Growth Stage Investing (Venture Capital)

Interview preparation summary · VC track

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INT.VG.1.a · What changes at the growth stage

Explain how growth-stage investing (roughly Series C and later) differs from seed to Series B in evidence, cheque size, ownership, downside protection, concentration and reserves, and say why you would choose it.

Growth-stage investing, roughly Series C and later, backs companies that already have real revenue, a repeatable way of selling and a plan to scale towards profit. The money is raised to expand, not to find a business model. An early-stage investor pays for a team and a vision and accepts that most companies will fail, so the fund depends on a few outliers. A growth investor pays for evidence: retention, unit economics, cohort data and a believable path to profitability. Cheques are larger, often tens of millions, and the stake is usually a minority, commonly somewhere around 5 to 20 percent, rather than the larger holdings an early investor can build. A fund makes fewer, bigger bets, so one failure costs far more of the fund and diligence has to be deeper. Because the company is more proven, the chance of losing everything is lower and the spread of outcomes is narrower, but the upside multiple on a winner is also smaller. Downside protection therefore matters more, through price discipline and terms such as a liquidation preference. Reserves are used differently: fewer rounds remain, so the share held back is usually smaller and is spent defending ownership in companies that have hit their plan. The usual mistakes are paying for a story as if it were seed, or assuming the control and cost-cutting rights of a buyout.

WORKED EXAMPLE: SIZING A GROWTH FUND'S CHEQUES AND OWNERSHIP

Brookfield Growth is an invented 500m fund that plans 16 initial positions and keeps 20% of the fund in reserve for follow-on cheques. It invests in a round that values an invented company at 500m post-money. Compare it with an invented 100m seed fund that makes 40 initial investments, holds 50% in reserve and invests at a 10m post-money valuation. Find the initial cheque, the ownership bought and the share of the fund that each position represents.

Answer: The growth fund writes about 25m initial cheques for roughly 5% ownership and 5% of the fund per position; the seed fund writes 1.25m cheques for 12.5% ownership and 1.25% of the fund per position.

> **Interview tip:** Give the contrast as three numbers (cheque, ownership, share of fund) and then say what it forces: fewer, better-evidenced bets with protection, instead of a portfolio built around outliers.

INT.VG.1.b · What changes at the growth stage

Compute MOIC and IRR from entry and exit values, allow for dilution and the loss ratio, and say what has to be true on growth, margin and exit multiple for a growth investment to reach its target return.

The multiple on invested capital (MOIC) is total proceeds divided by the amount invested. With one cheque and one exit, the internal rate of return (IRR) is the MOIC raised to the power of one over the years held, minus one, so 3.0 times over five years is about 24.6 percent a year. Proceeds equal ownership at exit times exit equity value, and ownership at exit is entry ownership reduced by dilution from later rounds. To say what has to be true, work backwards: take the target multiple, find the proceeds needed, divide by diluted ownership to get the exit equity value, divide by an exit multiple to get the revenue needed, and compare that with today's revenue to find the growth rate required. Value grows from three sources: revenue growth, margin improvement and the change in the multiple, and multiple compression as growth slows is the usual way a growth investment disappoints. Growth-stage funds commonly aim for roughly 2.5 to 3 times gross over four to six years, a lower multiple than an early fund hopes for from a winner, which is made possible by a lower loss ratio, meaning less capital invested in positions that return less than cost. The common mistakes are ignoring dilution and assuming the entry multiple will still apply at exit.

WORKED EXAMPLE: WHAT HAS TO BE TRUE FOR MARNELL CLOUD TO RETURN 3.0 TIMES

A fund invests 40m in the invented Marnell Cloud at a post-money valuation of 400m. Current ARR is 50m. The fund expects one later round that dilutes it by 10%, a five-year hold and a 3.0 times gross target. Treat exit enterprise value as equity value. What ARR is needed at exit if the company is sold at 8 times ARR, the same as the entry multiple, and what if it is sold at 6 times? What annual growth does each need?

