

WHAT IS DUE DILIGENCE?

Due diligence "DD" is fundamental to the investment process. It exists because as investors and human beings, we are usually attracted to startups based on the idea, the ambition, and the excitement that founders communicate during their pitches.

By nature, initial pitches are thus subject to many biases (founders can be overoptimistic or base important assumptions on highly subjective observations). The information provided during these pitches is declarative, and the time constraint does not allow for sufficient verifications.

Due diligence is the set of verifications undertaken by investors to confirm that the exciting projects that founders pitched do not have hidden secrets.

OUR APPROACH TO DUE DILIGENCE

Good due diligence is digging into past achievements of the venture and its forecasted developments. It requires both a down-to-earth fact-checking to estimate risks, and an entrepreneurial spirit to assess the potential of the venture.

As with any kind of analysis, robustness is positively correlated with the amount and quality of data available.

However, the shorter the history, the scarcer the data. This is why early-stage ventures are on a very different paradigm than later-stage investments.

THE BLACKWOOD APPROACH IS:

- Founder centric, as there is more data on founders and they are central to early-stage company success
- Systematized to sustain a large amount of deal flow: in fact, as most projects fail after early stages, only a fraction of what you source at this stage are good picks!
- Incorporating artificial intelligence to de-bias founders' assessment of their projects, notably using natural language processing to detect overoptimism and subjectivity

This article will highlight and showcase how we conduct our due diligence. We hope this will leave you with more insight into our process at BlackWood.

Bastian Larsen

CEO, BlackWood Ventures



"At BlackWood Capital Partners, we select startups on the basis of specific factors that have been proven to increase the likelihood of risk-adjusted outsized returns. These include the size of the potential market, the founder's prior achievements, the lead investor's track record, the incubator of origin, etc.

We look at the whole European market, as we believe that breadth and depth increases the odds of finding the next unicorn. We prefer to leave no stone unturned."

OUR DUE DILIGENCE PROCESS

We verify 10 important assumptions:

1. Need: The customers will recognize the need and be willing to pay for it

2. Solution: The solution solves the customer's need and is difficult to replicate

3. Team: The founders have the required skills and are fully committed

4. Market: The target market is large and is poised to grow at a rapid pace

5. Competition: The venture understands how to differentiate itself from competitors

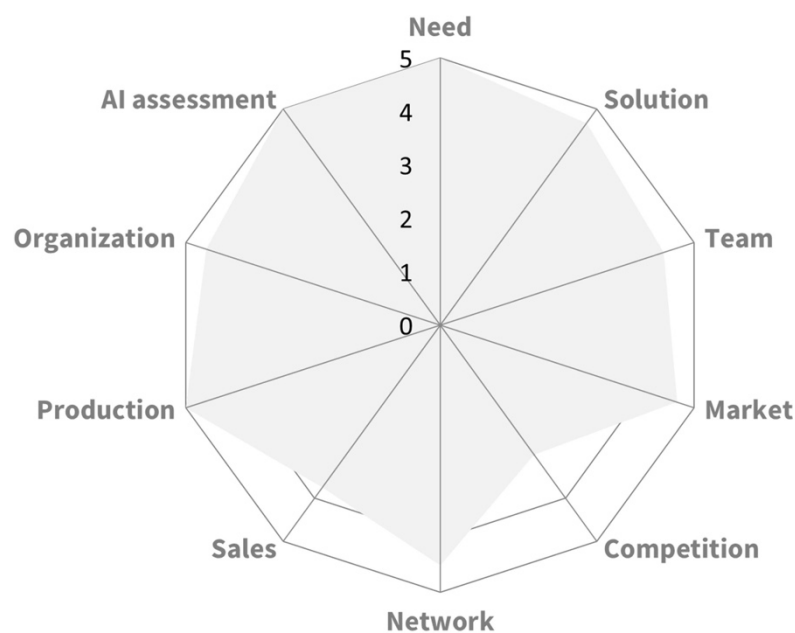
6. Network: The founders have a good reputation and a strong network

7. Sales: The venture has a clear revenue model, marketing and pricing strategy

8. Production: The operations are efficient and the scope is clear

9. Organization: The venture is organized and has a clear talent strategy

10. AI assessment: The venture scores highly on our proprietary AI analysis



Pina Laux

Investment Analyst, BlackWood Ventures



"Our due diligence process is designed to leverage artificial intelligence and conduct a deep analysis of the value proposition, business model, team, and financial aspects. The systematic automation of our investigative process allows us to synthesize quantitative and qualitative data consistently and at an accelerated rate. With a resulting selection rate of less than 1%, we ensure a high-quality deal flow."

We confirm these assumptions using a 6-staged systematized approach

In short, we examine the viability and future potential of a startup through a mix of qualitative and quantitative factors. We then select the most promising startups during our investment committee.

