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Creative Solutions, Inc. and Their Table-TXT Product

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Two young entrepreneurs are attempting to launch a universal SMS mobile ordering system that might be scalable on a global basis. They have asked a former advisor to invest in their nascent company. Having just received good news of a pending alliance offer, the entrepreneurs are also seeking advice from their advisor, and they reiterate their offer to sell shares to the advisor at a "ground floor" valuation. Students must assess whether Creative Solutions should pursue the alliance and whether the advisor should invest.

LAUNCHING WITH A PARTNER?

Professor Chippas listened to a voicemail from two former students:

"Dr. Chippas, it's Franco and Anthony here. Give us a call as soon as you can. We have some really exciting news to share!"

Francisco "Franco" Boden and Anthony Metzler had been working with Professor Chippas for a couple of years to help them think through their business model and identify the steps to launch their business. Chippas directed the entrepreneurship program at a private university and had taught Franco in venture capital and business planning classes a couple of years prior. The company launched under the name of Creative Solutions, Inc. (CSI), with Table-TXT being their lead product.

"Hey Doc, thanks for returning the call," Anthony piped from the other end of the line. "We just met with the president and VP of Secured Financial Networks (SFN), and they are very interested in a strategic alliance that would port our software to their product line of point-of-sale (POS) equipment. They've indicated that they would pick up most of the cost of development. What's more, they have preliminary interest in buying a 10% stake in the company, which should give us the capital we need to begin the marketing roll-out of Table-TXT. It gets better -- they also have a national sales force of 60 independent agents!"

Chippas responded with his characteristic guarded enthusiasm, "That's really great, Anthony. I'm really proud of your perseverance. I'm especially glad to hear that you won't have to build your own sales force. Have they sent you any terms yet?"

"Nothing in writing… but we had a five hour meeting with them, so we have a pretty good idea of what to expect. They hope to get us a term sheet[1] next week."

"As you know Anthony, this mobile device space is outside my area of expertise, but I'd like to take a look at your deal once you get some details just to make sure you're being treated fairly," responded Chippas.

[1] A term sheet is an agreement- in-principle between a company and an investor that outlines the amount of money to be invested, the securities to be received, and the conditions which would affect the transaction.

"Sure, we would actually appreciate that. If you still have an interest in possibly investing, we'd be willing to sell shares to you at our pre-money valuation ($10/share). Once we launch, we should become self-financing quickly, so we'll be closing the doors to investors."

"Well you know I've been really impressed with your progress, but if I did invest, it would be the first time I ever invested in a business launched by a former student. And it would only be in the $10,000 range."

"Yeah, you've told us that before, but we'd still like to have you as an investor."

Chippas expressed his appreciation for the offer and hung up the phone hopeful that the deal was as good as Anthony had indicated. The small Table-TXT team had worked very diligently for a couple of years to get this far, and they had gone largely uncompensated. Moreover, raising capital in 2010 in the aftermath of the Great Recession of 2008 had proven difficult. Chippas wanted to review the deal to evaluate whether Table-TXT should take the deal with the potential partner and to determine whether he himself should invest at this time.

THE FOUNDERS

Franco and Anthony met at a small private Florida university where Franco had majored in Business. Franco was an engaging personality with a gravitational attraction toward sales and marketing. Having grown up as the son of a dentist with typical upper-middle class opportunities, he was quite the cultural boundary spanner when it came to business. While in college, he worked for the owner of a struggling local Midas Muffler auto repair shop. By developing some clever marketing campaigns, cleaning up and redecorating the waiting room, and improving the shop operations, sales and profitability rebounded significantly.

Anthony was raised in an entrepreneurial home where his family had been involved in the coal mining business and in water purification technology. He had spent parts of eight years in high school and college working in a BMW repair shop and had thought of majoring in Mechanical Engineering before finally choosing Family Business. Anthony was marvelously articulate, having minored in Creative Writing. Combing his communicative skills, his attention to detail learned at the BMW shop, and his business skills gleaned from college, he was quite naturally the public face of Table-TXT. Moreover, Anthony had a great appreciation for Franco's business acumen and perhaps, most importantly, felt they had the ability to work through business disagreements while keeping their friendship intact.

Franco and Anthony met Zebadiah Long, the third partner, when he became their roommate midway through college. Zebadiah majored in Computer Science and combined strong software engineering and programing skills with the patience to listen to the business side of the company and describe consumer preferences and needs. Anthony appreciated the fact that Zebadiah was not a "software prima donna" and felt that Zebadiah was very creative and really good at working through programming challenges.

THE COMPANY AND PRODUCT

Franco, Anthony, and Zebadiah launched CSI to develop software that might potentially change the future of the restaurant / entertainment venue food service. Their chief product was Table-TXT, a SMS-based (text-message) platform that would allow customers to text orders from a cell phone by invoking a customized template designed for each particular restaurant, chain or venue. The four essential differences between the Table-TXT platform and existing online order systems were: (1) it was designed for in-restaurant service, not take-out; (2) it required no registration or downloading of an app; (3) it was designed to be used as needed for table service, generally – not just for ordering; (4) it did not require a smart phone (iPhone or Android).

The customer would benefit from shorter wait times for ordering, delivery, and service generally. On the wait-staff side, the system could run off a PC, tablet, or eventually be integrated into point-of-sale (POS) hardware (registers, order screens, etc.). The hardware allowed the establishment to confirm the order and advise the customer when the order was ready, while offering screen-views or printouts to the wait staff of pending orders by table.

