What Entrepreneurs Need to Know About the Angel Investment Process

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April 4, 2014
Today’s Podcast

• Who are angel investors?
• Where do you find angel investors?
• How do angels help entrepreneurs?
• How does the angel investment process work?
• What do angels expect?
• What kind of returns do angels get?
• What are key issues and concepts in 2013 & 2014?
• Where do you find more information about angels?
Who Are Angel Investors?

- Often successful, exited entrepreneurs or retired business persons
  - Active investors
  - Invest both time and money in companies

- Accredited investors - SEC definition
- Invest their own money **(not money managers)**
- Generally invest in local companies
- Invest at least $20K in businesses not run by family
- **2011:** 318,500 investors invested ~$22.5B in about 66,000 deals (mostly early-stage)
Geography – Where Do Angel Groups Invest?

Source: 2008 ACA Angel Group Confidence Survey
Investors Per Angel Group

Source: 2011 ACA Confidence Survey and 2011 Member Directory

Average = 43.1
Median = 34.5
How Do Angels Help Entrepreneurs?

- Many angels provide mentoring before and after investment
- Many serve as board members or observers
- Some join venture as C-level executive for an interim period
- Information rights in term sheet
- Often invest in multiple rounds to ensure entrepreneurs can grow
- Develop relationships with venture capital firms for expansion capital
- Help lead M&A process early on
- Angel monitoring/mentorship improves startup health
  - Harvard/MIT study shows angel support improves startup success rate
Angel Group Evaluation & Investment 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**
   - Board member represents member interests and seeks an attractive exit.

Source: James Geshwiler, CommonAngels, Boston
65% of Angel Groups Invest $150K to $500K Per Deal

- Investment surprisingly broad
- Average deal size increasing
- Syndication needed among groups to fill rounds entrepreneurs need

Source: ACA Confidence Survey, 2012
Average Total Investments Per Angel Group – 2011

Source: ACA-SVB Confidence Survey – March, 2011
Preferred Investment/Company Stage

Source: 2011 ACA Angel Group Confidence Survey and 2011 Member Directory
2012 Investment Preferences by Sector

- Business Products & Svcs
- Computer Hardware & Svcs
- Consumer Products & Svcs
- Electronics
- Energy & Utilities
- Environmental Svcs & Equipment
- Financial Services
- Healthcare
- Industrial
- Internet
- Media
- Mobile & Telecom
- Software

Percent of Groups

Source: ACA Summit Confidence Survey – 2012
Preferred Deal Terms

- Priced Rounds: 83%
- Convertible Debt: 14%
- Other: 3%

Percent of Groups

Source: ACA-SVB Confidence Survey – March, 2010
Note: 39 groups reporting (Caution: source data is incomplete & unverified)
A Word About Expectations Related to Returns

• 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 for Kauffman Foundation
Distribution of Returns by Venture Investment

Overall Multiple: 2.6X
Avg Holding Period: 3.5 years
Average IRR: 27%

Source: Returns of Angels in Groups, 2007
Trends and Key Issues – Angel Investment

- 4+ angel groups syndicate together & with family offices
  - Regions develop common terms and processes
  - Some interest in cross-border syndication
- Funds and sidecar funds (sustaining groups & expanding capital)
- Angel groups invest in multiple rounds
- Early exits – build early relationships between angels & strategics
- Vanilla term sheets – plain preferred stock
- Government interest in job creation
- JOBS Act and SEC rulemaking
More Information

Angel Investor Forum - Connecticut
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Angel Capital Association – National Association
www.angelcapitalassociation.org
www.angelresourceinstitute.org

NOTE: ACA & ARI are NOT sources of equity capital and can’t evaluate biz plans.