10 Common Angel Investor Mistakes in Down Markets

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How To Get Value From This Webinar

- Use chat to submit questions
- Yes, you'll get the slides and video
- We're recording, so come back and listen again
- Contact Annie Wong with questions: awong@angelcapitalassociation.org

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Where Do Stand?

- The U2R (Up and To the Right) Market is Over
- The Age of FOMO is Over
- The Age of Unlimited Liquidity is Over
- Age of Investor Consensus Is Ending
- Founder is No Longer Always King
- Unit Economics Matter
- Build to IPO Not Viable
- BUT …
  - Good companies still get funded
  - VCs and Founders share a common interest in avoiding down rounds
  - There is a large amount of “dry powder” out there
  - Limited Changes in Deal Terms and Modest Changes in Valuations Through Q2 2022 (still above pre-Covid levels)

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What Terms Are Likely To Change?

Term	2021	2022
Valuation	Sky's the Limit	Less than That
Amounts Raised	See above	See above
Fundraising Frequency	<12 months	18-24 months
Dividend	Non-accruing, when/if	Accruing
Preference	1x	Multiples, Capped Multiples
	Non-Participating	Participating, Capped Participating
	Pari Passu	Preference Waterfall
Anti-Dilution	Broad-Based Weighted Average	Ratchet?
Pay-to-Play	Often Not Enforced	Often Enforced, Sometimes Retroactively Enforced
Redemption Rights	Rare in early stage, Uncommon in later stage	More frequent (& misguided)?

What Should an Angel Do?

- **Diversify … Diversify … Diversify**
- **Increased Oversight**
- **Better Investment Screening**
  - **Seth Masters, VP NY Angels - What Superpower Should Startup Investors Seek?**
    - **A. Being 1000% better at finding companies with exits over $1 Billion**
    - **B. Being 50% better at finding companies with exits below $50 Million**
    - **C. Being 25% better at avoiding companies which fail to exit**

    (https://medium.com/@seth.masters/what-superpower-should-startup-investors-seek-966fad667027)

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The Top 10 List

1. Throwing Good Money After Bad

- Your prior investment is a sunk cost.
- Don't think of it as "protecting" your investment – it rarely is.
- Don't view this as dollar cost averaging – that may make sense in the public market but does not work in venture.
- Make the new investment decision on its own merits based on valuation, deal terms and the company's prospects.

2. Catching a Falling Knife

- Even though the company's valuation has fallen by 50% since your initial investment, its new shares are not "on sale."
- Valuations were unreasonably high.
- The process of rationalization of valuations, and the resulting write-downs, likely will continue for a while.

3. Good News is Just Over the Horizon Syndrome

- That company-saving deal that has been “stuck in legal for months,” and should close any day now, is likely not happening.
- If it has not closed until now “they may not be that in to you” and is probably not the best data point on which to base your investment.

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4. Doubling Down Rather Than Diversifying

- **Most Angel Investors are under-diversified.**
- **Academic studies have recommended 20 to as many as 50 ventures as the optimum diversification in this asset class.**
- **Rather than adding money to sustain struggling existing investments, consider using funds to diversify and have "more horses in the race."**

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5. Underestimating Zero

- **Unless you are really unlucky, most public company shareholders will never see investments go to zero.**
- **In venture, the majority of the ventures will not return the initial investment and a large number will return “zero.”**
- **This is an unappreciated risk by many venture investors.**

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6. Overvaluing Pro-Rata/Under-Valuing MFN

- **Pro-rata rights are not as important as before. Many ventures will be all too happy to take your funds.**
- **If you are investing through SAFEs or convertible notes, make sure they have MFN (most favored nations) clauses. These clauses will give you the benefit of more favorable terms given to subsequent investors.**

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7. Remaining FOMO Driven

- For the last few years, there has been a frenzied pace to investing. Lots of checkbooks out there and “U Snooze U Looz”.
- We are moving to a buyer’s market – so take a deep breath, ask the tough questions, perform due diligence and seek better deal terms.

8. “So and So” Invested is Not Due Diligence

- There is no substitute for doing your own homework
- Look for opportunities to collaborate with others

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9. Forget TAM and Think Unit Economics

- **TAM (Total Addressable Market) Projections are often unrealistically optimistic**
- **Unit Economics – Can the business be profitable and still capture a sizeable market?**
- **Think M&A/Not IPO**

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10. I Have Rights

- **As a SAFE or convertible note holder, you have surprisingly little protection.**
- **You are likely not owed fiduciary obligations of shareholders and even if your note is treated like debt, the protections afforded creditors mainly kick in once a company is insolvent or approaching it.**
- **If your SAFE/Note has converted, the Age of Parri Passu is likely over. Your investment is likely to be buried underneath a senior liquidation preference.**

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About The Author

Dror Futter, a partner at Rimon PC, is a venture capital and technology attorney who advises startups and their angel and venture fund investors and helps more established tech companies negotiate complex agreements. Previously he was the General Counsel of a venture capital fund and a venture-backed company.

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Thank you !