The product was not designed to replace the role of the wait staff but to enable them to respond more efficiently to the needs of the customers. For example, in a crowded bar, a customer could text her order without having to flag down wait staff or fight her way to the bartender. The bartender would then make the drink and present it to the waitress serving that table, who would deliver the drink. In a restaurant, the technology could also serve to show the waiter that Table 7 needs a refill on water. The message would appear on a screen in the bar or kitchen area, which Table-TXT software could display by table, making it easier for the wait staff to monitor the needs of their tables while in the kitchen, bar, or cash register.

The benefit to the establishment would be increased sales and better customer service (which would support return visits). Popular bars and restaurants recognized that business was easily lost during the peak hours when lines become long or service becomes slow.

The product is demonstrated in two different applications in the following YouTube videos:

http://www.youtube.com/watch?v=CPZrpP_pkJw (bowling alley)
http://www.youtube.com/watch?v=m45fk8kIvlk&feature=related (club environment)

Technologically, the basic platform was ready to begin customer testing. CSI had been waiting for several months for their short and long codes from AT&T. These codes would allow the system go live and would also define the address of the system for all messages that would be sent over it. The algorithm for contacting a particular bar or restaurant was [short code] for the phone number, then in the body of the message the user would type @ [restaurant's name] [table number]. So ordering from a particular store at Chili's might include the line @chilis1012. This would indicate Chili's store #10 table 12. The order would then be entered (See Appendix 2 for the usage instructions that would be on a restaurant table).

However, AT&T had been overwhelmed with issues relating to the launch of Apple's 4G iPhone, and, as a result, had suspended processing new short codes with the result that fully functional Table-TXT product demonstrations had been put on hold. This delayed the marketing effort as Table-TXT's most eager prospects wanted to see a live, online demonstration prior to initiating a live trial with their customers. Nevertheless, the offline product demonstrations had generated considerable interest and Franco had a list of call-backs to visit once the product went live.

The potential application of Table-TXT technology was quite broad: sports venues, bars and clubs, restaurants, hotels, etc. Eager for sales, Table-TXT had pursued every venue that had shown interest but felt that clubs/restaurants and sports venues would be the initial target venues. This market had hundreds of thousands of potential customers worldwide, but Franco and Anthony were determined to start with restaurant/club owners they knew in the Orlando area, then work toward getting in restaurant chains and sports venues. They felt it was critical to get the product installed as soon as possible as everyone they called on wanted to know where it was currently being used. Local restaurateurs offered the quickest adoption potential.

Table-TXT had received considerable interest from general managers at Buffalo Wild Wings (BWW), a chain of about 650 restaurants. The managers had forwarded their interest to the corporate office requesting that Table-TXT be considered for system-wide installation. Other interested chains included Zorbaz – a chain of about a dozen restaurants in the Midwest, Chili's (1400 units), and Ale House (about 20 units). Several owners of multiple non-chain restaurants in the Orlando area where CSI was based were firmly behind implementation and seemed likely to be the company's first clients.

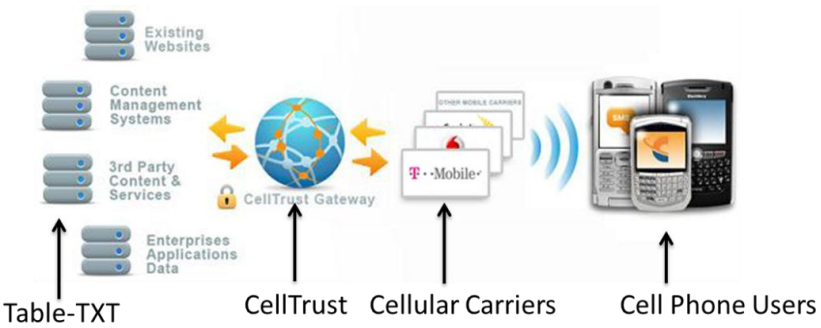
Finally, the tourist board of Aruba was eager to have the system integrated island-wide to make the tourist experience more convenient. Serving as an online concierge for everything from scuba excursions to massages, the board anticipated that Table-TXT would increase both consumer expenditures and make the process of finding and booking reservations easier. A simple island-wide directory of Table-TXT users would be developed for easy cyber-navigation to companies using Table-TXT.

A POSSIBLE PARTNER

CSI had hired Sandra Gabriel and Russell Lafreniere as marketing and fundraising consultants. Through their efforts, Anthony and Franco had been introduced to SFN Inc.'s management from whom CSI was awaiting a term sheet. SFN had sales associates that worked closely with concessionaires in two professional basketball venues – the Staples Center in Los Angeles and the Verizon Center in Washington, DC. SFN felt that Table-TXT was especially well suited to high volume, fast service environments like athletic venues. In addition, Gabriel was seeking to interest Mark Cuban, owner of the Dallas Mavericks into coming on as an investor. This would potentially give Table-TXT entrance into the Dallas arena as well as Cuban's chain of 58 movie theatres. CSI had made even more progress with the Orlando Magic whose executives had seen their presentation and were enthusiastic about the prospects of using the system. Furthermore, according to Metzler, they felt that it was likely that the Table-TXT platform would spread throughout the NBA arenas by streamlining the purchase of concessions and making it more convenient for the customer.

CELLTRUST AND THE TABLE-TXT BUSINESS MODEL

When a cell phone user sent a text message to another user, it traveled directly over the network of the phone company to the receiving phone. If, however, a third party was involved (such as Table-TXT) either as a content provider or as a distribution list provider, the message had to first be connected with the content or the distribution list housed on a server. CellTrust was a leading provider of such "connecting" services and was CSI's choice for its Table-TXT platform. A "short code" was a phone number authorized by the carrier and linked at CellTrust to the third party's server. CellTrust billed according to the number of texts purchased by the third party provider. The text purchase would then be "inventoried" at CellTrust and reduced by each message sent on that short code. When the inventory of purchased texts was depleted, Table-TXT would purchase more messages. The diagram below depicts the relationships described above.



