## Saïd Business School cases

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# Guidebook

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This Note was prepared by Kathy Harvey, Director Executive MBA, Tim Jenkinson, Professor of Finance and Allen Morgan as the basis for class discussion.

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## Introduction

Jeff Lewis, co-founder of Guidebook, checked his watch, calculated how long he had left of his night flight from San Francisco to London Heathrow and decided he should cram in an extra half hour's work before trying to get some sleep. This would be his third visit to the new London office of Guidebook, which had grown from a small technology start up three years ago, developing an app for convention organisers, into a firm of over 100 employees with offices in California, South Korea and now London. The UK office was still tiny, with only four employees, but the opportunities to expand and build market share in Europe were clear.

Jeff intended to use this trip to make some decisions about new hires in Europe and to reflect on the latest plans to raise cash for the firm's expansion. Guidebook had recently started burning cash and he was talking to investors about a new round of funding. Jeff reflected on how far the firm had come since its early days in a basement in Palo Alto. He was the only non-technical co-founder in a group of three old school friends who founded Guidebook. The other two founders were Kevin Wood, a software developer, and Peter Lada, who focussed on product design. Since joining Guidebook Jeff had fulfilled almost every role from chief marketing officer to sales director and chief scout for fundraising.

Now, as the company grew, he found himself more of a mentor to the new team members involved in expanding the firm. He was enjoying the firm's transformation, but the plans to raise funds and expand further raised some important questions. In particular having built a great platform for expansion they faced a choice – dash for growth and sell a lot more equity in the firm, or continue to grow steadily and retain control for longer. This was not an easy decision.

## Guidebook

Guidebook was founded in 2011 "to connect people and places". It offers clients the technology and services they need to create customised apps for events, conferences, campus information and a range of other corporate meetings. Instead of carrying around bulky conference guides, contact lists or maps, customers simply download an app and use it as the window to different interactive sources of information. By the time the London office opened in 2014 it had created 30,000 apps and attracted almost two million dollars from angel and venture capital investors. Jeff had already worked for one Silicon Valley start-up as it prepared for an IPO but had kept in touch with Kevin and Peter. He decided to leave his job and join them at the point where it was billing a couple of thousand dollars a month selling a variety of apps, none of which focused on the events industry. However, two of the founders regularly attended a well-known Seattle-based gaming convention, PAX, and were approached by the organisers to develop an app for the event. They did this as a favour, and called the app *The Conventionist*. To their surprise, enquiries for similar products started to flood in due to word of mouth endorsements, and suddenly a free app developed as a favour began to look like a seriously marketable product. Initial monthly sales grew from $2,000 to $12,000 within two months. Jeff and his co-founders changed the name on the office door to Guidebook, got some legal advice, incorporated the company in Delaware and started to pay themselves small salaries. For Jeff it suddenly started to mean something.

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Over the next four years the company grew to 100 employees, picking up clients from a variety of small firms, including conference and event organisers. But the scope for providing information online via apps was far broader, including guides for college students, shopping centres and even national parks. Competitors were also appearing but the founders of Guidebook remained convinced that long-term competitive advantage lay in their ability to develop the most flexible technology, which would allow clients to develop their own services alongside Guidebook.

However, growth was also bringing increased complexity. In particular, Guidebook and its competitors had to navigate the minefield of national and international agreements on data protection and privacy. European legislation on data regulation, for instance, restricted how Guidebook could customise its products for clients outside the U.S. jurisdiction. Understanding how to overcome these issues before their competitors could be a big factor in the success or failure of any expansion plans.

## Jeff Lewis

The son of two Stanford graduates, Jeff Lewis grew up in Palo Alto and studied astrophysics at University of California at Santa Cruz. He saw himself as part of the Silicon Valley eco-system, and anticipated making his fortune through entrepreneurship. His first experience, as an employee in an expanding start-up, had made him think carefully about the best way to grow a company. When the founder wanted to sell out for $300m the firms' investors, hoping for even greater returns, blocked the sale. As the company's fortunes and valuation dipped, Jeff watched as the founder's stake in the company fell by over $100m dollars.

