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Angel Investors: Are They for Me?

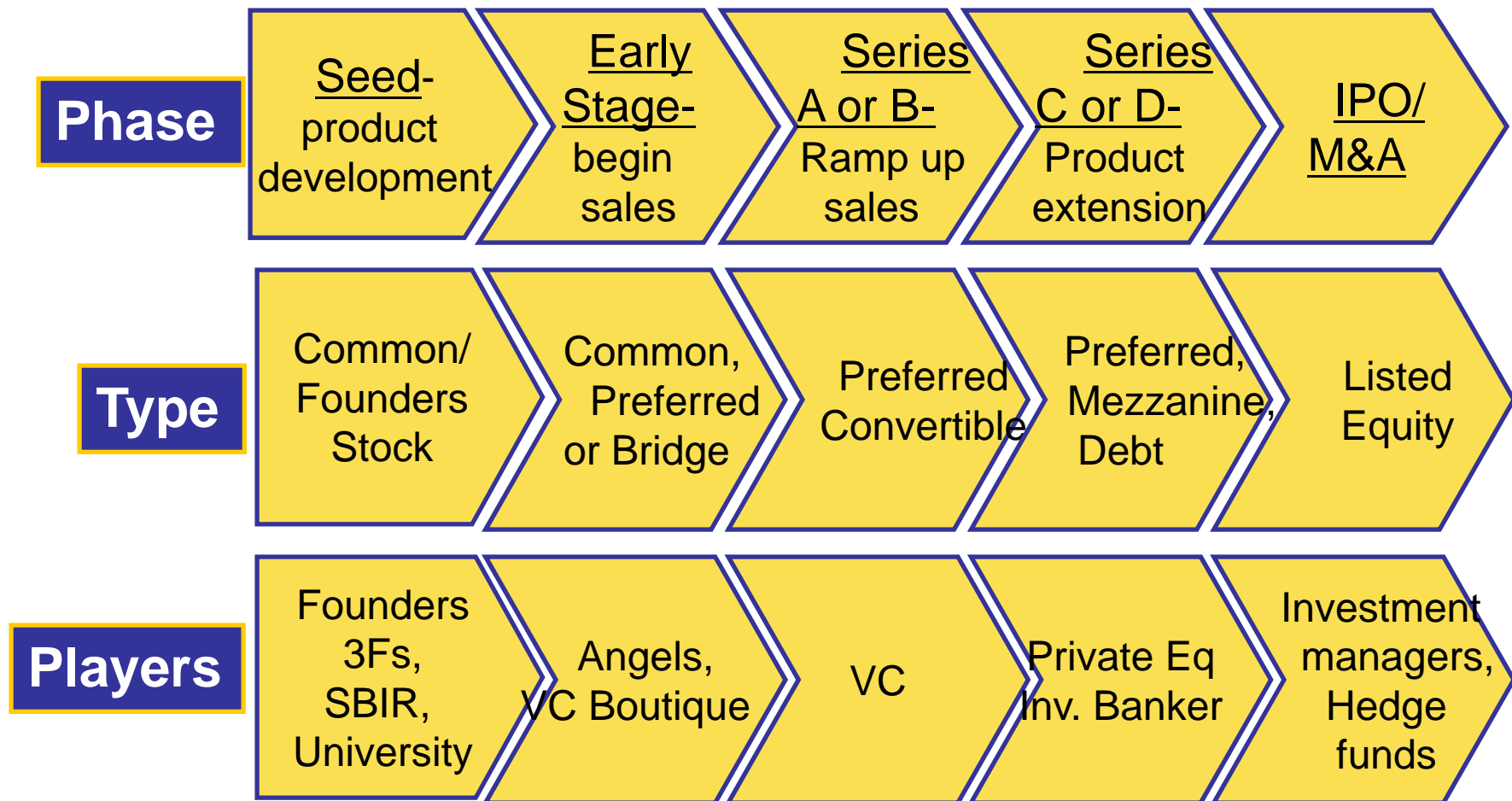
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Angel Investor Forum
www.angelinvestorforum.com

June 16, 2009

First, the big picture of the investment cycle....