Adapted from CellTrust website (http://www.celltrust.com/mobile-aggregation.html)

Table-TXT had three ways to make money. Primarily, it would sell text messages in bulk to their retail accounts (restaurants, etc.) who would offer them at no charge to their customers who used the Table-TXT system. The per-unit cost of a message from CellTrust, the industry wholesaler of messages, decreased dramatically with volume purchased. By purchasing in quantities of one million messages or more, Table-TXT could be highly profitable. Secondly, they could sell advertising on the messages; finally, they charged modest fees for hardware and set-up (see Table 1 for pricing).

Table 1. *Pricing*

Cost of messages to CSI from CellTrust	1 cent/ message
Price of messages to larger chain restaurants	5 cents/message
Price of messages to smaller accounts	6 cents/message

CSI anticipated buying messages in quantities of 1 to 3 million

Generally, it would take about three messages per restaurant/club order: one message to order, one to confirm and clarify any ambiguities, and one when the order was ready. CSI anticipated making about four to five cents per message. In situations where a customer's order was ambiguous, one additional message would be anticipated from both the customer and the establishment. It was not anticipated that the system would replace the wait staff. Rather, it would help them do their jobs in a more efficient and customer-sensitive manner.

COMPANY FINANCING

The company had been financed to this point by friends and family members primarily, along with some near-exhausted credit cards of the founders. Fortunately, the founders were all single, shared a house that also served as their office, and worked side jobs to make ends meet.

Anthony had prepared a cash budget for 2010 (see Table 2) and financial projections for three years (see Table 3). Chippas was an admitted technological laggard when it came to mobile computing. He recognized that he did not use his cell phone for much more than voice calling, and, therefore, would not be able to offer any insights into whether the market would go for this new technology. While he thought the technology was clever, he had frequently asked if Table-TXT had booked any actual subscribers yet and was eager to know what their experience with the system had been. He had also expressed concerns about the cost of building a sales force to sell the product.

The cost to bring a restaurant or club online was estimated to be about $800 to $1,000, for which they would charge a setup fee of $1,850. The costs included table and promotional material about how to use the service, employee time, and a dedicated computer with printer. Depending on the venue, a client may not require the computer/printer.

Table 2. *2010 Cash Budget*

Max Offering Cash Flow 2010	Development Costs	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	Total Item EOY
Cash on Hand (beginning of month)	0	0	0	8,106	8	17	74	357	152,862	135,941	172,091	274,475	467,610	
CASH RECEIPTS														
New client setup		0	0	0	0	0	0	9,250	27,750	55,500	74,000	129,500	138,750	434,750
Monthly fee		0	0	0	0	0	0	0	2,000	3,500	6,500	10,500	17,500	40,000
Initial messages		0	0	0	0	0	0	25,500	21,000	40,500	60,000	90,000	97,500	474,750
Restock messages		0	0	0	0	0	0	0	15,000	26,250	48,750	78,750	131,250	300,000
Arena fees		0	0	0	0	0	0	0	0	0	0	0	0	1,249,500
Arena messages		0	0	0	0	0	0	0	0	0	0	0	0	
Advertising revenue		0	0	0	0	0	0	7,200	12,600	23,400	37,800	63,000	90,000	
Investor cash injection	149,500	2,500	10,250	6,400	3,260	15,610	4,000	170,730	0	0	0	0	0	210,250
TOTAL CASH RECEIPTS	149,500	2,500	10,250	6,400	3,260	15,610	4,000	212,680	78,350	149,150	227,050	371,750	475,000	
Total Cash Available (before cash out)	149,500	2,500	10,250	14,506	3,268	15,627	4,074	213,037	231,212	285,091	399,141	646,225	942,610	
CASH PAID OUT														
Purchases (Computer Hardware)	0	0	0	0	0	0	0	26,000	19,500	39,000	52,000	91,000	97,500	
Purchases (Promotional Materials)	0	0	0	0	0	0	0	600	450	900	1,200	2,100	2,250	
Purchases (Marketing Materials)	0	0	48	430	0	0	0	500	375	750	1,000	1,750	1,875	
Executives' Salary	118,500	0	0	0	0	0	0	15,000	15,000	15,000	20,000	20,000	20,000	
Food/Travel	3,907	583	396	245	42	1,400	1,500	1,500	3,000	1,000	1,500	1,500	4,000	
Sales Commission	0	0	0	0	0	0	0	3,475	6,575	12,575	18,925	30,875	38,500	
Marketers' Salary	0	0	0	0	0	0	0	1,500	1,500	1,500	1,500	1,500	1,500	
Advertising/Promotion	5,400	0	0	0	0	0	0	2,500	30,000	2,500	5,000	5,000	5,000	
Design	230	241	0	0	0	0	0	1,000	4,000	2,000	3,000	3,000	3,000	
Engineers' Salary	0	0	0	0	0	0	0	0	5,000	5,000	7,500	7,500	7,500	
Technology Fees	0	79	84	0	33	33	91	91	91	109	109	127	127	
Server System	650	20	20	20	20	20	76	76	140	140	140	210	210	
MessageMedia Service	6,700													
CSCA Vanity Shortcode Fee	0	0	0	3,000	0	0	0	0	3,000	0	0	3,000	0	
Celltrust Service	0	0	0	3,000	0	0	0	850	850	850	850	850	850	
Bulk SMS Credits	0	0	0	1,300	3,000	10,700	0	0	0	25,000	0	0	0	
Operating Expendables	425	150	46	692	16	0	50	350	350	500	500	500	500	
Office Supplies	5,538	627	0	924	0	0	0	200	250	200	300	300	300	
Rent	3,516	350	350	350	0	0	1,300	1,300	1,300	1,300	1,300	1,300	1,300	
Utilities	797	150	150	150	0	0	400	400	400	400	400	400	400	
Internet	900	75	75	75	0	0	80	80	80	80	80	80	80	
Telephone	2,145	225	225	495	0	0	220	220	220	220	220	220	220	
Accounting & Legal	792	0	750	743	0	0	0	2,000	0	0	3,000	0	0	
Insurance	0	0	0	0	0	0	0	400	0	0	400	0	0	
Taxes	0	0	0	0	0	0	0	2,133	2,998	3,639	5,118	6,395	7,209	
Fees/Dues	0	0	0	24	140	400	0	0	0	0	0	0	0	
SUBTOTAL	149,500	2,500	2,144	11,423	3,250	12,553	3,717	60,175	95,079	112,663	124,042	177,607	192,321	
Owners' Withdrawal	0	0	0	3,075	0	3,000	0	0	0	0	0	0	0	6,075
TBL-TXT Royalty	0	0	0	0	0	0	0	0	192	336	624	1,008	1,680	3,840
TOTAL CASH PAID OUT	149,500	2,500	2,144	14,498	3,250	15,553	3,717	60,175	95,271	112,999	124,666	178,615	194,001	
Cash Position	0	0	8,106	8	17	74	357	152,862	135,941	172,091	274,475	467,610	748,609	

