 million, profitability desired.
- Raising capital more challenging due to VC "overhang problem" from 1,700 companies they've already invested in. For every successful company, VCs now must invest in four companies, and expect two to go bankrupt and one "walking dead."
- Private equity market is a new opportunity with many institutions, but boom is over. Requires cash generation and operating leverage improvement.

Greg Erman networking after the meeting

ARM Azad, PhD, is President & CEO of Prospeed.net Inc.(www.prospeed.net), a facilities-based CLEC network using fiber optics, lease lines and data center collocations. Dr. Azad is also CTO of Sustainable Energy Solutions (www.sustainable-energy.us), focusing on energy efficiency using technology integration and monitoring. He can be reached at 508.393.6708 or email at armazad@prospeed.net.

Spotlight on Entrepreneurs

WI POWER

Mike Feldstein, VP Engineering

Product: Wireless battery charging technology for portable consumer products that eliminates power cable and connectors. Breakthrough technology supports transition to wireless products.

Seeking: $6 million over two years, $1 million to start for product development and customer explorations.

Phone: 508.654.0700

Email: mfeldstein@wipowerinc.com

Website: www.wipowerinc.com

ELECTROLYTIC OZONE INC.

Bill Yost

Product: Green technology — smaller, more efficient ozone generator produces cells that generate ozone dissolved in water. Positioned as OEM supplier to ozone system companies. Unique IP and supply agreements in $320 million market seeing 18 percent annual growth.

Seeking: $3 million for small manufacturing facility construction and market development

Email: bill.yost@harrisinternational.com

The WPI Venture Forum invites entrepreneurs to make a one-minute practice elevator pitch at monthly programs. Content is limited to seeking investors or potential partners, but not customers. Overhead slide allowed and one pitch per season, per business idea. For a helpful template and submission criteria, please visit:
www.wpiventureforum.org/Programs/spotlight.html

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