Jeff worried about finding himself in a similar position where he lacked control of his own destiny. He and his co-founders had big ambitions for Guidebook so they had to raise capital, but they were reluctant to jump into the arms of the first investor. Jeff envisaged leading the company for some time to come; he enjoyed mentoring and passing on the knowledge he had gained to the new crop of employees who formed part of the firm's expansion. He was aware that, in Silicon Valley, the venture capitalists of Sand Hill Road were always on the lookout for the next potential homerun. If he took too much money from the wrong sort of investors he and his colleagues would be at the mercy of their ambition for huge returns. Analytical by nature, he was also keen to protect the jobs and the share options of his employees. When he exited the firm it had to be on the right terms.

## Initial funding

Jeff and his colleagues were relieved when a local angel investor known for mentoring start-up founders in the valley approached them. Allen Morgan, a former partner in the renowned venture capital firm Mayfield, had worked closely with Reid Hoffman and Peter Theil, and was well connected with the major VC funds. Now an angel investor, he derived a lot of personal satisfaction from mentoring founders and being their "Sherpa" as they continued their entrepreneurial climb. He had heard good things about Jeff Lewis and Guidebook. Allen had

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seen similar companies start and fail before, but the recent ubiquity of tablets and smart phones led him to believe that conditions were now more favourable for firms like Guidebook to thrive.

Through Allen and a co-investor, Russ Seigelman, the Guidebook founders raised $200,000 in July 2011 through a convertible note [see exhibit 1]. By raising capital in this way, all parties delayed the thorny issue of valuation. The firm grew from five to fifteen staff and by mid-2012 was turning over $30,000 a month. At this stage they made some half-hearted attempts to secure more funding, pitching to VC firms unsuccessfully. Jeff didn't worry too much; he and his co-founders had endless debates about how much money they should be asking for to grow but the presence of healthy monthly revenues kept pushing back the need to raise more capital. Instead they could enjoy building the product and the customer base. When, soon after receiving their first angel funding, they were approached by a potential buyer, the decision to turn them down didn't seem a difficult one. A larger publicly traded competitor, which offered apps for trade shows, was looking for providers with the right technology to help it grow and offered to buy Guidebook for $8-10m. The team were working sixteen-hour days and knew they had to expand but the thought of waving goodbye to the possibility of larger long-term gains was simply not attractive enough.

Now that Guidebook had turned down its first credible buyer, the impetus to grow increased. Allen Morgan could see that unless the company started to court VC investors with a credible story about growth potential, they could miss out and linger in the small business start-up phase for too long. The company still had enough money to support its current customer base. Indeed, from August 2012 to May 2013 they made profits averaging $50,000 a month. They were growing steadily through this period, with expenses growing from $100K to $200K a month. During these early days they spent almost nothing on marketing – the product sold by word of mouth. But they knew this would not last forever as competition increased.

## Scaling up

To fund their expansion, Jeff decided Guidebook needed to raise around $1.7 million, and began to look at potential VC partners. Through Allen's contacts Jeff approached MHS Capital, a small fund of $50m and within a few days he was making his first pitch to Mark Sugerman, who turned up at the Guidebook offices in his tuxedo after attending a wedding in the valley. It was a completely different experience from Jeff's earlier pitches to VCs. He immediately felt that MHS Capital was genuinely interested in helping Guidebook succeed, not just in setting the most favourable terms for itself as an investor. Life as a start-up CEO was getting tougher for Jeff. He sensed that Mark and his colleagues would hold him accountable but would also give him the support he needed. It was his first role as CEO and he wasn't sure yet how to play it to his firm's best advantage. Allen had advised him to get the best people possible to support him and Mark seemed to be that person. Three more meetings followed, including one with an experienced Chief Technology Officer who checked out their technology credentials, before the deal was signed. MHS capital offered $1.3m with the rest of the $1.7 coming from a variety of other investors, giving them an 8.29% stake in Guidebook at a pre-money valuation of $18.8m.