Source: company documents

Table 3. *Financial Projections, Calendar Years 2011-13*

	2010	2011	2012	2013
SALES	$ 1,483,500	$ 5,934,000	$ 17,802,000	$35,604,000
COST OF SALES	$ 325,000	$ 1,300,000	$ 3,900,000	$ 7,800,000
GROSS PROFIT	$ 1,158,500	$ 4,634,000	$ 13,902,000	$ 27,804,000
GENERAL, SELLING & ADMINISTRATIVE	$ 382,300	$ 1,529,200	$ 4,587,600	$ 9,175,200
OPERATING PROFIT	$ 776,200	$ 3,104,800	$ 9,314,400	$ 18,628,800
INTEREST	$0	$0	$0	$0
TAXES	$ 217,336	$ 1,086,680	$ 3,260,040	$ 6,520,080
NET INCOME	$ 558,864	$ 2,018,120	$ 6,054,360	$ 12,108,720

Extrapolated by author from company's 2010 projections using the following assumptions
1) Revenues grow more slowly in the ensuing years, increasing 4x in 2011, 3X in 2012, and 2X in year 2013
2) Margins do not expand, a conservative assumption
3) Taxes are 28% for 2010; 35 % thereafter
4) It should be noted that the 4x revenue growth between 2010 includes the fact that they only sold for half the year in 2010. The rate of sales growth peaks in 2012.

COMPETITION

While several companies were providing related services, none was as robust and user-friendly as Table-TXT. Zingle and Fango were two of the closest competitors, but both lacked a few key services that the Table-TXT offered. Both were started and funded by entrepreneurs at Harvard University. Zingle used a custom printer with a cellphone-like device integrated so that each location had its own phone number and texting that number simply allowed for a printed order. Fango used a POS service that charged directly to one's credit card and transmitted all information via a data plan. It had been installed in three small arenas. Neither of these two companies provided a true interactive ordering method. Gomobo was configured similarly, but there were just alternative ways to submit orders. All competitors' services required the user to create an online profile and download an application before using their service. Table-TXT was dedicated to ease of use and minimal customer labor. It could utilize applications in the future for credit card processing, but CSI felt that the base of the platform should remain SMS-only for ease of use. Both Zingle and Fango had landed contracts with several large fast food chains including McDonalds and Burger King. Gomobo had contracts with Five Guys, Subway and Cold Stone Creamery. CSI did not see fast food venues as their target market.

Table 4. *Competition*

SMS Ordering Service	GOMOBO	ZINGLE	TBL-TXT	FANGO
Online Account	YES	YES	N/A	YES
Location Awareness	NONE	NONE	YES	YES
Dedicated Short Code	NONE	NONE	(825-898)	SMARTPHONE ACCESS ONLY
International Capability	NONE	NONE	YES	YES
Pick-Up or Delivery	PICK-UP	PICK-UP	BOTH	BOTH
Take Away or Dine In	TAKE AWAY	TAKE AWAY	BOTH	ARENA ONLY
Sensitive Information	ONLINE PROFILE	ONLINE PROFILE	DATA PLAN ACCESS ONLY	DATA PLAN ACCESS ONLY
Website	http://gomobo.com/	http://www.zinglenow.com/	http://tbl-txt.com/	http://thefango.com/

INTELLECTUAL PROPERTY

CSI had a trademark on "TBL-TXT" plus utility and process patents pending with the U.S. Patent and Trademark Office. The patents, filed through a leading Orlando patent attorney covered unique features of their SMS-based ordering protocol. It appeared that some of the existing competition might be in violation of their patent, once issued. Nevertheless, CSI management felt that the key to success would not ultimately rely on patent protection but rather in getting a strong, first-mover position in the market.