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Companies Backed by Angels



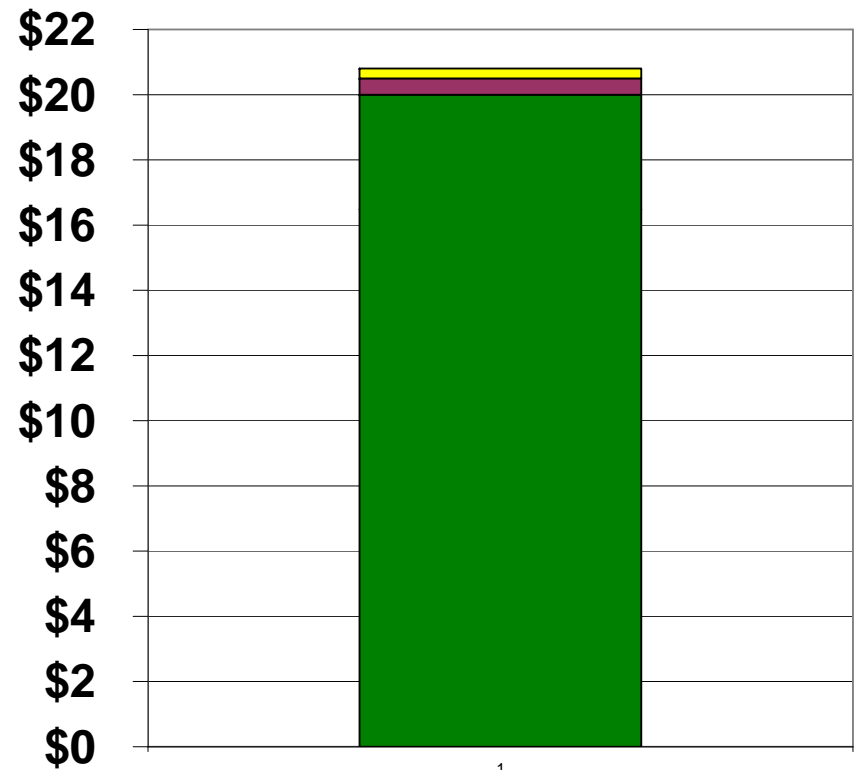


Annual Sources of Start-up Funding

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

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

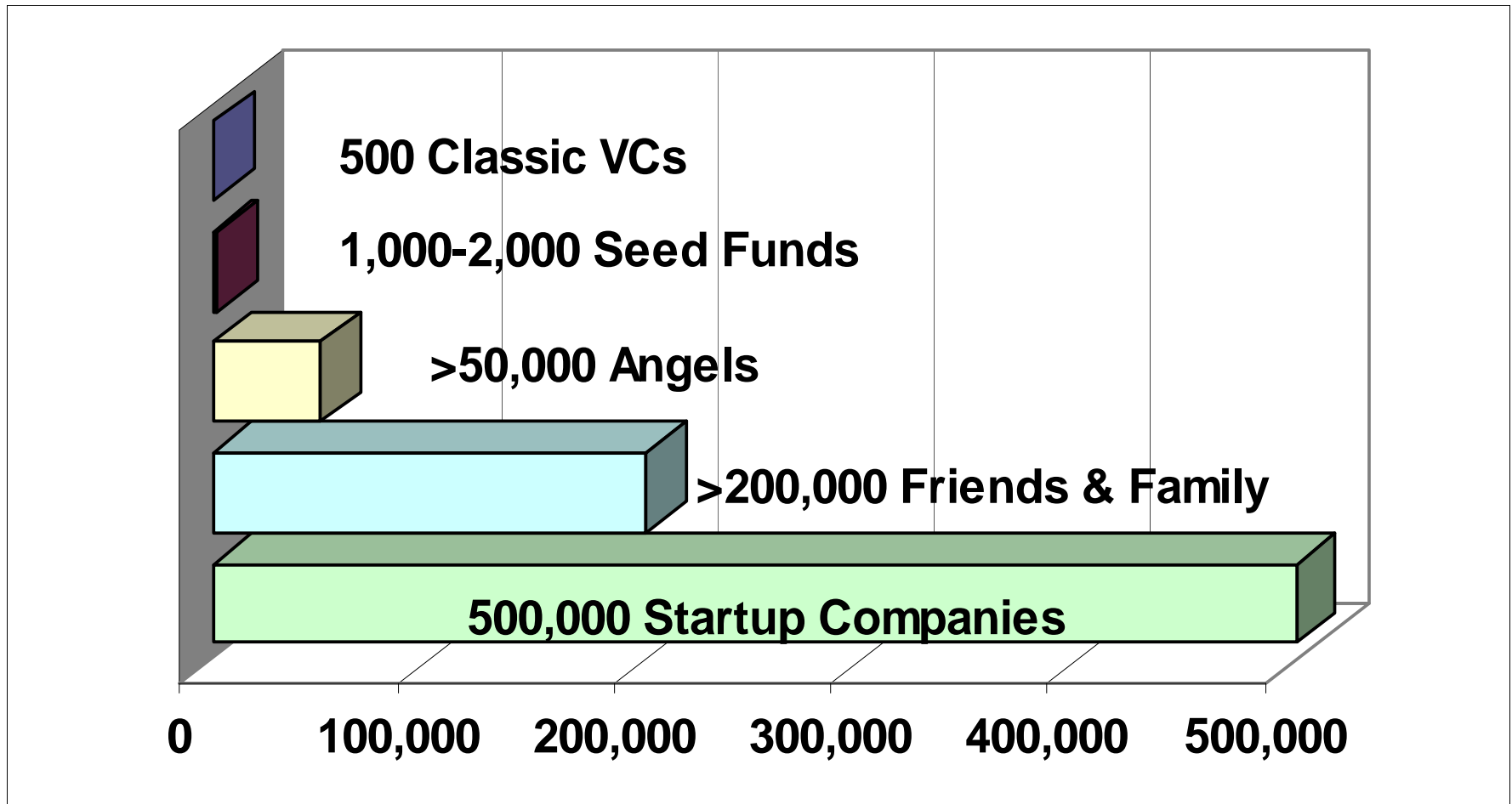
Friends & Family ~\$60 billion





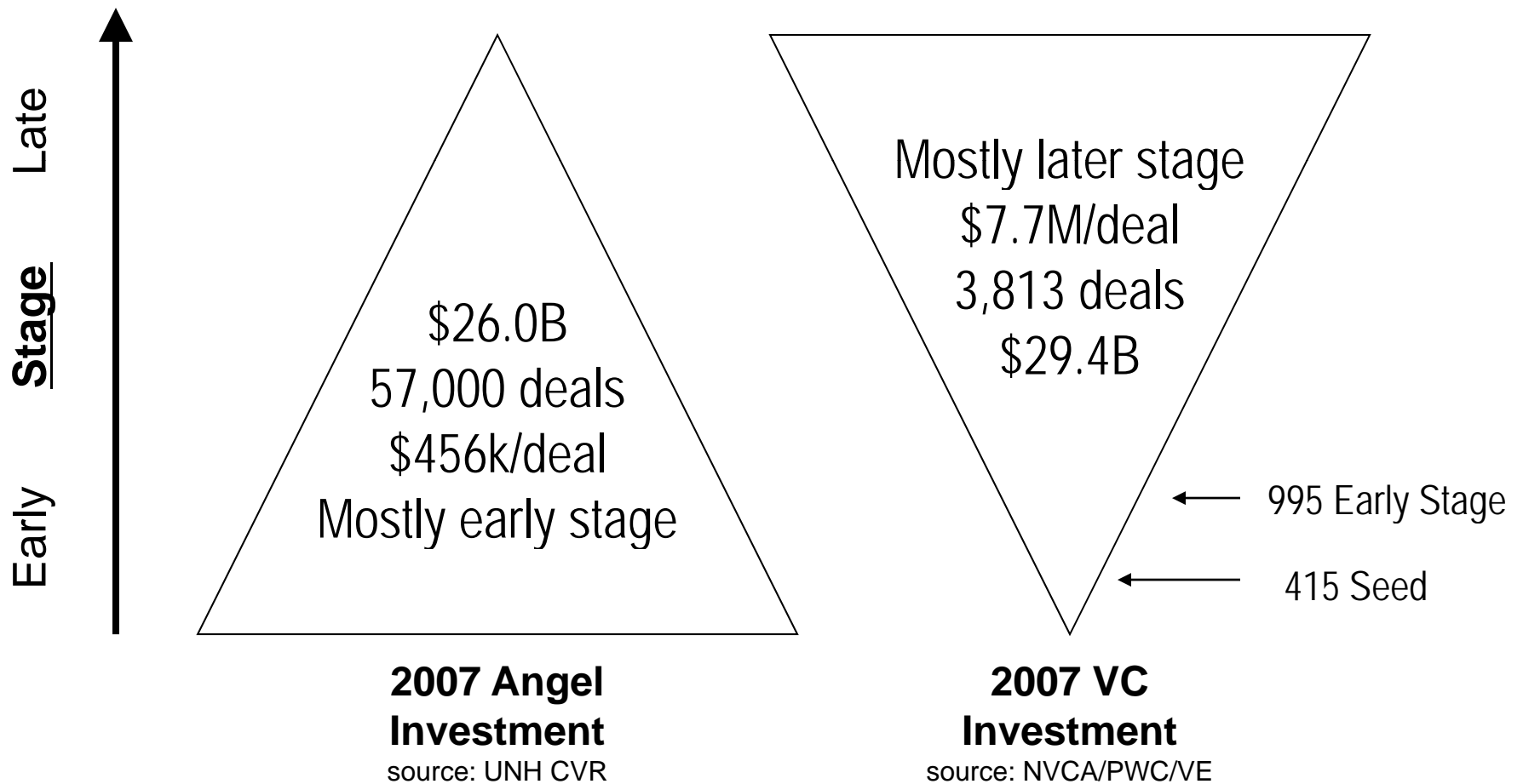
New Company Formation

Source of Equity Funds – Typical Year





Equity Capital Markets Large, Complementary

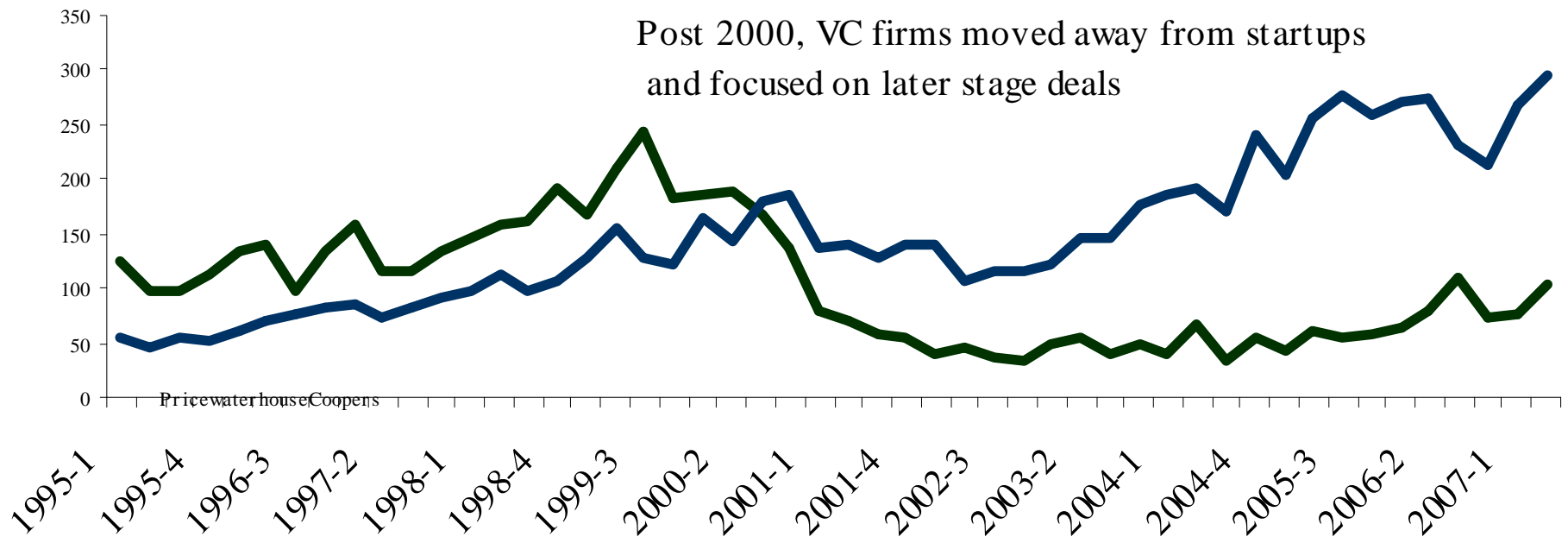




VC's Shifted to Later Stages

Startup vs Late Stage Deal Count

— Startup/Seed Deals — Later Stage Deals

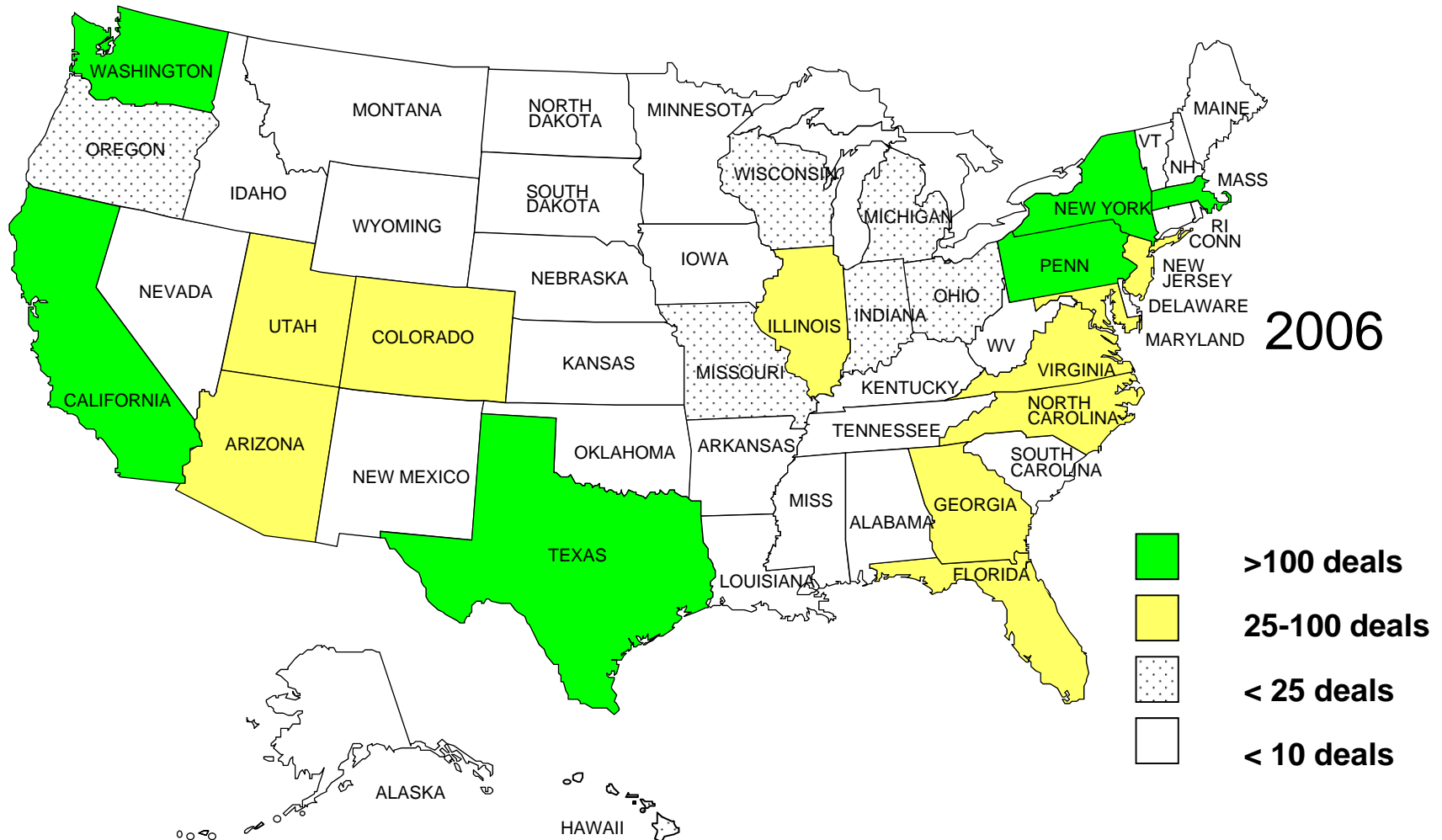




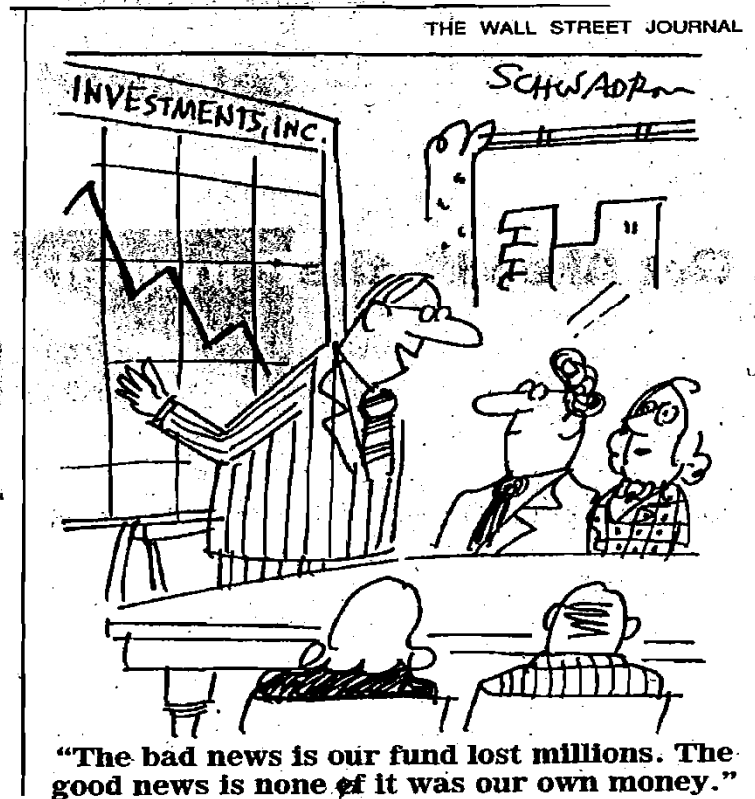
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VC Deals by State



VCs have fiduciary responsibility to their limited partners. Angels risk their own capital.





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So What is an Angel?

AIF definition is –

- Accredited investor
- Appetite for high potential early stage investments
- Patient capital
- Willing to assist entrepreneurs
- Has lost money in venture in past!



