Important Things for Entrepreneurs to Know about Angel Investors
HAIL TO THE JOB CREATORS

From 1980 to 2005, firms less than five years old accounted for all net job growth in the United States.

Equity Capital Markets Large, Complementary

2008 Angel Investment
source: UNH CVR

Mostly early stage
$19.2B
55,480 deals

2008 VC Investment
source: NVCA/PWC/Thomson Reuters

Mostly later stage
3,808 deals
$28.3B

440 Seed
New Company Formation

Source of Equity Funds – Typical Year

- 500 Classic VCs
- 1000-2000 Seed Funds
- >50,000 Angels
- >200,000 Friends & Family
- 500,000 Startup Companies
VC Deals by State

>100 deals
25-100 deals
< 25 deals
< 10 deals

2006
Bay Area Draws Most Investment Dollars

Regional Investment in the United States 3Q'06

- Bay Area: 38%
- Southern California: 11%
- New England: 10%
- New York Metro: 8%
- Texas: 5%
- Potomac: 4%
- Washington State: 3%
- Research Triangle: 2%
- All Other US: 19%

Source: Dow Jones VentureOne/Ernst & Young
Annual Sources of Start-up Funding

Venture Capital  ~$.3 billion
State Funds       ~$.5 billion
Angel Investors  ~$20 billion

**Angels: 90% of outside equity for start-ups?**

Friends & Family  ~$60 billion

Sources: MoneyTree, NASVF, multiple studies on informal capital
Companies Backed by American Angels

AMBIT
Broadband

myspace.com
a place for friends

MySpace

Best Buy

Facebook

Yahoo!

Amazon

Bitpipe

Costco

Alcoa

Red Hat

Cisco

Starbucks

Google

Green Dot

Regeneration Technologies, Inc.

Ask.com

PayPal
Why Angels Matter

A really great angel helps an entrepreneur:

1. See around the corner
2. Gain a sober second opinion
3. Network with people who can help build the business
4. By being an ambassador
5. Gain credibility in a field

Source: David Pecaut, Boston Consulting Group, 9/06 NAO
Growth in Number of American Angel Groups

Sources: Center for Venture Research (pre 03 data) and Kauffman Foundation/ACEF (04-09 data)
Angel Groups are Small - but Important - Subset of All American Angels

- U.S. Millionaires: 4,200,000
- 3 study Estimates of Informal Investors: 1,000,000
- Center for Venture Research - Active Angels (est.): 225,000
- Investors in angel groups: 12,000

2009 Report from Spectrem: $1 millionaires down in 2008 27%, those with $5 million down 28%
World Wealth Report (Capgemini): 19% drop in HNWI and 22.8% drop in wealth in 2008
Premise on Angel Groups

• Creating new class of investor
  – Entrepreneur-friendly
  – Developing sophistication/ excellent processes
  – Growing geographic diversity

• Market efficiencies developing
  – Entrepreneurs can locate more easily
  – Investors get better quality deal flow, while individuals maintain anonymity
  – Building partnerships with other angel groups and VC community for follow-on funding

• Beginning to close capital gap
Angel Organizations Can Help Fill Capital Gap

<table>
<thead>
<tr>
<th>Stage</th>
<th>Pre-Seed</th>
<th>Seed/Start-Up</th>
<th>Funding Gap between $500,000 and $2,000,000/$5,000,000 (depending on region)</th>
<th>Early</th>
<th>Later</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source</td>
<td>Founders, Friends and Family</td>
<td>Individual Angels</td>
<td></td>
<td></td>
<td>Venture Funds</td>
</tr>
<tr>
<td>Investment</td>
<td>$25,000 to $100,000</td>
<td>$100,000 to $500,000</td>
<td></td>
<td></td>
<td>$2,000,000/$5,000,000 and up</td>
</tr>
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</table>
### Comparing Average Group Investment Data