CHIPPAS'S DECISION CRITERIA

Generally, Chippas used his Risk Assessment Grid (Table 5) to evaluate the likelihood of operational success. If he felt the odds were good for operational success, he would then consider the pricing of the deal and the extent to which he felt the price of the offering already reflected growth expectations. He did not like to invest if more than two categories were rated "high", but if the deal was right, that was not a hard and fast rule. For seed-stage money, Chippas had up to $10,000 he could afford to lose but wanted at least a 50% annualized return to compensate him for his risk and wanted to see a viable exit by the end of year four. In the CSI deal, Chippas felt that if the company was going to be successful, it would be evident by year four since that time frame would give Table-TXT ample time to either be rapidly gaining traction or prove itself unattractive to the market.

Table 5. *Risk Assessment Grid*

RISK CATEGORY	DEFINITION	EVALUATIVE HINTS
Management Risk	Is management experienced and competent in their fields? Balanced team (finance, sales, and operations)?	Mitigated by prior experience, education, professional network, balanced team
Technology Risk	Is the product complete and does it work to specification?	Mitigated by having alpha/beta/launch versions
Market Risk	"Will the dogs eat the dog food?" How much? How broad is the market?	Mitigated by prior sales, competitors' sales. Aggravated by product that require consumer to change behavior or business ops
Distribution Risk	Are the distribution channels available and can they be affordably reached?	Mitigated by contracts with distribution chains; aggravated by having to develop the channels
Value Chain Risk	Are there likely difficulties or uncertainties in the value chain?	Aggravated by foreign supply, scarce components, etc.
Financial Risk	What is the debt load? How is the liquidity?	Check liquidity and leverage ratios
Operating Risk	Are high fixed / capital costs required for start-up?	Aggravated by high fixed costs
Legal Risk	Are there risks relating to lawsuits? IP?	Aggravated by pending suits or practices/behaviors that invite litigation
Moral Risk	Are there sketchy behaviors on the personal or corporate levels?	Aggravated by past record, reckless personal behavior, etc.

CSI'S DEAL

CSI had 1,000,000 shares authorized, and was seeking to place between $210,000 and $500,000 worth of shares at a price of $10 each in lots of 300 shares or more. While they felt the $210,000 number would be all they would need to get to cash-flow breakeven, they would be willing to sell up to $500,000 worth of shares if a strategic or institutional investor required a larger investment to make it worth their effort. CSI's management believed that after their initial financing, further growth could be financed from cash flow, and the door would close to outside investors.

Prior to the financing, CSI had no debt and $190,000 of stock outstanding representing 19,000 shares. Chippas was intrigued by the prospect of being able to purchase shares at $10/share. If CSI placed only 21,000 new shares (the minimum) at $10/share, and he bought 1000 shares for his $10,000, he would own 1,000 of 40,000 post-financing shares outstanding or 2.5% of the company. He needed to calculate how much his $10,000 would need to grow to give him a 50% compounded return over four years, and then he needed to assess whether his 2.5% of the company might actually be worth that much by the end of year four. This latter calculation would certainly involve making some assumptions about the future.

VALUATION CONSIDERATIONS

Public software companies typically traded at valuations of 2-4 times sales. However, some research suggested that privately traded stocks were subject to a 40% illiquidity discount. In addition, the publicly traded companies were generally more stable than start-ups implying that CSI should be valued below these numbers, but, on the other hand, CSI anticipated a much higher growth rate, implying a higher valuation.

Institutional investors in start-ups typically targeted 50% annualized return on investment. Angel investors and strategic investors could be expected to want at least 20% annualized return.

To help Chippas assess the value to CSI of teaming up with SFN, he pulled up SFN's recent financial data filed with the SEC (see Appendices 1A and 1B). His decision seemed to have two components: Should he encourage CSI to pursue a relationship with SFN? Should he invest in CSI?

APPENDIX 1A. ***SECURED FINANCIAL NETWORK, INC. CONSOLIDATED STATEMENTS OF OPERATIONS***

	Three Months Ended		Six Months Ended	
	June 30, 2010 (Unaudited)	June 30, 2009 (Unaudited)	June 30, 2010 (Unaudited)	June 30, 2009 (Unaudited)
REVENUES				
Sales	473,261	214,959	734,469	357,665
Cost of Goods Sold	328,002	182,223	491,703	307,708
Total Gross Income	145,259	32,736	242,766	49,957
EXPENSES				
Administrative Expenses	278,297	175,166	435,950	328,830
Professional and Consulting	23,035	79,785	58,370	136,944
Depreciation and Amortization	10,565	1,578	21,131	3,156
Interest Expense	105,257	176,415	271,696	355,025
Total Expenses	417,153	432,944	787,148	823,955
Net Loss before other income (expense)	(271,894)	(400,208)	(544,382)	(773,998)
Other Income (expense):	343,428	75,826	343,428	75,826
Deriv. and Liquid. Income (Expense)	30,798	(19,567)	29,798	96,563
Net loss before Provision for Income Taxes	102,331	(343,949)	(171,156)	(601,609)
Provision for Income Taxes	-	-	-	-
NET GAIN (LOSS)	$102,331	$(343,949)	$(171,156)	$(601,609)
Basic and Diluted				
Net Gain (Loss) per Common Share	$0.00	$(0.01)	$(0.00)	$(0.01)
Weighted Average Number of Shares				
Common Shares Outstanding - basic and diluted	59,987,287	51,275,020	58,987,287	50,699,700