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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



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Investing through Angel Groups

- Dividing the work eases the pain
- Variety of vertical experience available
- Standardized processes & term sheets
- Deal flow enhanced – entrepreneur-friendly
- Individual investors pick the deals they like
- Greater potential to diversify investment portfolio



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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

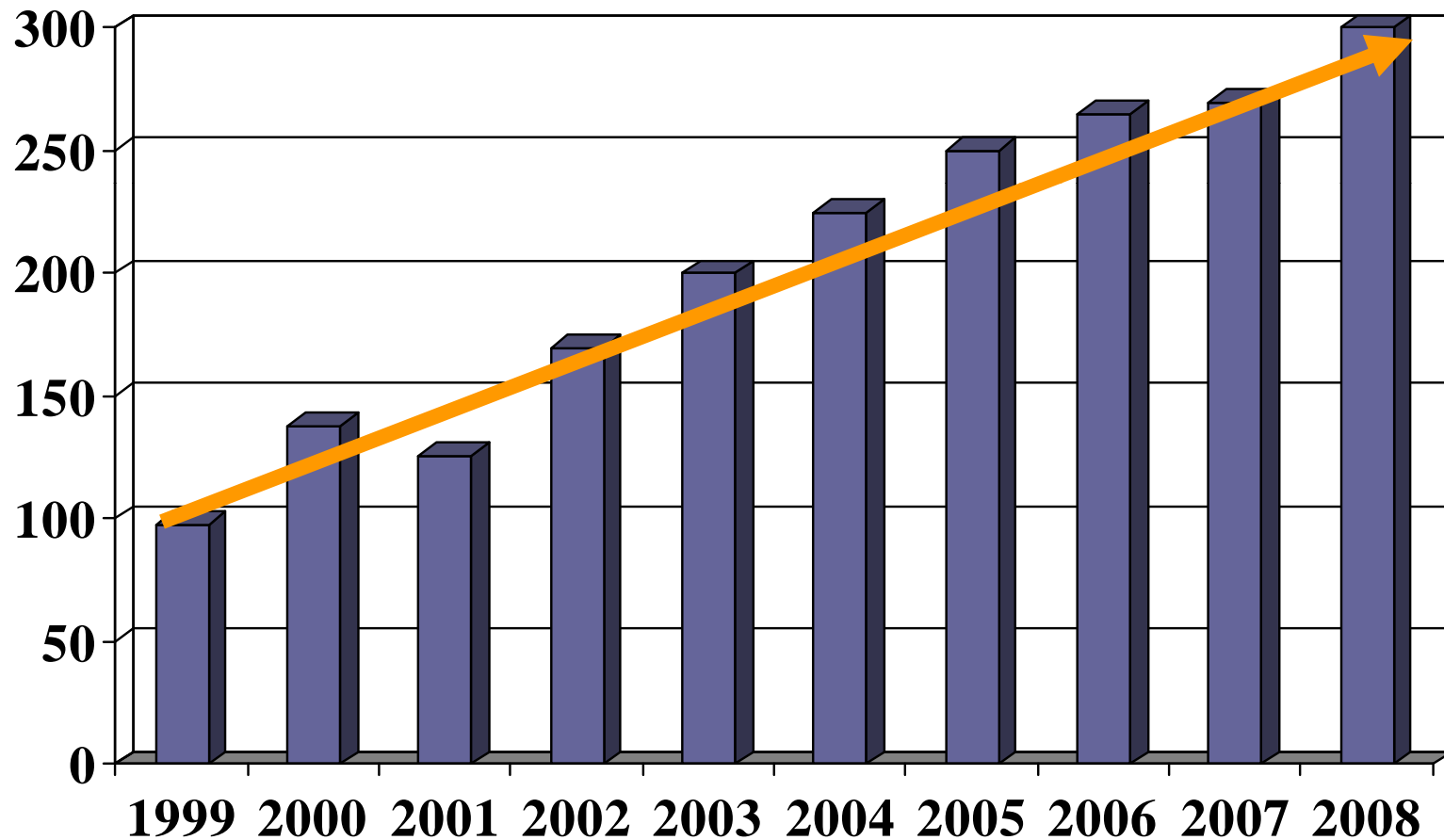
Stage	Pre-Seed	Seed/Start-Up		Early	Later
Source	Founders, Friends and Family	Individual Angels	Funding Gap between \$500,000 and \$2,000,000/\$5,000,000 (depending on region)	Venture Funds	
Investment	\$25,000 to \$100,000	\$100,000 to \$500,000		\$2,000,000/\$5,000,000 and up	



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Growth in Number of American Angel Groups



Sources: Center for Venture Research (pre 03 data) and Kauffman Foundation/ACEF (04-08 data)

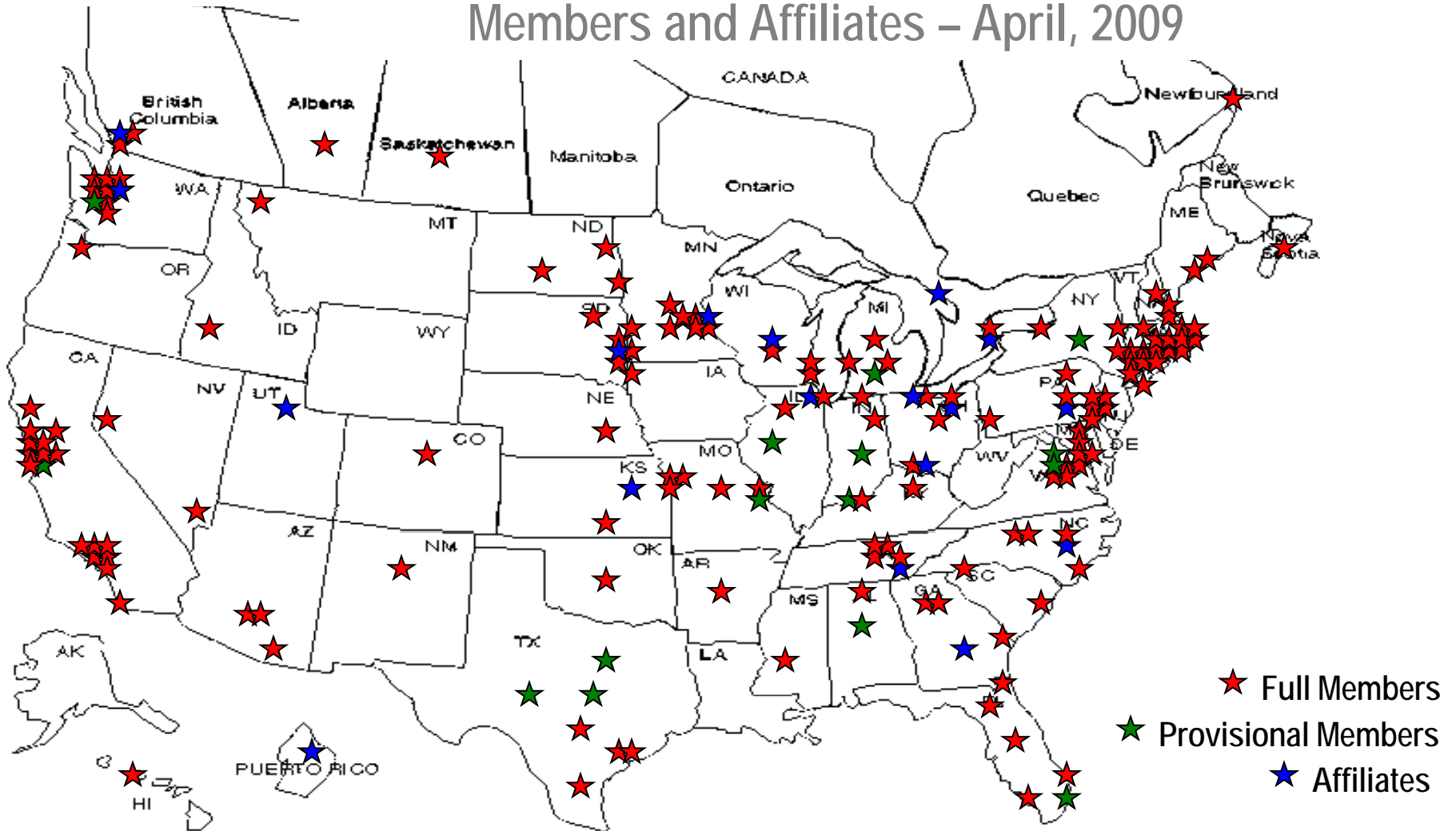


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Angel Groups Cover Innovation Hubs and More: Members and Affiliates – April, 2009





