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COVER STORY

How to lure investors*

*If you're not in health care

Landing venture capital in Music City is a steep climb for startups outside of our signature industry. Yet the company that lured the largest investment last year was Franklin's Digital Reasoning. It came down to sales, credibility and Nashville.

Stories by Eleanor Kennedy
Photos by Nathan Morgan

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COVER STORY

HEALTH CARE HEAVY

WHEN PLAYING TO NASHVILLE'S STRENGTHS CAN HURT US

With the Nashville Entrepreneur Center's new music-tech accelerator and Jumpstart Foundry's new focus on health care, Music City's startup community is making plenty of efforts to build disruptive businesses in industries where the city already leads.

But for those interested in new ideas outside music and health care, the climb remains steep.

Finding investors outside of health care "will become increasingly harder," said Nicholas Holland, founder of Nashville tech companies Centresource Interactive Agency and Populr. "It's already harder, because when you pitch something that people don't have experience with, that's already a mountain you have to climb."

In its early days, Holland said, Jumpstart Foundry was a place to launch different ideas. And while the entrepreneur understands the pivot to health care for increased success, he's not certain which investors or groups are now open to the idea of funding "crazy, wild ideas."

On the flip side, he acknowledges, those ideas aren't always worth backing.

"I sometimes have to get on to entrepreneurs about feeling entitled and blaming the city and blaming investors for their lack of investment," Holland said. "If you have some wild idea that doesn't fit the investor profile here in Nashville, that's not a reflection on Nashville, that's a reflection on you and your idea."

For Tim Estes and Rob Metcalf, of Franklin-based Digital Reasoning, finding local investors who understood their idea has been challenging, but eventually the Nashville investment community got on board.

That's important, Metcalf said, because Nashville needs more companies like his to build its tech scene.

"You both benefit from the community you're in, but you also give back to it in a very organic way," Metcalf said. "In our world, folks are very mobile. If they can find great opportunities in Nashville, then there's a strong case to stay here. If there aren't, people have to go elsewhere."

—Eleanor Kennedy



Tim Estes is CEO and founder of Digital Reasoning.

If startups can sell it,

BY ELEANOR KENNEDY
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Tim Estes has one good reason you should care about the growth of technology in Nashville.

"If you don't have vibrant technology in your community, you're not going to be a first-class city," said Estes, CEO and founder of Franklin-based Digital Reasoning.

But despite local efforts to foster high-tech growth and investment in the city, the conventional wisdom remains: It's awfully hard to raise money in Nashville if you're not in health care.

And yet, the Middle Tennessee company that raised the most capital last year was not a health care company. It was Estes' Digital Reasoning. The software company brought home the region's biggest investment of 2014 from some of the world's best-known backers with a \$24 million funding round led by Goldman Sachs and Credit Suisse. It was the company's third injection of capital from outside investors, including a contribution from the Nashville Capital Network, a group of more than 130 area angel investors.

Nashville tech companies that want to follow in their footsteps and land significant venture capital, from both local and out-of-town investors, also have to land paying customers and tech-savvy investors that inspire confidence in the company. And they have to show why being in Nashville is an asset, not a liability.

Digital Reasoning's path to land investors provides a road map for how the



"We're not going to go into any company where we don't have champion investors involved."

SID CHAMBLESS, executive director, Nashville Capital Network

Nashville tech community can continue to push for industrial diversity – and why it should.

"If I have an idea ... there's capital that I can raise and I can go and find smart entrepreneurial folks to build it with me, I'm likely to keep the company there," said Rob Metcalf, Digital Reasoning's president. "And it's those small companies that grow that really can have a huge and disproportionately positive impact on the economy."

Seek expert investors

When Sid Chambless, executive director of the Nashville Capital Network, first met with Digital Reasoning's Metcalf, the company wasn't looking to raise money. And Chambless' group wasn't looking to invest.

It was 2012, and, in response to entrepreneurial chatter about the lack of tech

investment in the city, the network was working to diversify its portfolio. But before it could simply start investing in technology companies, Chambless said, the group had to ensure it had the investors it needed to make sound deals.

"We're not going to go into any company where we don't have champion investors involved," Chambless said. "If we don't understand or we don't have investors that can add real value that can help with that due diligence – that can help with the post-investment involvement – we're just not going to do it."

That meant the group needed to find investors with expertise in industries outside of health care. That was made slightly harder, Chambless said, by the fact that the health care industry is where most of Nashville's investors made their money.

For advice on how to find those partners, Chambless turned to area tech company leaders like Metcalf. While he was at it, Chambless mentioned the network might be interested in supporting Digital Reasoning.

Two years later, that conversation translated into more than \$2 million invested by the Nashville Capital Network. Buoyed by a co-investment from Cristobal Conde, a well-known technology investor and former CEO of publicly traded software giant Sungard Data Systems, the network's tech-oriented investors got on board. But it wasn't just the tech enthusiasts who were convinced.