Jeff was happy with the deal, which was signed in July 2013, 2 years after the original convertible note investment. A key factor for Jeff, as CEO, was getting a good deal for the

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Guidebook employees. They negotiated an option pool for employees equal to 12.5% of the fully-diluted capitalization. Jeff felt a sense of relief when the deal went through. He could go to work in the converted bank offices in Palo Alto each day and know that he had done his best to protect his colleagues' future.

## The fork in the road

Now Guidebook could really take off, and hired another thirty staff. Jeff started to think about moving to better premises, and the expansion in Europe and South Korea got underway. Suddenly everything was happening at a quicker pace. Emails from other venture capital funds, expressing interest in the firm, started coming in at the rate of two a week, but Jeff was in no hurry to raise more capital and was especially wary of some of the bigger funds. Then costs seriously overtook revenues. By October 2014, the firm was burning through cash at the rate of $200,000 a month and at this run-rate the company had about 7 months before running out of cash. To Jeff and his co-founders it seemed like there were three options for Guidebook. They could reduce the growth rate, return to profitability and might be able to avoid a subsequent funding round entirely. Or they could raise a modest round (in Silicon Valley terms) – maybe $5-10m – and go for a valuation of say $50m, giving up a relatively small stake in the company and avoiding losing control over exit. Or they could really scale up internationally as fast as possible on the back of raising maybe $30m, and really try to blow the competition out of the water. The latter was tempting, but they would probably cede control of the company and their own destinies.

Jeff was aware that most people in Silicon Valley would dash for growth, gain market share, and worry about the profits later. But he remembered the story of the tortoise and the hare. Having mulled this choice for some time, it was time to make a decision.

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## Exhibit 1: The initial convertible note financing

THIS NOTE AND THE SECURITIES ISSUABLE UPON THE CONVERSION HEREOF HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR UNDER THE SECURITIES LAWS OF CERTAIN STATES. THESE SECURITIES MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED, PLEDGED OR HYPOTHECATED EXCEPT AS PERMITTED UNDER THE ACT AND APPLICABLE STATE SECURITIES LAWS PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT OR AN EXEMPTION THEREFROM. THE ISSUER OF THESE SECURITIES MAY REQUIRE AN OPINION OF COUNSEL REASONABLY SATISFACTORY TO THE ISSUER THAT SUCH OFFER, SALE OR TRANSFER, PLEDGE OR HYPOTHECATION OTHERWISE COMPLIES WITH THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS.

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**<u>CONVERTIBLE PROMISSORY NOTE</u>**

July 2011

FOR VALUE RECEIVED, Guidebook Inc., a Delaware corporation (the "**Company**"), promises to pay to XXX (the "**Holder**"), the principal sum of **Two Hundred Thousand** ($200,000.00) dollars. Interest shall accrue from the date of this Note on the unpaid principal amount at a rate equal to [illegible]% per annum, compounded annually. This Note is subject to the following terms and conditions.

1. **<u>Maturity</u>.** Unless converted as provided in Section 3, this Note shall mature on the first anniversary of the date hereof (the "**Maturity Date**") and be due and payable upon demand by the Holder.

Subject to Section 3 below, interest shall accrue on this Note but shall not be due and payable until demanded by the Holder on a date on or after the Maturity Date. Notwithstanding the foregoing or anything to the contrary herein, the entire unpaid principal sum of this Note, together with accrued and unpaid interest thereon, shall become immediately due and payable upon the occurrence of an Event of Default (as defined below). In addition, the Holder shall not be precluded from pursuing any legal or equitable remedies that it has available to it.