Comparing Average Group Investment Data

	2008	2007	2006
Number of investments	6.3	7.3	7.4
Total dollars invested	\$1.77 mil	\$1.94 mil	\$1.78 mil
Dollars invested per round	\$276,918	\$265,926	\$241,528
Number of new companies	3.7	4.5	4

In 2008:

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

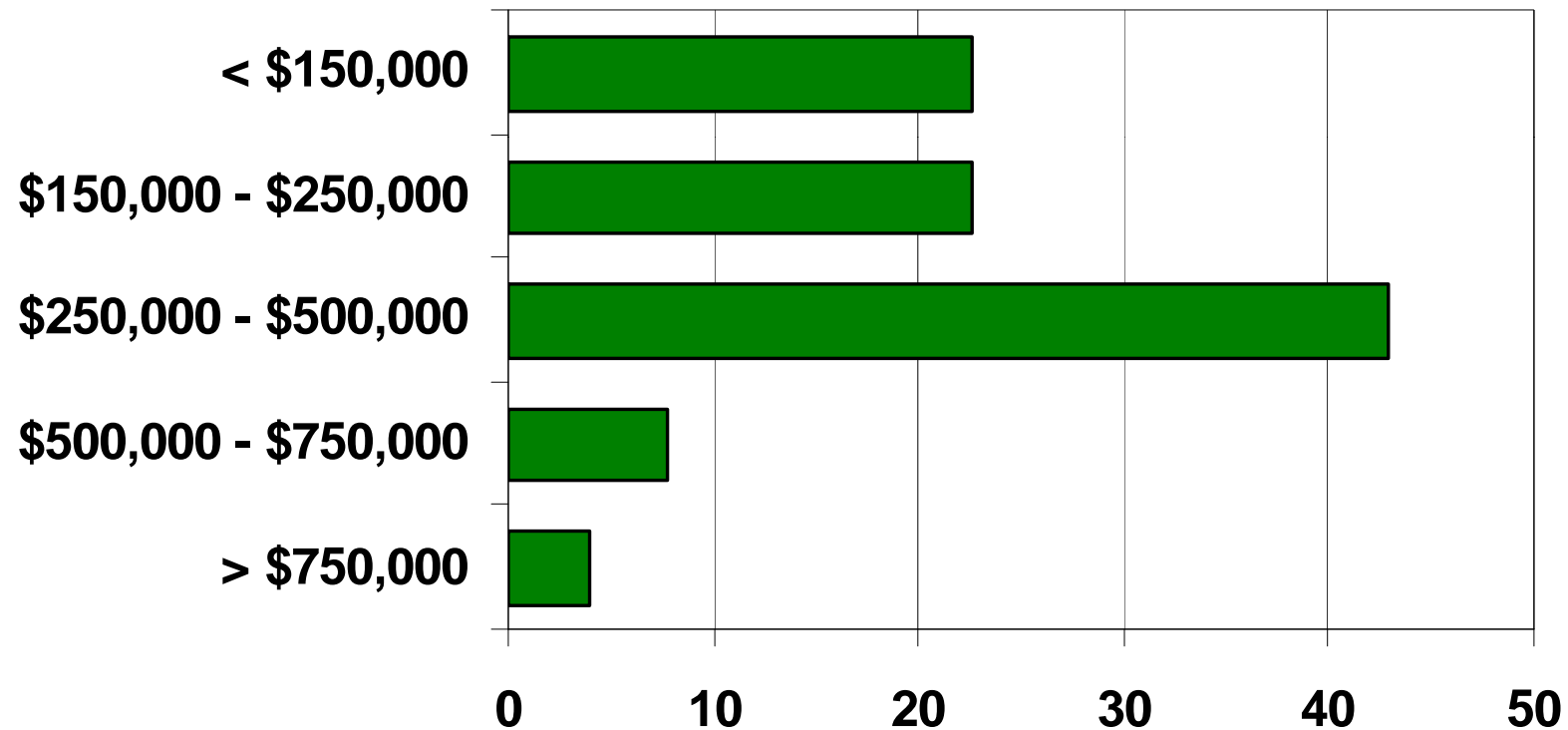
Source: ACA Angel Group Confidence Surveys – 2007, 2008, and 2009 (self-reported, not verified)



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Average Preferred Investment Per Round - 2008