"When Cris committed to invest alongside of us and then our folks internally that had technology experience got excited, it really created a great deal of



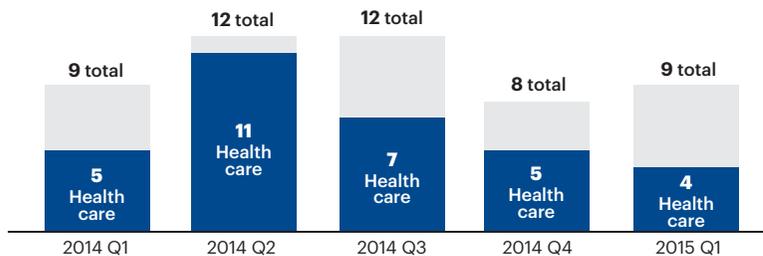
Rob Metcalf is COO and president of Digital Reasoning.

PHOTOS BY NATHAN MORGAN | NASHVILLE BUSINESS JOURNAL

investors will come

THE LION'S SHARE OF LOCAL DEALS

While some local companies outside of health care had success raising money in Nashville in 2014, the city's signature industry remained the dominant player for venture capital.



SOURCE: MONEYTREE REPORT, BY PRICEWATERHOUSECOOPERS AND THE NATIONAL VENTURE CAPITAL ASSOCIATION

momentum and confidence around that investment," Chambless said. "There were a number of health care services executives who invested alongside of Cris and our technology investors."

Sell the business, not the tech

Digital Reasoning makes software products in a field known as cognitive computing. Essentially, the firm teaches computers how to process and analyze unstructured data like text. Its earliest client was the federal government, followed by players in the financial industry.

Outside of Nashville, Digital Reasoning has sought partners that fall squarely within its customer base.

That's meant turning to three primary areas of the country: Washington, D.C., where the intelligence community resides; California, where there's a technical understanding of machine learning and cognitive computing; and New York,

where the financial industry lives. They've been successful in each place.

As for Music City, Metcalf said, "Folks in Nashville understood that this was something unique and likely valuable, but until you can kind of validate what you're doing with customers that you know and understand, it's much harder to go put your capital into something."

When Chambless first met Estes in the mid-2000s, the company didn't have the commercial applications it does today.

"When we ultimately closed on the investment is when they were at a point where it was transitioning from a technology to a business," Chambless said.

Metcalf, who joined Digital Reasoning in 2010, agrees. All that's come together in the past few years and helped the company land big-name customers – like investment leader Goldman Sachs – that prove the technology's potential.

That proof was another key to landing

local buy-in, Chambless said.

"The threshold for funding may be different here than it is in hard-core technology communities. The investors who are making these types of investments in Nashville aren't likely to invest strictly in code," he said.

Find assets in Nashville

Whenever they talked to potential investors, Estes and Metcalf frequently heard the same questions: "Why are you in Nashville?" and "Where is that an asset, where is that not?"

For some venture capital firms, it was too big a negative. About half the leading firms in the Silicon Valley require proximity, Estes said, meaning an investment was out of the question unless the company moved. For others, while distance won't shut down potential funding, it can lead to lower valuations and more diluted control for the founders – which can lead to quicker exits before the big-money mark is reached.

Even with those challenges, however, Estes, a Tennessee native, never seriously considered giving up on Music City.

Both Estes and Metcalf said Nashville has strong cultural advantages, and its growing profile has helped recruit and retain the talent they need.

And while the company is just now evaluating its entrance into health care, Estes said he's always seen potential to add that industry to Digital Reasoning's roster.

"I never accepted that you had to do formulaic things like go to Silicon Valley," he said. "If you really want to do it, you can do it from Nashville."

THIRD ROUND

Franklin-based Digital Reasoning has landed three rounds of funding since 2010.

- ▶ **2010:** Undisclosed investment from In-Q-Tel, the nonprofit venture arm of the U.S. intelligence community
- ▶ **2011:** \$4.2 million from individual investors
- ▶ **2014:** \$24 million led by Credit Suisse and Goldman Sachs, including funding from Nashville Capital Network

SUCCESS STORIES

Digital Reasoning may have snagged the biggest investment in Nashville in 2014, but it's not the only non-health care company that's been able to lure investors. Here are a few Nashville-based companies outside of health care that landed more than \$1 million from investors in the past 16 months.

\$1.8M

Raised in 2014 by Overdog, an app that connects pro athletes with fans through video games

\$1.9M

Raised in late 2014 and early 2015 by XOEye Technologies, which sells wearable technology tools for manufacturers and other blue-collar industries

\$7.98M

Raised in 2014 and early 2015 by Citizengine, which makes a political engagement app

\$3M

Raised in 2014 by Wealth Access, a wealth management platform designed for financial advisers and high-net-worth clients

\$4.6M

Raised in two rounds in 2014 and early 2015 by Auramist, a consumer cooling product company

\$18.85M

Raised in two rounds in 2014 and early 2015 by Smartvue Corp., a wireless video surveillance company

SOURCE: SEC FILINGS, MONEYTREE REPORTS, COMPANY NEWS RELEASES