2. **<u>Conversion</u>.**

(a) **<u>Financing</u>:** If the Company or a successor corporation formed pursuant to the conversion of the Company (the "**Successor Corporation**") completes an equity financing transaction or a series of related transactions yielding aggregate proceeds of at least One Million Dollars ($1,000,000) in a single transaction (or series of related closings of a single transaction) the conversion of the Notes (the "**New Equity Financing**") on or prior to the Maturity Date, the entire unpaid principal amount of and accrued but unpaid interest, if any, on this Note shall automatically convert into such equity securities issued and sold in the New Equity Financing (the "**New Equity**

**Securities**”). The number of New Equity Securities to be issued upon such conversion shall be equal to the quotient obtained by dividing (x) the entire unpaid principal amount of this Note plus accrued plus unpaid interest, if any, by (y) the lesser of (A) 80% of the price per share paid by the investors in the New Equity Financing and (B) the price per New Equity Security if such price had been based on a “pre-money valuation” of the Company or the Successor Corporation, as the case may be, equal to six million dollars ($6,000,000). The term “pre-money valuation” shall mean the pre-money valuation placed on the Company in the term sheet memorializing the New Equity Financing, and shall include all outstanding securities, all options, warrants and similar derivative securities, and all options, warrants and derivative securities reserved for future grant pursuant to equity plans adopted by the Company’s board of directors.

(b) **Corporate Transaction**. In the event of a Corporate Transaction prior to full payment of a Note or prior to the time when a Note is converted in a New Equity Financing (as provided herein), at Lender’s election, (i) all outstanding principal and unpaid accrued interest due on such Note shall be converted into that number of Conversion Shares equal to the quotient obtained by dividing the outstanding principal and unpaid accrued interest on a Note to be converted, or portion thereof, on the date of conversion, by the lesser of (y) $6,000,000 and (z) the aggregate proceeds paid in the transaction by the acquiring company (as determined in good faith by the Company’s board of directors; or (ii) the Lender shall be paid an amount equal to all outstanding principal and accrued and unpaid interest.

(c) **Mechanics and Effect of Conversion.** Upon conversion of this Note pursuant to this Section 3, the Holder shall surrender this Note, duly endorsed, at the principal offices of the Company or the Successor Corporation or any transfer agent of the Company or the Successor Corporation. The Company or the Successor Corporation will, as soon as practicable thereafter, issue and deliver to such Holder, at such principal office, a certificate or certificates for the number of New Equity Securities to which such Holder is entitled upon such conversion. Upon conversion of this Note, the Company or the Successor Corporation will have no further obligation of repayment with regard to the principal amount and accrued interest being converted. No fractional New Equity Securities will be issued on conversion of this Note and in lieu of any fractional New Equity Securities, the Company shall pay in cash the value of such fractional New Equity Securities.

(d) **Equity Securities Agreements**. The Holder agrees that as a condition to the issuance of any New Equity Securities pursuant to the conversion of the Note, the Holder shall become a party to such agreements entered into among the purchasers of such New Equity Securities and the Company or the Successor Corporation.

3. **Event of Default**. For purposes of this Note, The occurrence of any of the following shall constitute an “**Event of Default**”:

(a) The failure by the Company to pay any amounts due under this Note when due.

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(b) A material breach by the Company of any representation or warranty made by the Company under this Note.

(c) The Company's failure to observe or perform any other covenant, obligation, condition or agreement contained in this Note.

(d) The Company's material indebtedness for borrowed money is accelerated as a result of a default or breach of or under any agreement for such borrowed money, including but not limited to loan agreements, or material breach under any real property lease agreements and capital equipment lease agreements, by which the Company is bound or obligated.

(e) The filing of a petition in bankruptcy or under any similar insolvency law by the Company, the making of an assignment for the benefit of creditors, the appointment of a receiver or trustee to take possession of the property or assets of the Company, or if any involuntary petition in bankruptcy or under any similar insolvency law is filed against the Company and such petition is not dismissed within thirty (30) days after the filing thereof.

If the default is pursuant to Section 5(a), 5(b), 5(c) or 5(d) the Company shall have thirty (30) days to cure such default after the earlier of (i) receipt of written notice of default from the Holder of the Note specifying the nature of the Company's default or (ii) the date in which Company should have reasonably become aware of the occurrence of an Event of Default. If the Company is unable to cure any default within the cure period set forth herein, as determined by the Holders of Note, the Holder may, at its option, accelerate repayment of the principal amount and any accrued interest of this Note in which case such amounts shall be due and payable immediately.