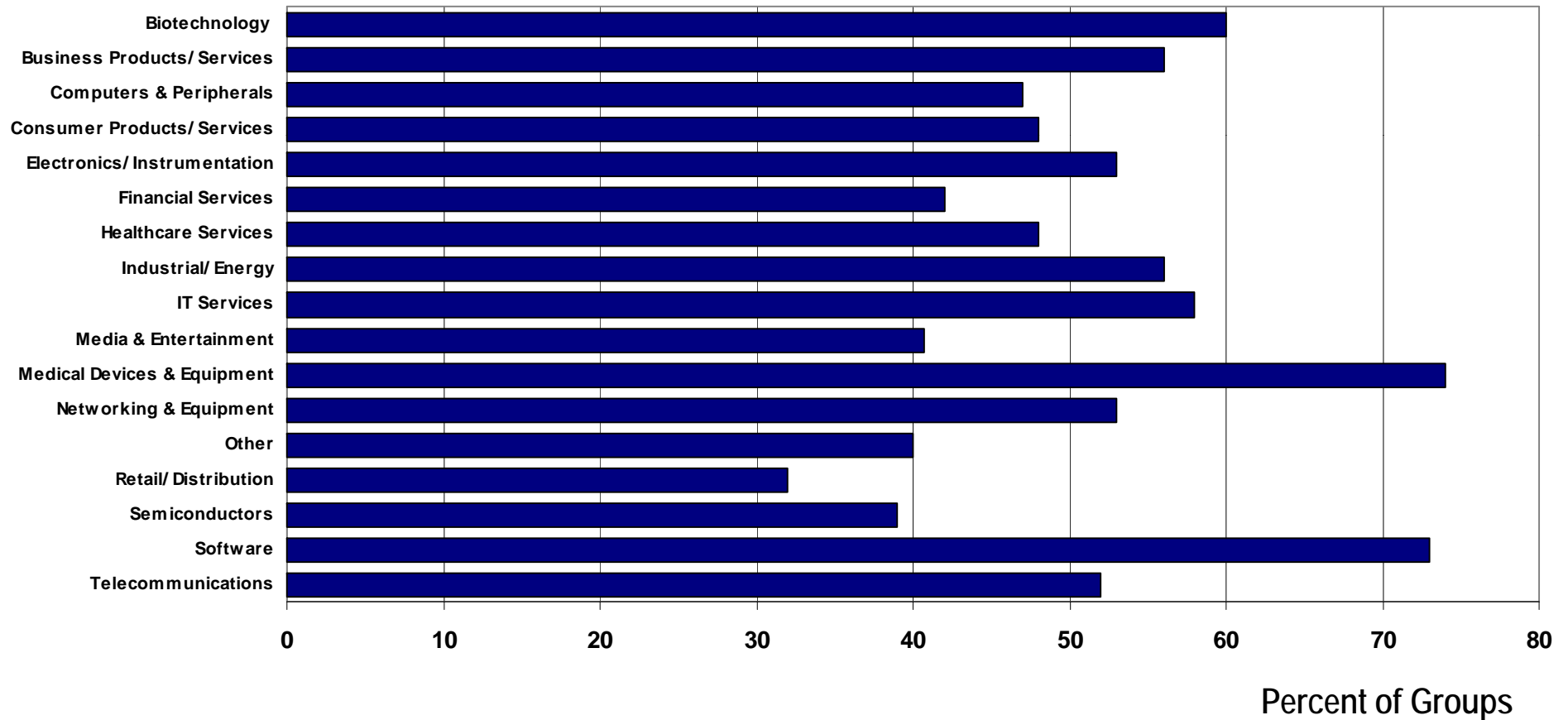


Percent of
Groups

Source: 2009 ACA Angel Group Confidence Survey and 2008 Member Directory



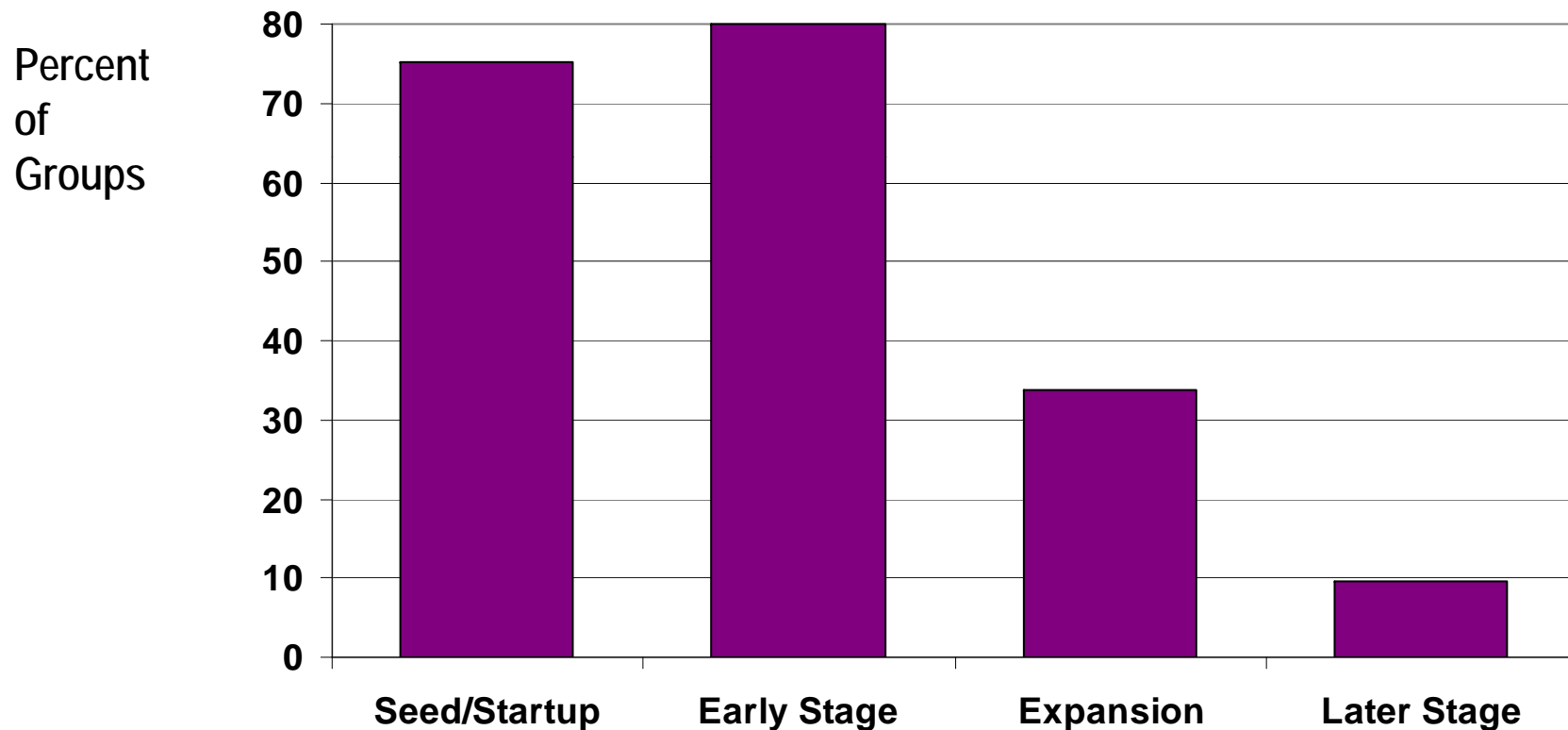
Investment Preference – 2008-2009



Source: 2009 ACA Angel Group Confidence Survey and 2008 Member Directory



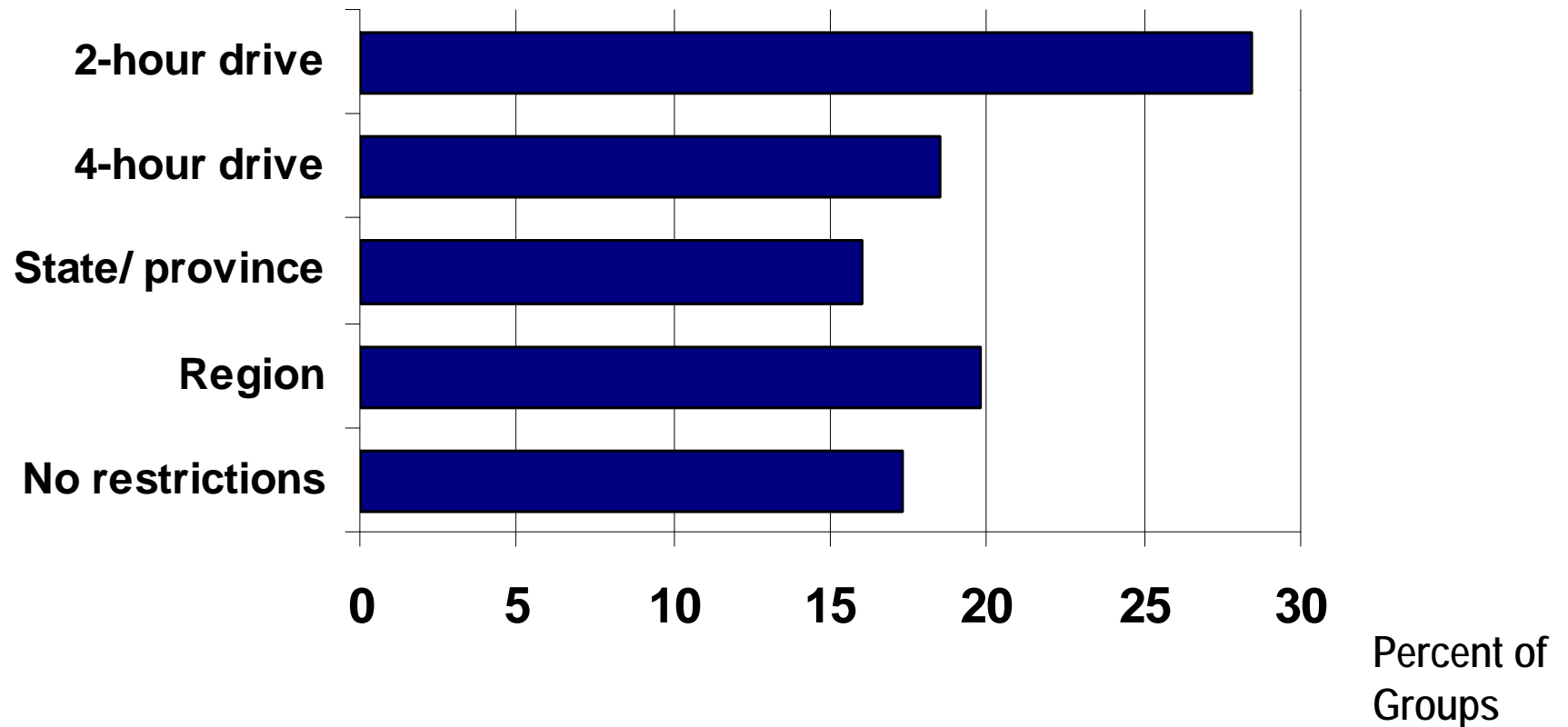
Preferred Investment/Company Stage – 2008-2009



Source: 2009 ACA Angel Group Confidence Survey and 2008 Member Directory



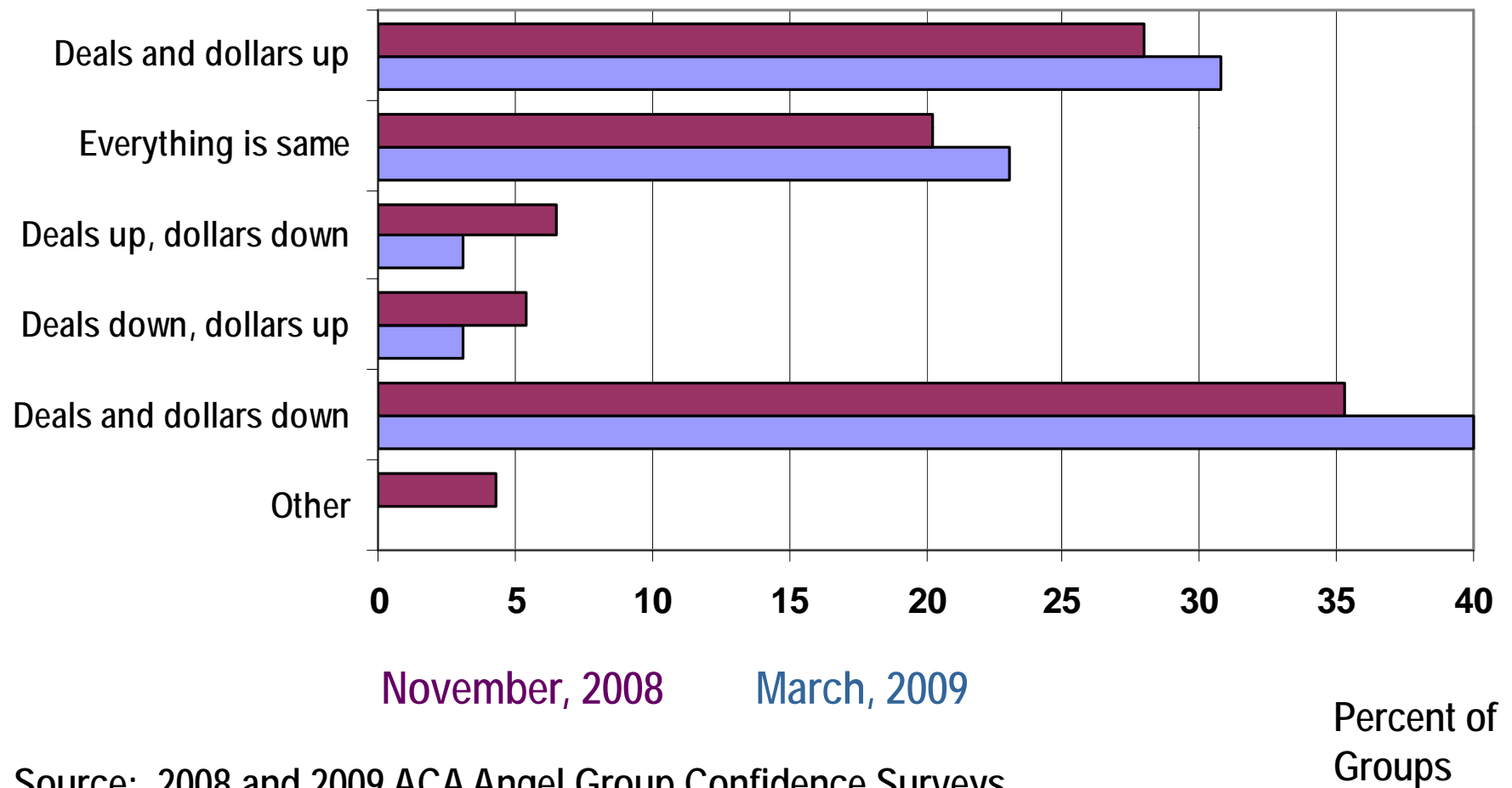
Geography – Where do Groups Invest?