Stage 1: Screening Evaluation

This stage is conducted at demo days, pitch events, or when we receive inbound pitch decks for review. First, we quickly weed out projects that do not correspond to our mandate. Typically, later-stage startups with outsized valuations are ruled out at this stage. We look for passionate and committed founders, solving important problems with disrupting solutions, that show exciting expansion opportunities



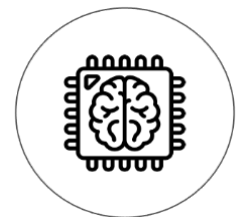
Stage 2: Introductory Calls

Startups that passed our initial screening evaluation receive invitations for introduction calls. During these calls, we gain insights on the founding team's idea, expertise, and ability to communicate the most exciting parts of their company. Furthermore, we challenge them on key parts of their business to gain insights into their logical reasoning in regards to e.g. their business model, how they see incumbents responding to them, and the initial target segment. We look for founders that have laid the groundwork, that can back up their strategy with notable experiences and arguments. We try to avoid unprepared founders who show short-term thinking, or are unable to explain the reasoning behind key parts of their business.



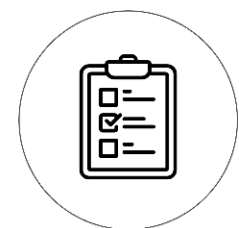
Stage 3: Artificial Intelligence-based Analysis

If the founding teams impress our analysts in the introduction calls, a due-diligence questionnaire (DDQ) is sent out to the startup and examined for key performance indicators. To obtain an unbiased and comparable assessment between startups, BlackWood leverages its proprietary AI methods that enable analysts to account for the varying degree of subjectivity and sentiment across founders.



Stage 4: Investment Analyst Analysis

In addition to the AI analysis, BlackWood analysts assess and score the DDQ to provide comparability of startups from different industries and stages. Having reviewed hundreds of DDQs, we benchmark the performance of the startup in ten different categories against comparable ventures. We identify potential red flags, such as high dependencies on influential partners and macroeconomic conditions, or significant gaps in the team constellation that will not be filled in the short term. We look for well-argued answers, which might include specific experiences from a founder's past.



Stage 5: Investment Committee

The goal of this stage is to challenge ourselves on the appraisal of the company. The committee might decide to invest or pass on each startup. It can also raise potential blind spots in the analysis that must be clarified before investment. Potential red flags raised at this stage revolve around the perceived added value of the startup to its ecosystem, the strength of the team, and the credibility of the business model. When the project excites the team, we enter negotiations!



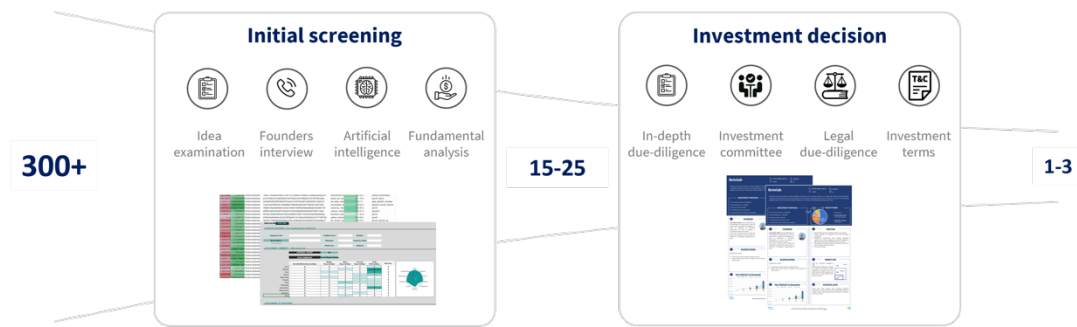
Stage 6: Legal Due-diligence (LDD) and Investment Terms

The purpose of LDD is to assess the potential risks of a transaction by investigating the obligations and liabilities of the target company. This stage is usually lighter in due diligence for early-stage investing, as compared to PE or even later-stage VC investment.



During the negotiation of the investment terms, the provisions of the agreement for the investment are agreed upon with the founders, such as valuation, class of shares, investor rights, and more.

<1% SELECTION RATE



The truth about red flags

For every 300 startups we review every month, only 15 on average will remain after our initial screening process has concluded. This means that 95% of startups are rejected because their project did not fit our investment thesis, but most often because they were not able to share their excitement with our team.

Many factors come into play, such as the customer need, generated traction, unique selling points, and market timing. Most of all, we look at the composition and track record of the team.

The chosen ones

In order for the startup to reach approval, they must first showcase every aspect of their business through our six stages of due diligence.

In other words, the startup must have excited our team and made us feel that they are onto something big. This initial feeling must then sustain a lengthy due-diligence process, confirmed by our research and AI, and be approved by the Investment Committee. In the end, our goal is to only invest in the top 1%.

TO WRAP IT, WE CHOOSE TO:

- 1 Invest in an A team with a B product, rather than an A product with a B team
- 2 Systematize our approach to analyze a large deal flow
- 3 Leverage AI to de-bias founders' assessment and enrich our analysis