APPENDIX 1B. ***SECURED FINANCIAL NETWORK, INC. CONSOLIDATED BALANCE SHEETS***

ASSETS

	June 30, 2010 (Unaudited)	December 31, 2009
CURRENT ASSETS		
Cash	$ 27,788	$ 4,009
Accounts receivable, Net	54,097	60,219
Employee Advances	8,171	-
Inventory	234,886	441,932
Prepaid Expenses	11,602	15,327
Total Current Assets	336,544	521,487
FURNITURE AND EQUIPMENT (NET)	18,374	21,928
OTHER ASSETS		
Refundable Deposits	5,170	5,170
Intangible, Net	71,136	77,373
Total Other Assets	76,306	82,542
TOTAL ASSETS	$ 431,224	$ 625,957
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts Payable	413,138	507,858
Notes Payable	1,496,954	1,626,954
Accrued Expenses	1,289,060	1,293,886
Derivative and Liquidating Liabilities	418,273	448,071
Line of Credit	880,000	1,163,084
Secured Convertible Note - In Default	257,500	312,232
Total Current Liabilities	4,754,925	5,352,085
STOCKHOLDERS' DEFICIT		
Common Stock authorized is 100,000,000		
shares at $0.001 par value. Issued and		
outstanding on June 30, 2010, 62,286,006 shares		
and December 31, 2009, 55,688,568 shares.	62,286	55,689
Additional Paid in Capital	4,939,321	4,372,334
Accumulated Deficit	(9,325,307)	(9,154,150)
Total Stockholders' Deficit	(4,323,700)	(4,726,128)

APPENDIX 1C. ***OTHER NOTES OF INTEREST FROM THE 10-K FILING of JUNE 30, 2010***

GOING CONCERN

Our financial statements have been prepared on the basis that we will operate as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. We have incurred net losses each year since inception and have relied on the sale of our securities from time to time and loans from third parties to fund our operations. These recurring operating losses have led our independently registered public accounting firm Sherb & Co, LLP to include a statement in its audit report relating to our audited consolidated financial statements for the years ended December 31, 2008 and 2009 expressing substantial doubt about our ability to continue as a going concern. Our ability to continue as a going concern is dependent upon our ability to obtain the necessary financing to meet our obligations and repay our liabilities when they become due and to generate profitable operations in the future. We plan to continue to provide for our capital requirements through the sale of equity securities, however, we have no firm commitments from any third party to provide this financing, and we cannot assure you we will be successful in raising working capital as needed. There are no assurances that we will have sufficient funds to execute our business plan, pay our obligations as they become due or generate positive operating results.

APPENDIX 2. ***TABLE-TXT INSTRUCTIONAL "TENT" FOR BAR/RESTAURANT TABLES***

tbl-txt
the premier interactive
text ordering service
Send a text to 825-898 followed by:
@ Joe's 11
prefix venue table

Then write your order or message to the staff,
send the text, and wait for confirmation!

Then write one of the following message commands!
CANCEL - to cancel your order if the wait is >7 mins
HELP - for assistance with the text ordering service
WAIT - to check the text order queue wait time
STOP - to opt out of the TBL-TXT service

Your use of tbl-txt is subject
to the Terms of Use Agreement.
www.tbl-txt.com/terms.html
Our Privacy Policy is available at:
www.tbl-txt.com/privacy.html

INSTRUCTOR'S MANUAL

CASE SYNOPSIS

Start-up firm Creative Solutions, Inc. (CSI), developers of Table-TXT, a software platform that enabled text-message ordering in food service and entertainment venues, was bootstrapping the company with small equity sales to family and friends and was on the cusp of landing some equity financing from one or more strategic partners. Dr. Chippas had been asked to invest in the company and must evaluate whether the investment makes sense for a modest amount of risk capital that he had available. A long-time advisor of the company, Chippas must evaluate the particular risks associated with the company, assess the likelihood of success, and then determine whether CSI's proposed valuation of the shares will give him the return he requires based on future performance expectations. The case requires the student to evaluate the risk factors of the new company and first year projections, gauge the value of the firm, and determine if and when Chippas should invest. Pedagogically, Chippas represents seed/early stage venture capital investors, angel investors, and "friends and family" investors.

RESEARCH METHODOLOGY

The case was developed from pro bono consulting work done by the author, who is disguised as "Professor Chippas" in the case.

USAGE

This case is about uniting available data on a highly scalable business in a new market space with a framework for thinking through business risk so that the student can systematically address *if* and *when* one should invest. The case is especially targeted for use early in a course on entrepreneurship, entrepreneurial finance, or venture capital at the upper-level undergraduate or graduate levels. It is also useful in entrepreneurship sections of strategy courses.

TEACHING OBJECTIVES

1) To present a systematic risk framework by which students can evaluate a potential investment in an early stage company in a nascent industry.
2) To evaluate the suitability of a potential strategic partner.
3) To provide an exercise in early stage company valuation.

THEORETICAL LINKAGES

Risk. In this case, risk is conceptualized along the lines of Tyebjee and Bruno (1984) who factor analyzed 23 variables thought to influence the investment decisions of venture capitalists and identified five dimensions: market attractiveness, management capability, product differentiation, threat resistance, and cash-out potential. Similarly, Roberts and Barley (2004) interviewed partners at four marquee venture firms in California and identified a similar set of investment criteria. Using a similar methodology, Hardyman, Lerner, and Leamon (2004) examined best practices among venture capital firms including how they evaluated investments. The Risk Assessment Grid is an attempt to develop a tool to systematically evaluate the likelihood of start-up success by elaborating on the categories and observations of the above authors.

Strategic Alliances. The literature broadly identifies correlates of successful alliances (e.g., trust, commitment, complementarity, financial payoff) (Shah and Swaminathan, 2008). Kanter (1994) develops more specific and operational guidelines conveniently named the "Eight I's That Create Successful We's": Individual Excellence, Importance, Interdependence, Investment, Information, Integration, Institutionalization, and Integrity. Aspects of this simple but highly usable framework can help guide students in evaluating the likelihood that the SFN alliance would be successful.