Source: 2008 ACA Angel Group Confidence Survey



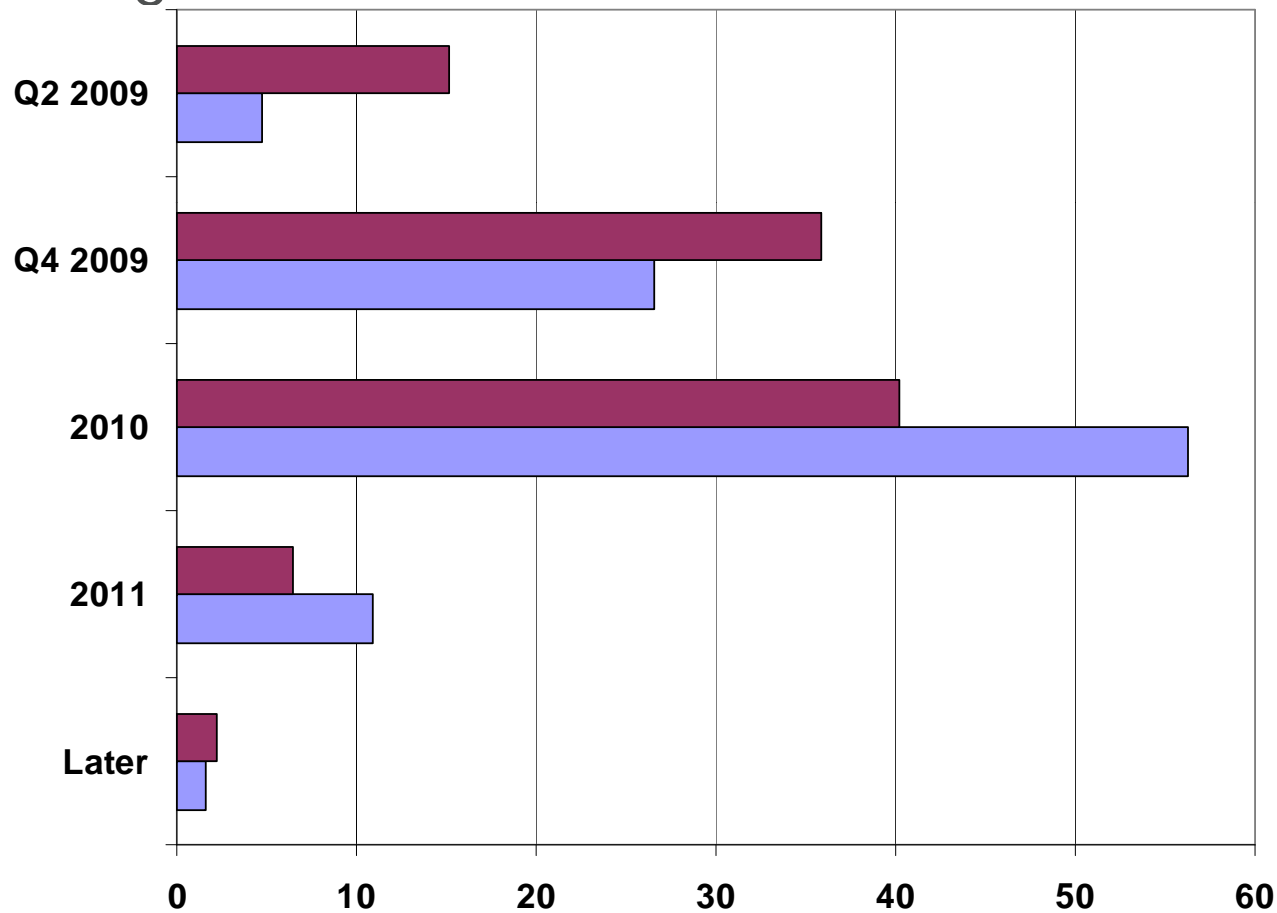
Predictions for 2009 Overall Investment Changed in 4 Months





2009 Prediction:

How Long Will Credit Crunch/ Current Economy Last?



November, 2008
March, 2009

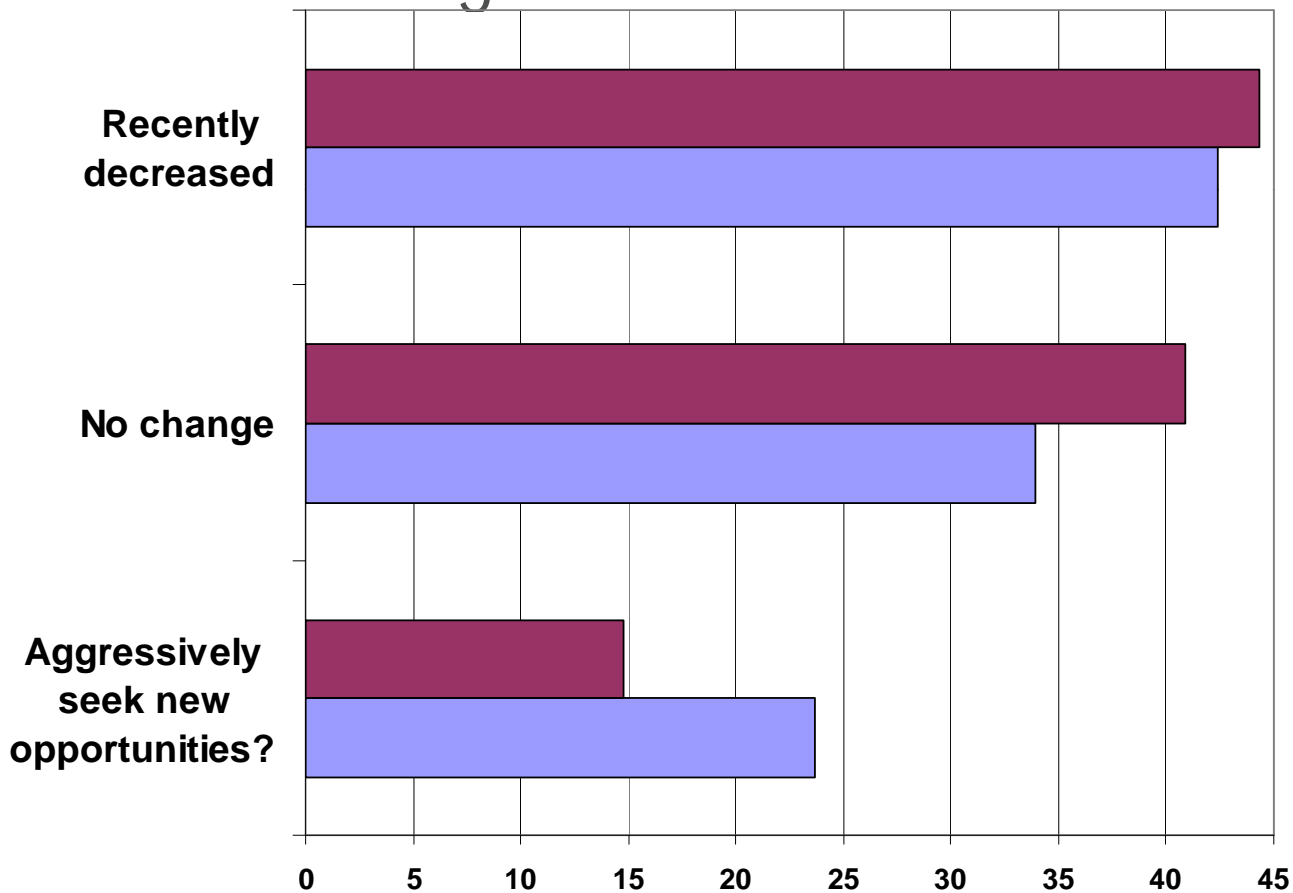
Source: ACA Angel Group Confidence Survey – 2008 and 2009

Percent of
Groups



Impact of Recession:

Appetite for Adding New Ventures to Your Portfolio?



November, 2008

March, 2009

Source: 2009 ACA Angel Group Confidence Survey



2009 Prediction:

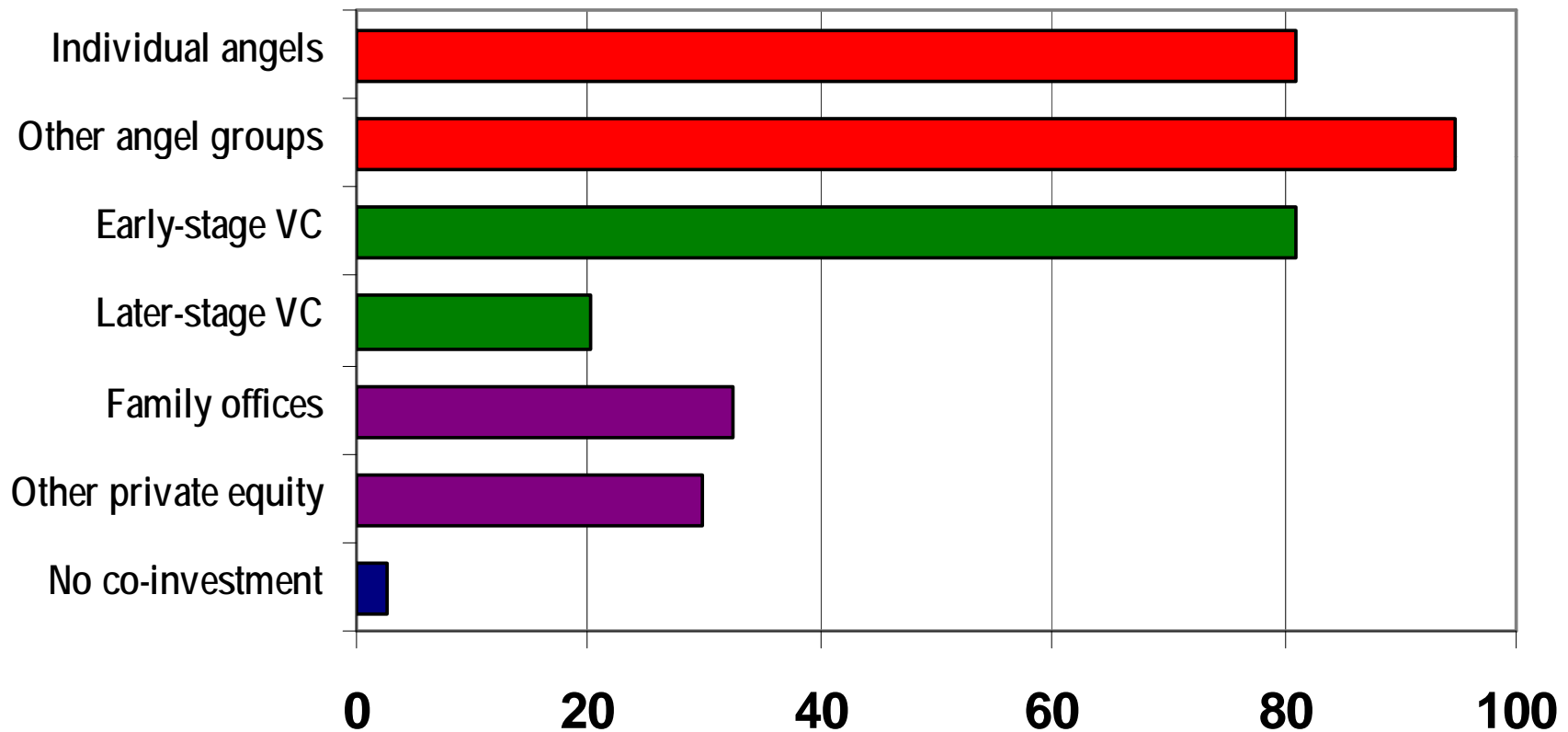
Plan Major Changes to Group Structure or Investment Process?

