

The Very Model of a Modern Memorandum

Ten years ago I wrote an article for the first number of the *Australian Venture Capital Journal*. It bemoaned the lack of equity capital for small businesses and start-ups.

Things have improved a lot. There are more funds, and lots of eager young MBAs both producing and reviewing investment proposals. So my diatribe of 1992 does not warrant a re-run.

Rather, to mark Victor's magnificent achievement over ten years of publishing this august journal, it seems appropriate to celebrate the role of those who prepare the investment proposals that are the life blood of the venture capital industry, of whom I am one.

Writers of investment proposals are the unsung heroes of wealth creation. They drove the booms in investment in each decade since the 1970s, then enjoyed quiet holidays during the boring corrections that followed. They reached their zenith in the new millennium, in the IT industries internationally and in rural managed investment schemes in Australia. Their work has generated interest even from the regulators.

Before the most recent correction, I attended a seminar on such wealth creation. It was an evangelical experience! Angels dropped in to share their exalted views. I was mortified to learn they did not worship business plans produced by mortals like me. They needed only a short, illuminating summary to determine which investments would yield their target return of just 20 times in two years.

Their omniscience was confirmed by connection to telcos whose value was truly out of this world. I understand that authorities are now investigating some of those miracles, presumably to edify the angels and punters of the next decade.

Meanwhile, we business planners and investment proposal writers have resumed our rightful role. Who else, I ask you, can ascribe a multi-million dollar value to a business with no income, no assets and negative net worth, but lots and lots of potential. We, I submit, create much more wealth than all the processing plants in Redfern. Or in the country, for that matter. But modern venture managers no longer venture beyond Redfern, whereas they used to roam nearly to the Blue Mountains.

Investment proposal writers are the true value-adders in our economy. Their comparison with other sorts of adders is hurtful. They should be revered, not reviled, and the (added) value of their work celebrated, not denigrated.

Their most redeeming feature is modesty. It is set out for all to see in the Disclaimer on the first page. They take no credit for any of the information that follows.

I admire modesty. Someone once kindly suggested I have much to be modest about.

My contribution to Victor's decade of achievement is a model for the ubiquitous document that underpins our industry: Business Plan, Information Memorandum, Prospectus, or whatever. It highlights some innovative and clever facets of these documents that have emerged in recent times, within the excellent trade we ply.

Information Memorandum for Rock Plants Limited

Disclaimer

The owners, shareholders, employees, lawyers, accountants, auditors, relations and hangers-on of Rock Plants Limited (RPL or the Company) totally deny any responsibility for the information in this document. We just made it up.

By opening the envelope containing this publication, you undertake to keep confidential all the information herein, and any other scuttlebutt not in the public domain, and to indemnify all of us from any resulting suit, loss of income, or hair.

This document is not an offer of securities, even though we would really like you to buy some. They are a hell of a good investment, if just a tad speculative.

This is an excluded offer under Section 708 of the Corporations Law because it is distributed with the 10th anniversary edition of the *Australian Venture Capital Journal*. Everyone knows that all Victor's readers are not only professional and sophisticated, with lots of money, but also kind and generous. You just could not find nicer people to be on your Board.

Disclosure

The kindly folk who put this document together are entitled to some humungous fees. An initial fee of \$100,000 is payable, despite the fact that all the work was done by Gordon Pender and Company in preparing the Business Plan, for little reward. The fee is capitalised in the forecast as non-Intellectual Property. A complex web of success and trailing fees amounts to about 10% of the capital to be raised. It is excluded from the projections so as not to diminish the underlying profitability of the business, on which the extravagant valuation is based.

Purpose

The purpose of the plan is to:

- Attract equity capital of \$5 million for just 5% of the shares of the company
- Secure a bank loan of \$2 million, secured by a first charge over the intangible asset
- Initiate a feeding frenzy among state and local government authorities to supply soft loans and grants in order to locate the business in their area
- Facilitate a loan of \$10 million from the federal government's Elaborate Support for Trade and Industry Concessional Loans (ELASTIC Loans) program
- ~~and make lots of money for the promoters.~~

Rock Plant Technology

The *Rock Plant*TM is a fabulous innovation by Australian biotechnologists involving genetic modification of eggplants. The trendy gourmet vegetable *aubergine* has been modified by inserting DNA from a compatible rock into the egg that is the progenitor of the plant. The resulting *Rock Plant*TM is itself a gourmet delicacy, but has more body and significantly longer shelf life than the humble eggplant it resembles in appearance. It has many other exciting uses, and can be produced at much lower cost.