Valuation. The case employs the Venture Capital Valuation method articulated by Sahlman and Willis (2003) and further popularized by Timmons/Spinelli, (2007) in their text *New Venture Creation.* Chapters 13 and 14 of this text also present a framework for deal structure and negotiation, which can provide students with ways of thinking about whether SFN might be an appropriate partner.

THE RISK ASSESSMENT GRID

The case posits its own conceptual framework by showing Chippas's grid for evaluating risk in early stage companies.

CASE QUESTIONS

Evaluate the risk profile of an investment in CSI using the RAG.

Does the cash budget seem to suggest that the entrepreneurs have a good understanding of the expenses necessary to launch the business? Do the expense items seem complete?

Does the revenue ramp-up seem reasonable? Evaluate the assumptions and the actual numbers. Can the company be successful with a much lower penetration rate?

Would you advise Dr. Chippas to invest his $10,000 in this company (assuming the investment is but an incidental piece of his portfolio)?

ASSIGNMENT QUESTIONS

Using Dr. Chippas' Risk Assessment Grid (RAG) assess the company's likelihood of being a successful start-up.

RISK CATEGORY	DEFINITION	RATING
Management Risk	Is management experienced and competent in their fields?	High: Demonstrated per-severance; inexperienced; worked well to get this far, very young. No financial person. OK at best for now but will need to hire experienced leadership soon.
Technology Risk	Is the product complete and does it work to specification?	Med: Alpha version works; not payment-compatible yet. Effectiveness of platform seems diminished w/o payment capability.
Market Risk	"Will the dogs eat the dog food?" Can the product be priced to endure adequate margins?	High: Requires change in consumer behavior of work flow at restaurant AND consumer behavior of end customer. – A strong negative; lots of interest and enthusiasm; no signed contracts; actual usage rate not predictable. CSI bases its projections on 30% usage rate. Could be much lower, would take time to ramp to 30% in any case.

Distribution Risk	Are the distribution channels available and can they be affordably reached?	Med - high: Channels seem open, but how expensive will the sales effort be to secure contracts with customers? Are independent reps the right approach? If captive sales force, major upfront costs to support/compensate them are likely as revenue earned is mostly recurring.
Value Chain Risk	Are there likely difficulties or uncertainties in the value chain?	Low: high hurdle of getting short/long codes already cleared.
Financial Risk	What is the debt load? How is the liquidity?	High: No company debt; but liquidity poor. Chippas's modest investment would not solve even the immediate problem. So in the absence of other major investors, liquidity problem remains even if Chippas invests.
Operating Risk	Are high fixed / capital costs required for start-up?	Low -med: Low fixed costs, but software dev. costs pose a hurdle at the start.
Legal Risk	Are there risks relating to lawsuits? IP?	Low: While they have a patent pending, it could be overthrown even if issued. However, nature of product suggests that first mover advantages will accrue, so patent protection is of uncertain value to success anyway.
Moral Risk	Are there sketchy behaviors on the personal or corporate levels?	Low: "creep-factor" not existent.

***Which of the RAG categories seems most threatening to the success of the business*?**

The profile is typical of a tech start-up. The management risk can be mitigated through hiring if the company is successful early on, and credit must be given to the fact that the company has come a long way so far. Nevertheless, success at the level anticipated in the projections will require the addition of at least an experienced controller.

Several critical risks include the market risk, the distribution risk and financial risk: The product is basically a new product with little direct competition. As such, it is difficult to assess the extent to which the product will catch on. Ask the class to assess the product's acceptance. Would they use it? Under what circumstances? Where? Where not? Their penetration rate used for modeling seems too high for investing purposes (i.e. Who knows? But if we drop the acceptance rate from almost 1 in 3 to 1 in 8, does the budget still work?). The second critical risk relates to the cost of acquiring new accounts. Hiring a sales force and paying travel expenses and commissions is a very cumbersome and expensive way to generate contracts – especially since sales are earned as an annuity stream. This suggests a financial model that may require more access to borrowed working capital than anticipated. It should also be assumed that restaurant chains will pilot test the platform in a few stores before large-scale adoption, so system-wide adoption would depend on the company's ability to secure a fast change in consumer ordering behavior. Asking consumers to change aspects of their behavior is generally risky and at best requires a vigorous educational effort. This product requires that *both* the restaurant customer and the restaurant itself change prior behaviors (with respect to ordering and workflow, respectively).

Another concern is technological development. While integration with a payment system has been promised and is purportedly not difficult, it is not present in the Alpha version and likely to be critical for broad consumer acceptance of the product. Moreover, it is not clear that they have the expertise to make this integration.

Other categories are not high-risk.

What approach should be used to value the company? Why?

Valuing a small business in a new industry with a new product is a fool's errand –but a necessary errand nonetheless. The instructor should emphasize that investors are buying the future. With no "past", a wide range of assumptions may be supportable. In reality, valuation in such circumstances may be as much a function of how badly the company needs the money and whether it has any other options. Approaching this from Chippas's perspective, his $10,000 investment needs to grow to $50,625 in 4 years [10000*((1+.5)^4)] for him to meet his hurdle rate of return. If he owns 2.5% (from the case) of the company, the valuation of the whole company would need to be at least $2.025 million at the end of year 4 ($50,625/.025). Clearly, if the company performs anywhere close to management's expectations, it will be worth many times than that. Applying a 2 to 4 times sales multiple and a 40% illiquidity penalty to the 2010 projections, which only cover 6 months of revenue, would value the company at $1,249,500 [sales] x 2 [low-end price/sales multiple] x (1-.4) [liquidity discount] x 2 [sales figure only for ½ year, sales multiple based on full year] = $2.998 million… and this is after only 6 months of his 4 year investment horizon! The question becomes whether one has such serious misgivings about the projections as to discount them to levels below Chippas's return threshold. This calls for close scrutiny of the projections.