Increase member angels	29.2%
Decrease member angels	0.0%
Establish sidecar fund	19.4%
Raise new fund	12.3%
More investment in portfolio cos	32.3%
More co-investment with other groups	53.8%
Increase co-investment (general)	35.4%
Update industry preferences	15.4%
No changes planned	21.5%
Other changes	23.1%

Source: 2009 ACA Angel Group Confidence Survey



Co-Investment/ Follow-On Preferences



Source: 2008 ACA Angel Group Confidence Survey

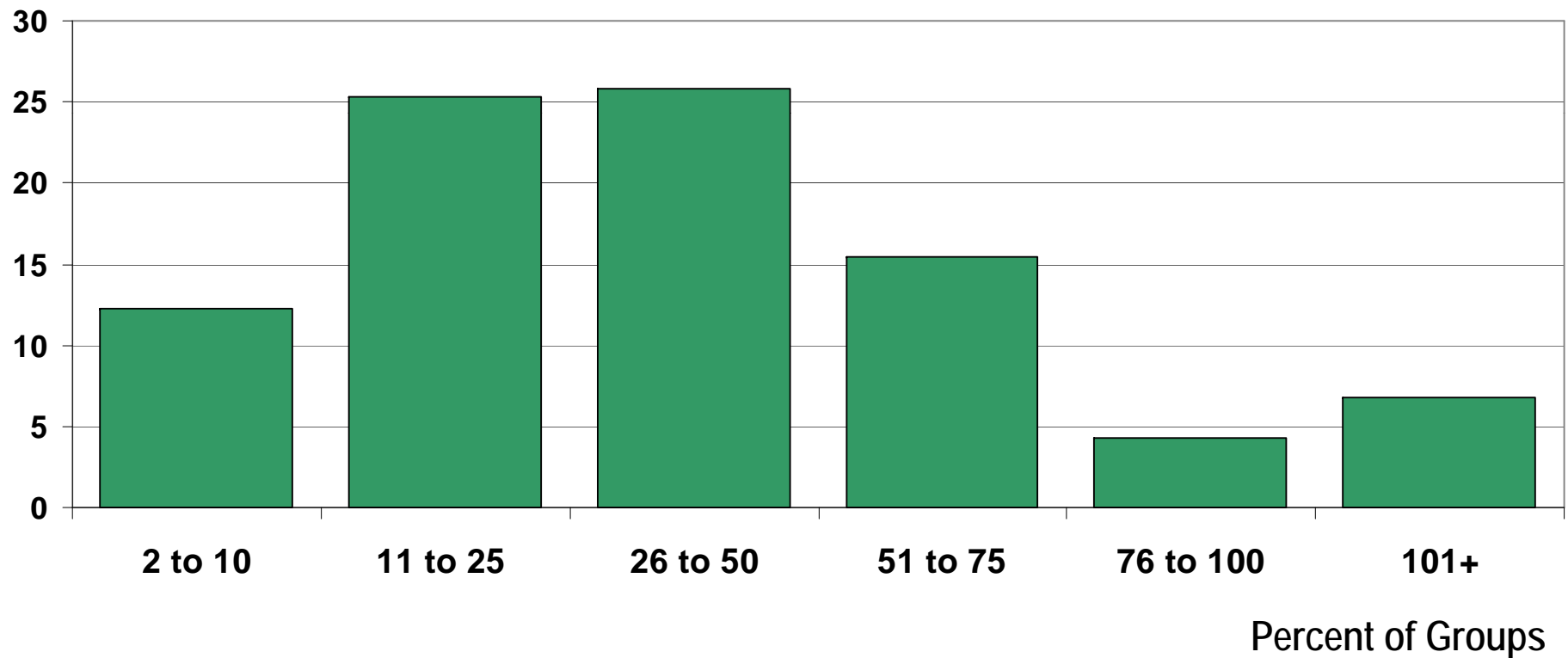
Percent of
Groups



Investors Per Group

Average = 43.6

Median = 32.5



Source: 2009 ACA Confidence Survey and 2008 Member Directory



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*“Risk comes from not knowing what you are doing.”
Warren Buffett*

The three strongest factors in angel investor success:

- Due diligence time
- Investor experience and expertise in industry
- Investor ongoing participation with portfolio companies

Source: Wiltbank and Boeker, “Returns to Angel Investors in Groups” (2007)



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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?



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Finding Angels

- Business plan in top shape
- Referral from someone the angel knows and trusts (lots of networking)
- Web site matching – caution!
 - www.vfinance.com, <http://activecapital.org>, www.gensx.com,
www.fundinguniverse.com
- Find local angel group
- Directories of angel groups:
 - www.angelcapitaleducation.org
 - www.angelcapitalassociation.org (includes only ACA member groups)
 - www.angelsoft.net



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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



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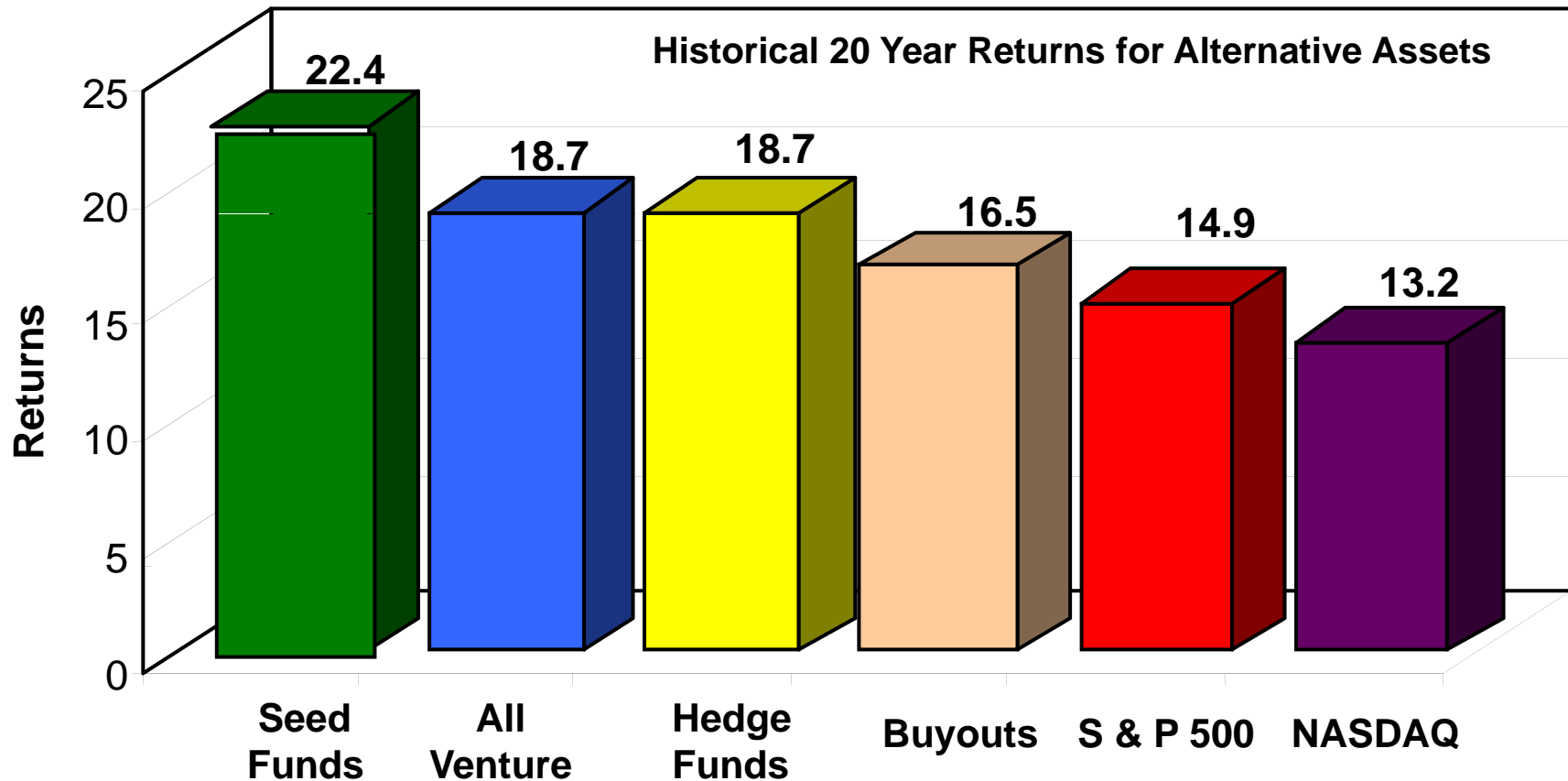
A Word About Return Expectations

- **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?