Products

Research by a leading Australian university (refer Disclaimer) has demonstrated that the *Rock Plant*[™] has unique nutraceutical properties. It has the potential both to cure cancer and enhance sexual performance (if we can just change the colour).

The *Rock Plant*[™] can also be used to produce conventional rock cakes and, in an exciting new development, *Rock'n'rolls*[™] (patent pending), that are set to replace hamburgers as the preferred fast food of the health-unconscious majority.

Now we have developed *Plastirock* – a new material for immobilising intractable waste. *Plastirock* will bind corrosive and poisonous wastes so that they can be “safely” dumped somewhere in central Australia. It has an expected half-life significantly greater than that of the scientists and politicians promoting its use.

Marketing

The company's marketing plan for its products is elegant and simple.

- Negotiations are “approaching completion” with major supermarket chains to sell fresh Rock Plants using the catchy promotion, “Eat this, or you'll die”.
- Rock Cakes are poised to become a major international fast food phenomenon. Market penetration will begin in Australia. As production costs decrease with economies of scale (see innovative spreadsheet attached), export markets will be developed, first in Asia and then in America and Europe.
- The potential market for *Plastirock* is enormous. It is as big as a black hole – a phrase also used to describe the likely cost of its development. It will enhance synergy and reduce inherent risks, being an industrial market negatively correlated with the prime target retail and wholesale markets. [Who writes this stuff?]

The Driving Force

The Rock Cake Company is the brainchild of Fred Gecko – a distinguished Australian farmer and businessman. Fred was a winner of the Bond Medallion for Entrepreneurs. His elder brother, Gordon, was a Wall Street legend in the 1980s. Fred has an international reputation for developing businesses that add value to Australian primary production. Most notable was his effort to transform wallabies, prematurely turned off (as they say) on the roads of Wallaby Island, into the international gourmet success story, *Sundried Wallaby*.

Valuation

The present value of the business has been conservatively estimated using the “sum of discounted future cash flows” methodology imprinted on the brain of every business school graduate, and now widely adopted by the firms that employ them.

To the conservative estimate of NPBTDA for year 55 has been applied an earnings multiple of 103.764. That figure was carefully calculated from a selection of those in our super-comprehensive data base of NASDAQ multiples for (the very few) companies (that had any earnings) during a period of similar development during the year 2000 (most of whom are now history). Trust us.

The appropriate discount rate [based on a precedent in a real IM which used, for a start-up company, the cost of capital for an established multi-million dollar business in the same industry] is 12%.

Answer: \$100 million. Please refer to Disclaimer if you have a problems with this.

The Deal

We propose to offer five shares at \$1 million each – a modest premium to NTA – and half a seat on the Board.

We acknowledge that venture managers prefer instruments other than boring ordinary shares, such as convertible, redeemable, (disposable?) notes, preferably with a nice interest rate. Such instruments have been popular since the 1980s when, at the height of the “recession we had to have”, innocent investee companies were paying 20% pa for their equity, and just 16% on their debt.

Surprisingly, a few survived. That experience encouraged venture fund managers in their fascination with convertible instruments. Their collective wisdom somehow fails to tell them that paying interest on equity is not sound. Though they are “patient investors”, their own masters still demand a running yield. Silly, isn’t it?

The proposed deal is therefore negotiable. We deferentially acknowledge that the Golden Rule applies: he or she who has the gold, makes the rules. T’was ever thus.

Recommendation

Buy! Don’t miss this opportunity. This one is bigger than Looked Smart at the time.

Investments can be made only on the form not attached to the Prospectus.

Forward cheques to gp@gordonpender.com.

Gordon Pender has been writing business plans since venture capital was discovered in Australia in the 1980s. He is writing a book on business planning.

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