4. **Transfer; Successors and Assigns.** The terms and conditions of this Note shall inure to the benefit of and be binding upon the respective successors and assigns of the parties. Notwithstanding the foregoing, the Holder may not assign, pledge, or otherwise transfer this Note without the prior written consent of the Company, except for transfers to affiliates. Subject to the preceding sentence, this Note may be transferred only upon surrender of the original Note for registration of transfer, duly endorsed, or accompanied by a duly executed written instrument of transfer in form satisfactory to the Company. Thereupon, a new note for the same principal amount and interest will be issued to, and registered in the name of, the transferee. Principal and interest are payable only to the registered holder of this Note.

5. **Governing Law.** This Note and all acts and transactions pursuant hereto and the rights and obligations of the parties hereto shall be governed, construed and interpreted in accordance with the laws of the State of California, without giving effect to principles of conflicts of law.

6. **Notices.** Any notice required or permitted by this Note shall be in writing and shall be deemed sufficient upon receipt, when delivered personally or by courier, overnight delivery service or confirmed facsimile, or 48 hours after being deposited in the U.S. mail as certified or registered mail with postage prepaid, if such

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notice is addressed to the party to be notified at such party's address or facsimile number as set forth below on the signature page or as subsequently modified by written notice.

7. **Amendments and Waivers.** Any term of this Note may be amended by the written consent of the Holder and the Company. The Maturity Date of this Note may be extended with the written consent of the Holder. Any amendment or waiver effected in accordance with this Section 8 shall be binding upon the Company, the Holder and any transferee of any Note.

8. **Officers and Directors Not Liable.** In no event shall any officer or director of the Company be liable for any amounts due or payable pursuant to this Note.

9. **Expenses**. The Company hereby agrees, subject only to any limitation imposed by applicable law, to pay all expenses, including reasonable attorneys' fees and legal expenses, incurred by the Holder of this Note ("Costs") in endeavoring to collect any amounts payable hereunder which are not paid when due, whether by declaration or otherwise. The Company agrees that any delay on the part of the Holder in exercising any rights hereunder will not operate as a waiver of such rights. The Holder of this Note shall not by any act, delay, omission or otherwise be deemed to have waived any of its rights or remedies, and no waiver of any kind shall be valid unless in writing and signed by the party or parties waiving such rights or remedies.

8. **Approval**. The Company hereby represents that its board of directors, in the exercise of its fiduciary duty, has approved the Company's execution of this Note based upon a reasonable belief that the principal provided hereunder is appropriate for the Company after reasonable inquiry concerning the Company's financing objectives and financial situation. In addition, the Company hereby represents that it intends to use the principal of this Note primarily for the operations of its business, and not for any personal, family or household purpose.

9. **Delays or Omissions**. No delay or omission to exercise any right, power or remedy accruing to the Holder upon a breach or default by the Company under this Note shall impair any such right, power or remedy of the Holder, nor shall it be construed to be a waiver of any such breach or default, or an acquiescence therein, or of any similar breach or default thereafter occurring. Any waiver, permit, consent or approval of any kind or character on the part of the Holder of a breach or default under this Note, or any waiver on the part of the Holder of any provisions or conditions of this Note, must be in writing and shall be effective only to the extent specifically set forth in such writing. All remedies, either under this Note or by law or otherwise afforded to the Holder, shall be cumulative and not alternative.

10. **Titles and Subtitles**. The titles of the paragraphs and subparagraphs of this Note are for convenience of reference only and are not to be considered in construing this Note.

11. **Severability; Usury**. Should any provision of this Note be determined to be illegal or unenforceable, such determination shall not affect the remaining

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provisions of this Note. In the event that any interest paid on this Note is deemed to be in excess of the then legal maximum rate, then that portion of the interest payment representing an amount in excess of the then legal maximum rate shall be deemed a payment of principal and applied against the principal of this Note.

[Signature Page Follows]

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