Evaluate the cash budgets. Do they seem reasonable in amounts and complete in items? Keep in mind that this is a start-up in a new industry.

The cash budget seems reasonably complete with respect to expense line items. Novice entrepreneurs often fail to include a salary for themselves – not a problem here. Additionally, they have a large increase in engineering salary in the month they anticipate beginning the porting of Table-TXT to SFN's POS equipment. One can make the case that the sales/marketing budget items do not reflect the size or expense associated with a national rollout. More importantly, however, is the top line – sales. See question 6 below.

Do you think the product will be readily adapted by restaurants? Why or why not? What due diligence might Chippas perform to gain insight into whether /how fast the technology might be adopted?

a) Students should recognize that successful adoption will require *both* penetration of the restaurant market *and* ultimate usage by customers. Students may argue the following points with respect to adoption:

   - The technology changes the workflow at the restaurant (e.g. orders are coming into a new location and must be answered by someone; wait staff job changes, etc.).

   - The cost to the restaurant is not directly controllable by the restaurant. In a busy context, it is likely that customers would use it for common table requests (more butter…water…catsup, etc.). Between ordering drinks, food and desert, the cost to the restaurant for messages could easily run $.50 per table. Multiplied by the number of table turns per month, the outlay for a restaurant serving 100 tables 30 days per month could approach $1,500. This would be a substantial outlay and would quickly attract the scrutiny of the controller to determine if a corresponding increase in revenue could be detected.

b) Students should consider the following:

   - They do not have ANY sales yet,

- They are anticipating a 30% usage rate among the restaurant's customers. This seems astonishingly high for projections. Keep in mind that the system must get sold twice – once to restaurants and again to restaurant customers. This increases market risk. Students should run the numbers based on an adoption rate of 5 and 10% and see how that impacts profitability.

- SFN's 60 independent sales offices cannot be relied on to distribute the product. Assuming all SFN's sales went through their independent channel, each office only averaged about $15,000 per year of SFN product sales (from SFN's financials). This means SFN's products are likely to be incidental to their independent sales representatives' businesses, meaning that they would be weakly supported.

- It is quite common for early stage entrepreneurs to talk about all the irons that are in the fire (Aruba, Mark Cuban, Chili's, Staples and Verizon centers, etc.). However, nothing has "popped" yet, so the value of these potential associations must be discounted considerably.

Students should point out that Chippas should certainly contact existing users of competitors' products and see what their experience has been. What percent of their customers are using the product? What are barriers to adoption at both the restaurant and consumer levels? How has the Fango product worked in the several small entertainment venues it is in? Is it utilized much?

Evaluate SFN as a strategic partner.

FSN is a weak strategic partner.

- It has a "going concern" warning in its most recent 10-Q filing (appendix 1c). This suggests that it may not be able to come up with the resources to help CSI engineer Table-TXT into its next generation of POS equipment.

- CSI boasts 60 selling agents distributed nationwide. However, they have less than $1 million in sales as a company. This means that the average agent sells less than $15,000 of SFN equipment per year, and implies that SFN's line is probably not an important item to any of the agents and a non-seller to more than a few. Since distribution (signing up restaurants) is a critical managerial issue to the success of the company, relying on this torpid network to do the job seems like a recipe for disaster.

- SFN has only four employees and acquired Blue Bamboo last year. Coupled with the fact that they outsource sales, they seem like a company where top-management is more focused on deal-making than on executing on operational imperatives. Allying with SFN could plausibly entangle CSI's dedicated and operationally-focused management with loss of control over some operational functions.

Should Dr. Chippas invest in the company?

Without funding from the SFN deal or elsewhere, the financial risk increases to "HIGH" since Chippas's modest investment would not have a material impact on CSI's liquidity. Because of SFN financial condition (Going Concern warning), Chippas should not presume that SFN will come through with much money. Moreover, the market risk is high since the product would not only impact the restaurant's operations, but it would also require the end customer to change his/her behavior. Changing consumer

behavior usually requires an intensive educational/promotional effort, which is often not successful. The technology and distribution risks are medium to high. SFN's ability to deliver a sales force should be seriously questioned for reasons previously mentioned. CSI has yet to begin to build their payment application that they mentioned, and that would be necessary to allow for secure mobile payment (which cannot be done on SMS protocol). Chippas may want to hold his investment in abeyance until he has more visibility into both the restaurant acceptance rate and the customer usage rates and then tag along with a lead investor who can eliminate the immediate liquidity risk. It should be noted that if the company comes within even 50% of its projections, the valuation works extremely well for Chippas. While the company is enticing, some of these risks will likely need to be reduced before Chippas can prudently invest. The number and magnitude of the risks suggest that the cash projections have little reliability.

Here are some milestones that students may require prior to investing:

1) Knowing the percentage of customers that are actually using the service in venues where Table-TXT is installed would clarify market risk dramatically.
2) Being part of a larger financing that could fund more rapid product development and marketing rollout will reduce the company's financial risk – and, thus, Chippas's investment risk.
3) Securing a large contract with a venue chain would reduce marketing risk.
4) Releasing a product that is linked to a payment gateway would reduce technology risk.
5) Having several restaurants that have integrated Table-TXT into their operational workflow and found that the implementation was smooth and workflow not disrupted would decrease market risk.

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