Answer: At 8 times ARR the company needs about 167m of ARR (about 27% a year for five years); at 6 times it needs about 222m (about 35% a year), for a 3.0 times return and a 24.6% IRR.

Interview tip: Work backwards in order: proceeds, diluted ownership, equity value, exit multiple, revenue, growth rate. Then name the one assumption you would stress, usually the exit multiple.

INT.VG.2.a · Reading a scaled business

Judge whether growth at scale will last by reading net and gross retention together, separating price rises from true expansion, projecting how fast growth is decaying, and testing concentration and the quality of revenue.

At the growth stage a founder's growth rate is no longer the whole story. The question is how long it will last. Net revenue retention (NRR) is the current annual recurring revenue (ARR) of customers who were customers a year ago divided by their ARR then, so it includes expansion and is net of churn and contraction. Gross revenue retention (GRR) leaves out expansion and cannot exceed 100 percent. Read them together: a high NRR can hide a leaky base if a few large accounts expand while many others leave. Split expansion into seats, usage and price: a one-off list-price rise lifts NRR once and does not repeat. Growth rates decay as the base grows, so project growth persistence, the current growth rate divided by last year's, and check that net new ARR in pounds is still rising even as the percentage falls. Look at concentration, such as the share of ARR in the largest customer, and at quality of revenue: contracted and live against signed but not yet live, committed against variable usage, multi-year against month-to-month, and the effect of discounts and resellers. The usual mistake is to quote a blended NRR without asking what drove it.

WORKED EXAMPLE: READING TIDEWELL'S RETENTION AND GROWTH DECAY

The invented company Tidewell opens the year with 60.0m of ARR. During the year it loses 4.2m to churn and 1.8m to contraction, gains 10.2m of expansion from existing customers and wins 18.0m from new customers. Its largest customer pays 8.0m. Growth last year was 55%. Find NRR, GRR, this year's growth, how much of the net new ARR came from existing customers, the growth persistence and the largest customer's share.

Answer: NRR is 107% and GRR 90%; growth is 37% (down from 55%, persistence about 67%); only about 19% of net new ARR came from existing customers; the largest customer is about 9.7% of ARR.

Interview tip: Quote NRR and GRR together, then say what share of growth came from the base and how fast growth is decaying. Interviewers want to hear that you ask how long it lasts.

INT.VG.2.b · Reading a scaled business

Judge efficiency at scale with marginal and average CAC payback, burn multiple, the Rule of 40 and gross and contribution margin, and describe the path to profitability through operating leverage.

A growth investor expects a company to turn its growth into profit, so efficiency is judged at scale. Customer acquisition cost (CAC) payback, in months, is sales and marketing spend divided by the gross profit on the new ARR it bought, times twelve. Average payback can flatter a company whose channels are saturating, so compare it with marginal payback: the extra spend divided by the extra new ARR. The burn multiple is net burn divided by net new ARR, and a figure below about 1 is usually considered strong. The Rule of 40 adds the growth rate to a profit margin, usually free cash flow or EBITDA margin, and a company scoring 40 or more is generally regarded as balancing growth and profit; it is a screen, not a valuation, and must be read with the quality of growth. Gross margin is revenue less the direct cost of delivering it. Contribution margin goes further and also deducts the other costs that rise with each customer served, such as support and onboarding. The path to profitability is operating leverage: sales and marketing, research and development, and administrative costs fall as a share of revenue while gross margin rises, and the investor tests which lines are really scalable. The mistake is to praise growth while ignoring that the margin is deteriorating.

WORKED EXAMPLE: EFFICIENCY AT HALLORAN SYSTEMS

The invented company Halloran Systems grew ARR from 100m to 135m. New logos added 33m and expansion 14m, and churn and contraction took 12m. Sales and marketing spend was 50m, gross margin was 75%, net burn was 21m, and revenue for the year was 118m. Find CAC payback, the burn multiple and the Rule of 40 score.

Answer: CAC payback is about 17.0 months, the burn multiple is 0.6 and the Rule of 40 score is about 17.2: efficient growth, but not yet balanced with profit.