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of investments</td>
<td>6.3</td>
<td>7.3</td>
<td>7.4</td>
</tr>
<tr>
<td>Total dollars invested</td>
<td>$1.77 mil</td>
<td>$1.94 mil</td>
<td>$1.78 mil</td>
</tr>
<tr>
<td>Dollars invested per round</td>
<td>$276,918</td>
<td>$265,926</td>
<td>$241,528</td>
</tr>
<tr>
<td>Number of new companies</td>
<td>3.7</td>
<td>4.5</td>
<td>4</td>
</tr>
</tbody>
</table>

In 2008:
- 62.7% had follow-on or co-investments with VC firms
- 23.4% had 1 or more positive exits

Source: ACA Angel Group Confidence Surveys – 2007, 2008, and 2009 (self-reported, not verified)
Average Preferred Investment Per Round - 2008

Source: 2009 ACA Angel Group Confidence Survey and 2008 Member Directory
Investment Preference – 2007-2008

Source: 2008 ACA Angel Group Confidence Survey
Geography – Where do Groups Invest?

Source: 2008 ACA Angel Group Confidence Survey
Investors Per Group

Average = 43.6
Median = 32.5

Source: 2009 ACA Confidence Survey and 2008 Member Directory
Engaging Angels

• How do you find angels?
• What do angels expect?
• What attracts them to deals and/or entrepreneurs?
• What do entrepreneurs need to provide to angels?
Finding Angels

- Business plan in top shape
- Referral from someone the angel knows and trusts (lots of networking)
- Web site matching – caution!
- Find local angel group
- Directories of angel groups:
  - U.K: www.bbfa.org/uk
  - Europe: www.eban.org
  - North America: www.angelcapitaleducation.org
  - North America: www.angelcapitalassociation.org (includes only ACA member groups)
Investment Expectations

• From investor’s perspective
  – Return on Investment
  – Company involvement
    • As advisor
    • On board
    • Part of management
    • Or some want to be passive

• From company’s perspective
  – Find or provide follow-on investments
  – Introduction to potential partners or customers
  – Very little interaction
A Word About Return Expectations

• **Angel investing is VERY risky**
  – 1 or 2 of every 10 investments brings most of return
  – Hard to tell which companies will return

• **Current return estimates for portfolios:**
  – Annual IRR of 27% - 2.6X in 3.5 years*

• **If business gets VC funding later, angel investment is often diluted**

• **Some really great angels therefore looking for 10 to 30X potential**
  – Wide variety of expectations, depending on mix of motivations to be an angel

• **Correct valuation is critical**

*Source: Rob Wiltbank, Willamette University, November, 2007 paper*
Angel Returns: 20-25% Per Year?

Historical 20 Year Returns for Alternative Assets

- **Seed Funds**: 22.4%
- **All Venture**: 18.7%
- **Hedge Funds**: 18.7%
- **Buyouts**: 16.5%
- **S & P 500**: 14.9%
- **NASDAQ**: 13.2%

November study: IRR = 27% or 2.6X in 3.5 years

Source: Venture Economics, HFRI Equity Hedge Index

Rob Wiltbank, Willamette University
Process, Deals & Implications

• What’s the process for investment?
• What do the deals look like?
• What issues do entrepreneurs need to consider for angel and follow-on funding?
How Angel Groups Work: Typical Deal Process

1. **Submissions (~30 Plans Per Month)**
   - Managing Director pre-screens emailed submissions.

2. **Screening Team Review (5 – 10 Plans Per Month)**
   - Screening team votes on which companies to invite to general meeting.

3. **General Meeting Presentations (1 – 3 Plans Per Month)**
   - Managing Director polls members for level of investment interest in deals, recruits diligence team, and facilitates selection of deal lead to begin term sheet negotiations.

4. **Diligence & Term Sheet Negotiations (Coordinated by Managing Director & Deal Lead)**
   - Deal lead closes transaction and the sidecar fund invests in companies that attract at least $250K in investment from at least 5 members.

5. **Manage Investment (1 – 2 investments per quarter)**
   - Board member represents member interests and seeks an attractive exit.