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

Source: Venture Economics, HFRI Equity Hedge Index

Rob Wiltbank, Willamette University



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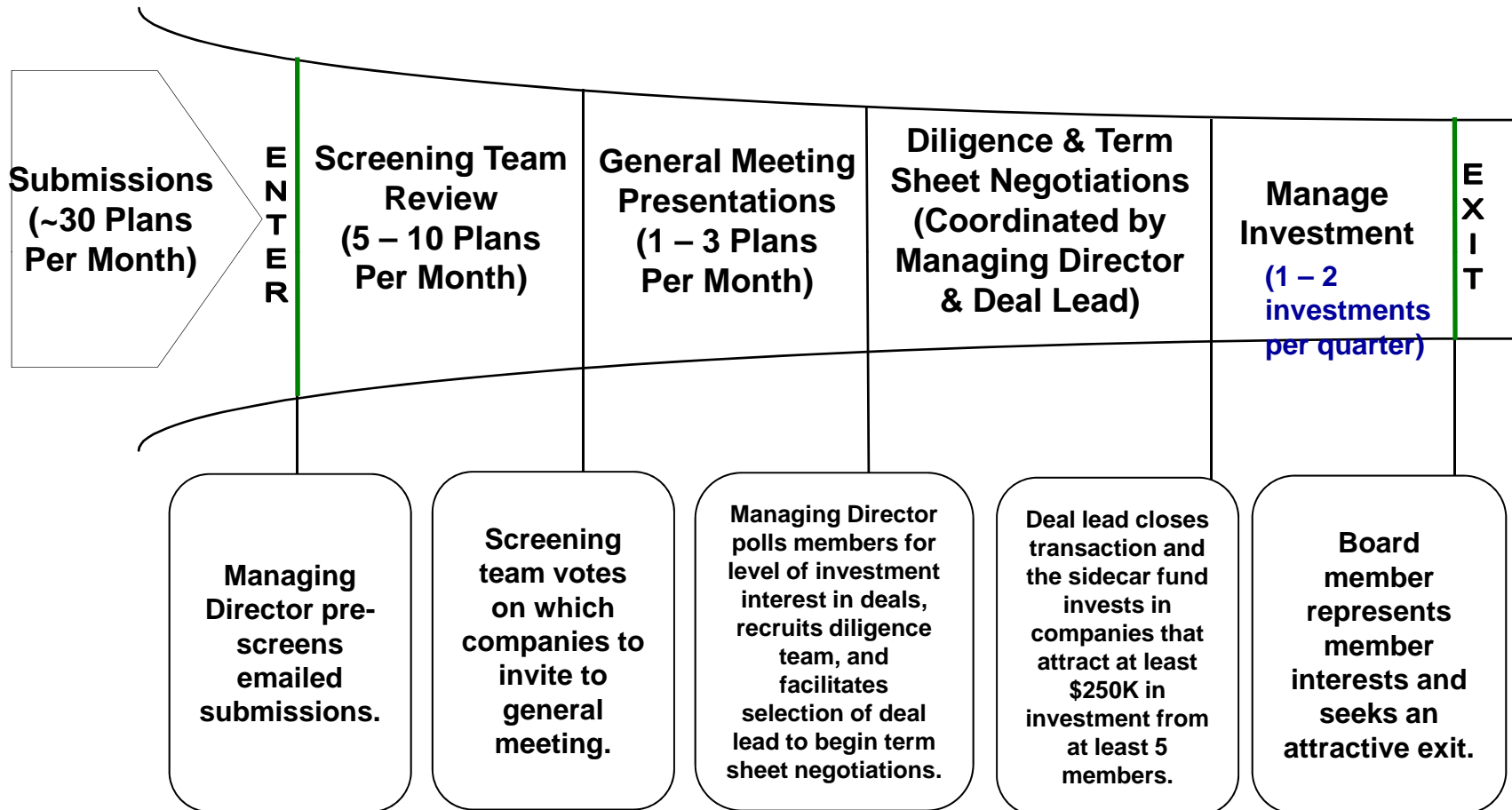


Process, Deals & Implications

- 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



Source: James Geshwiler, CommonAngels, Boston



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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



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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:
 - SBA - http://www.sba.gov/starting_business/index.html
 - The Business Mentor - www.fasttrac.org
 - INC Business Plan Building, Section by Section
http://www.inc.com/guides/write_biz_plan/20660.html



Forms of Business Plans

Elevator Pitch	Two minute verbal summary Product, opportunity, differentiation Attract interest – not closing
Executive Summary	2-4 page written summary Balanced presentation Attract interest – not closing
PowerPoint	20 minute verbal presentation Cover whole plan Find serious investors
Full business plan (write full plan first)	20-50 pages plus appendices Validation scorecard (due diligence) Basis for all other plan forms



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What Do Angels Look For in a Deal?

- Management
- Market
- Product



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Questions to ask yourself (Investors Will):

- What Type of Entrepreneur Are You?
- What Kind of Product Do You Have?
- Who Are Your Customers?
- How much have you invested?
- How much do you pay yourself?
- Who's on your team?
- How big is your moat?
- What's your development risk?
- What do you want the money for?



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Investment Criteria

- Exceptional management team with demonstrated track records in relevant industries
- Clearly articulated market position and value proposition for customers
- Ability to attract co-investment and follow-on capital
- Clear intellectual property strategy or position
- Defensible competitive position in an emerging or growth market
- Exit strategy for investors within 3-5 years
- Revenues that provide for a significant annual return, consistent with the investment risk
- Investment structure that offers a preferred or protected equity position



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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%



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Fundable Management Teams

- CEO
 - CEO experience
 - Vertical experience
 - Coachable (very important)
 - Leadership
- Team
 - Balance & Complete
 - Experience working together



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The Opportunity

- Scalable
 - \$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



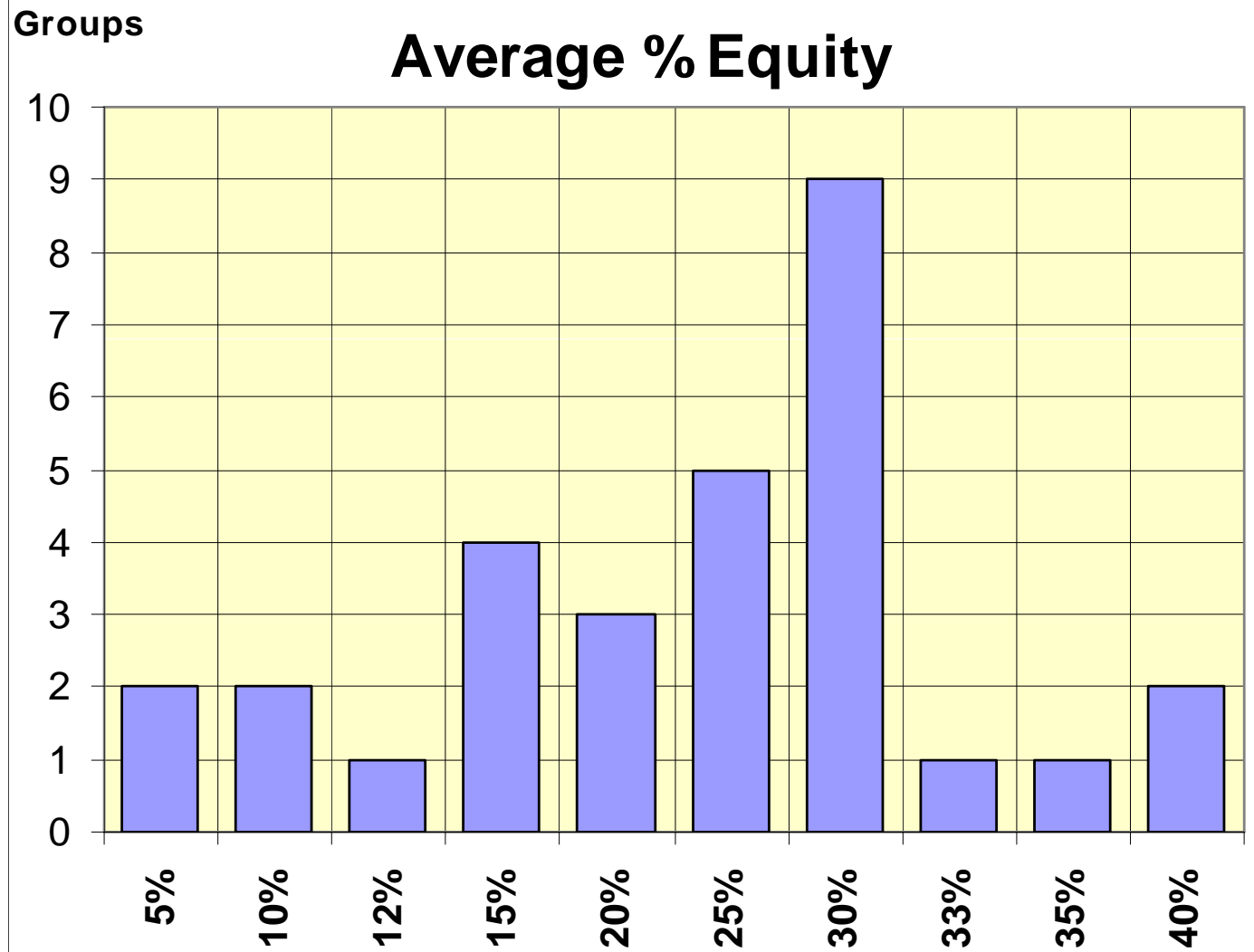
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Terms Preferred by Sophisticated Angels

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)



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Common Mistakes in Pitching Angels

- Only discuss technology/product
- Not prepared for presentation
(practice, practice, practice!)
- Presentation too long
- Inappropriate appearance



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Once you get investors to the table...

Closing the Deal



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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



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Understand the Terms

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



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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!**



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Kauffman Foundation's Angel Initiatives

- Education on investment process and opportunity
 - Power of Angel Investing
- Develop data and support research
- 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



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Information, Resources, and Support



ANGEL CAPITAL
EDUCATION FOUNDATION



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- Kauffman Foundation www.eVenturing.com
- www.angelcapitaleducation.org
- Angel Investor News
- Inc Magazine (and Web site)
- Books (see www.angelcapitaleducation.org)
 - ✓ *Term Sheets & Valuation – A Line by Line Look at the Intricacies of Venture Capital Term Sheets & Valuation*, A. Wilmerding (2003) \$10 from www.amazon.com
- Top level entrepreneurial support orgs
- Web sites match entrepreneurs and investors



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Angel Investor Forum

- Connecticut Based Angel Group (ACA Member)
- 40+ Active Investors
- Technology, Green/Clean, Healthcare, Media
- Recent Investments – Continuity Engine, ECKey, Q Tonic, Crimson Hexagon, Arbor Fuel, McNeil Designs
- www.angelinvestorforum.com