> **Interview tip:** Give the three numbers, then say they point in different directions and what would close the gap. Always say which margin you used in the Rule of 40.

INT.VG.3.a · Pricing and structuring the round

Value a growth company on enterprise value to ARR or revenue against growth, margin and retention, use growth-adjusted multiples and comparables with the right discounts, and treat a DCF as a cross-check.

Growth companies are usually valued on a multiple of ARR or forward revenue, because profits are small or negative. The multiple is applied to enterprise value, which is equity value plus debt less cash, so the equity value of a round is checked after that bridge. A multiple has to be read against what drives it: growth, gross margin, net and gross retention, scale and profitability. Two companies at the same multiple are not equally priced if one grows twice as fast. A growth-adjusted multiple divides the EV to ARR multiple by the growth rate in percentage points, which puts companies with different growth on one scale, though it is crude and breaks down at very high or very low growth. Comparables come from listed peers and from private rounds and sales. Listed peers are adjusted for size, liquidity and growth, usually with a discount for a private company, and private round prices reflect negotiated terms and are not clean market prices. Use forward growth, not last year's, so that a decelerating company is not paid for growth that has gone. A discounted cash flow (DCF) rests on a terminal value that can be most of the answer and on a discount rate with a wide range, so it works best as a cross-check, for example to ask what growth and margins the price implies and whether they are plausible. The mistake is to quote a multiple without growth and retention beside it.

WORKED EXAMPLE: IS THE ASK FOR FERRAND DATA FAIR?

The invented company Ferrand Data has 90m of ARR growing 45%, a 78% gross margin and 118% net retention. It has 70m of cash and 10m of debt, and the proposed pre-money equity value is 840m. Listed peers have a median EV to ARR of 6.0 times and growth of 25%. A fund applies a 20% discount to listed peers for size and liquidity. Test the price.

Answer: EV is 780m, or 8.67 times ARR (0.19 times per growth point); the discounted peer benchmark gives about 8.64 times, or 778m, so the price is fair if 45% growth is sustained.

> **Interview tip:** Show the bridge from equity value to EV first, then the growth-adjusted comparison, and end by saying which growth rate you used and why a DCF is only a cross-check.

INT.VG.3.b · Pricing and structuring the round

Explain the structure of a minority growth equity round: primary against secondary shares, liquidation preference types, protections and governance, convertible and structured alternatives, and venture debt.

Growth equity is usually a minority investment, so the investor protects itself through terms instead of control. A round may be primary, meaning new shares are issued and the cash goes to the company, secondary, meaning existing holders sell and the cash goes to them, or a mix. Primary shares dilute everyone and fund growth; secondary shares do not dilute and give founders and early holders liquidity, but add no cash to the business. The liquidation preference decides who is paid first in a sale. A 1x non-participating preference returns the amount invested or the as-converted share, whichever is higher. A participating preference takes the preference and then shares in the rest, sometimes up to a cap. Seniority matters more at growth stage because more capital has been raised: senior preferences are paid first, pari passu ones share pro rata. Anti-dilution and pay-to-play, which penalises investors who do not follow in later rounds, are also used. A convertible or structured round delays the price or adds protection, but costs the founders in other ways. Venture debt extends runway without much dilution, but adds fixed repayments, covenants and often warrants. Governance rights include a board seat or observer, information rights and vetoes over senior securities or a sale. The mistake is to compare headline valuation and ignore the preference.

WORKED EXAMPLE: A MIXED PRIMARY AND SECONDARY ROUND

An investor offers 100m for shares in the invented company Calder Freight at a pre-money valuation of 900m. Of the 100m, 70m is new primary shares and 30m buys existing shares from early holders. Find the investor's ownership, the cash the company receives and what a holder that sells nothing keeps. Compare with an all-primary round.

Answer: The investor owns about 10.3% (not 10.0%), the company receives 70m, and a holder that sells nothing keeps about 92.8%.

> **Interview tip:** Say which part is new money, which part is a transfer, and what each means for the company's cash and for dilution. Then add the question about what the cash is for.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.