Source: James Geshwiler, CommonAngels, Boston
Deal Flow Statistics – Angel Groups

- Prescreening: 1 in 4 to screening
- Screening: 1 in 3 to DD/ present
- Due Diligence: 1 in 3 to investment meeting
- Investment: 1 in 2 raise money
- OVERALL: 1 to 4 in 100 who apply receive investment
Writing Business Plans

• Entrepreneur MUST write plan (no consultants)
• See Pitching Angel Investors at www.eVenturing.com (Kauffman site)
• Use editors for clarity and brevity
• Resources:
  – The Business Mentor - www.fasttrac.org
## Forms of Business Plans

<table>
<thead>
<tr>
<th>Form</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Elevator Pitch</strong></td>
<td>Two minute verbal summary  &lt;br&gt;Product, opportunity, differentiation  &lt;br&gt;Attract interest – not closing</td>
</tr>
<tr>
<td><strong>Executive Summary</strong></td>
<td>2-4 page written summary  &lt;br&gt;Balanced presentation  &lt;br&gt;Attract interest – not closing</td>
</tr>
<tr>
<td><strong>PowerPoint</strong></td>
<td>20 minute verbal presentation  &lt;br&gt;Cover whole plan  &lt;br&gt;Find serious investors</td>
</tr>
<tr>
<td><strong>Full business plan</strong>  &lt;br&gt;(write full plan first)</td>
<td>20-50 pages plus appendices  &lt;br&gt;Validation scorecard (due diligence)  &lt;br&gt;Basis for all other plan forms</td>
</tr>
</tbody>
</table>
Angel Rating System

Management Team 0-30%
Size of Opportunity 0-25%
Product or Service 0-10%
Sales Channels 0-10%
Stage of Business 0-10%
Size of this round 0 - 5%
Need for more funding 0 - 5%
Quality of plan 0 - 5%
Fundable Management Teams

• CEO
  – CEO experience
  – Vertical experience
  – Coachable (very important)
  – Leadership

• Team
  – Balance & Complete
  – Experience working together
The Opportunity

• Scaleable
  – $30 million (min.) in revenues in 5 years
  – (VCs look for $100 million)

• High gross margins

• Large niche market

• Unfair competitive advantage

• Ready for customers
Terms Preferred by Sophisticated Angels

Moving toward “vanilla” term sheets with:

- Preferred stock
- Liquidation preference
- Board & information rights
- Anti-dilution
- Participation rights
39 groups reporting (Caution: source data is incomplete & unverified)
Common Mistakes in Pitching Angels

- Only discuss technology/product
- Not prepared for presentation (practice, practice, practice!)
- Presentation too long
- Inappropriate appearance
Once you get investors to the table…

Closing the Deal
Understand the Process

• Read how angel groups work
  (Cutting-Edge Practices in American Angel Investing
   J. May & E. O’Halloran, U of VA)
• Look on the website of your local group
• Network with those familiar with the process
• Know what to expect
• Be open and honest with investors
• Remain patient
Understand the Terms

• Start-up funding terms are unique
• Study these terms
  – Read *Term Sheets & Valuation* (A. Wilmerding - $15)
  – Talk to your advisors
  – Consult with experience entrepreneurs
• Stay flexible on terms, especially valuation
• Understand common practice
  (your region and business vertical)
Closing

• Read and understand the closing documents
• Remain patient with investors
• Communicate regularly with possible investors, use friendly persuasion
• Pursue low hanging fruit
• Get the deal closed…and execute the plan!
Kauffman Foundation’s Angel Initiatives

• Education on investment process and opportunity
  – Power of Angel Investing
• Develop data and support research (Returns study)
• Promote best practices and collaboration among angel groups
  – Angel Capital Education Foundation
• Develop tools/ education on starting groups
• Promote role models to expand participation of women and minorities
Information, Resources, and Support

- Kauffman Foundation [www.eVenturing.com](http://www.eVenturing.com)
- [www.angelcapitaleducation.org](http://www.angelcapitaleducation.org)
- Angel Investor News
- Inc Magazine (and Web site)
- Books (see [www.angelcapitaleducation.org](http://www.angelcapitaleducation.org))
- Top level entrepreneurial support orgs
- Web sites match entrepreneurs and investors
Need More Information?

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