AVOIDING CAPITAL PUNISHMENT:
ANGEL CAPITAL MODELS, EXITS & RISK MITIGATION STRATEGIES

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November 2017

New Zealand Angel Summit
SAFE HARBOR

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- This presentation should not be construed as an offer to buy, sell or recommend securities or provide investment advice.

- For guidance on any specific deal, please consult your Angel colleagues, your group’s diligence team, I-banker, attorney, therapist, grief counselor or Task Rabbit dry cleaner pickup artist.

- YMMV: forecasting is very hard, especially about the future.

- Some in high tech believe we’re living in the Matrix. That’s good to know when listening to any investment analysis.
US Angels are Becoming Mini-VCs

• 300 ACA US Angel Groups
• Institutionalization of angels
• Incubators, accelerators
• Increasingly, institutional angels s becoming “late seed” investors
• Angels often expect Series A – like milestones for seed stage companies
PREVIEW

- Angels often focus on the story! product! and vision!
- New angels often ignore the “boring stuff”
- But the “boring stuff”—like capital models and capital risks—are key to our outcomes
- There are multiple capital models and strategies:
  - Your startup’s capital model and strategy
  - Follow-on investors’ capital strategies
  - Your own Angel capital model and strategy
- These strategies are often misaligned!
The Story

The Capital Model
Angel Spectrum

- Go with your gut
- Reward-conscious
- You like the vision & passion
- You like the team
- Demos!
- You like the product
- Risk: “going native” too early and downplaying risks

- Trust, but verify
- Risk-conscious
- You know the market
- You’ve vetted the team
- Metrics & Milestones!
- Customers like the product
- Risk: knowing far less than you think you know
AGENDA

1. Introduction: The Rationale for Raising Capital
2. Capital Risk and Capital Models
3. Understanding Your Capital Model by Modeling Your Outcomes
4. Issues to Consider
5. The Agony and the Ecstasy
6. Lessons for Angels
WHAT (BESIDES EQUITY) DOES OUR CAPITAL BUY US?

Metrics

Milestones

M&Ms needed to get to the next phase of funding or growth.
BUSINESS MILESTONES AT EACH STAGE

• **Incubator**: MVP? Connect with angels
• **Angel**: Evidence of early customer interest, strong technical and business founders? Early evidence of key business hypotheses?
• **Series A**: Business model assumptions work, key exec hires, growing customer metrics
• **Series B**: Repeatable sales model, reduced CAC, broadened management team
• **Series C**: Can company scale
• **Series D**: Is company an emerging market leader
• **Series E**: Can company dominate global markets, its ecosystem and attract exit partners
Q: How much capital should a company raise from us?
A: Enough to achieve milestones and metrics needed to get to the next stage.

Q: How do we know what those metrics and milestones are?
A: Look at peer companies OR simply ask a targeted investor, “what M&Ms would make this deal compelling for you in 9 months?”
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ANALYZING INVESTOR RISKS: CAN WE MAKE MONEY?

• Technology Risk
  • Does it work? Can it work and scale in real life use?

• Management Risk
  • Is this team right for THIS deal?

• Market Risk
  • Will customers buy it?

• Competitive Risk
  • Can this company dominate its markets?

• Exit risk
  • Multiple buyers? Private Equity exit? Chance of an IPO?

• Capital Risks
KEY CAPITAL RISKS

• Capital inefficient business
• No follow-on investor, if needed
• Premature follow-on financing
  • Too early to have achieved milestones and metrics
• Changes in capital market sentiment
• Significant Dilution
• Down-round Risk
• Pay to Play
• Misaligned Investors
• Larger Liquidation Preference Stack
• Management Carve-outs
• Lack of outcomes alignment between investors and between investors and management
• Late stage investors with no ties to Angels in the cap table
RISKS INCREASE WITH MORE TIME AND MORE CAPITAL

More Capital, More Angel Risk

Series D
Series C
Series B
Series A
Institutional Angel
Incubator
Friends & Family
MORE CAPITAL ≠ HIGHER RETURNS TO ANGELS

(SOURCE: ROBERT WILTBANK, 2014)
TO MITIGATE CAPITAL RISK, DO DILIGENCE ON A COMPANY’S LIKELY CAPITAL MODEL

Each company has its own capital model influenced by its sector.

The funding needed:

• to get to the next round or breakeven
• to get to scale and lead the market
• to exit (and the number of rounds to get there)
• The timing of cash flows (contract to cash cycle)
• The capital efficiency of the business model
• Likely sources of funding at each stage
• The key capital risks inherent in the business model & companies in this industry
• The exit values and multiples for this sector, and what they imply for Angels
CAPITAL-RELATED DILIGENCE QUESTIONS TO ASK MANAGEMENT

• What’s the minimum capital needed to achieve the goals of this round? Besides us, where’s the rest coming from?
• How much are you raising in the next round? What metrics do you need to get there?
  • Have you talked to likely next-round investors or strategic partners?
• How much investor capital (after this round) will you likely need to get to scale?
• If revenue stage: Of this year’s revenue forecast, how much is done? How much is coming from pipeline and known accounts? How big is the remaining gap? How are you filling that gap?
• What companies do you benchmark yourself against?
• What are recent exit multiples for companies like you in your market?
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2/3 of Venture-Backed Companies Fail to Yield a Positive Return

Includes data from Dow Jones VentureSource and other sources
Top 10% of exits returned 75% of all cash

AVERAGE RETURN = 2.6X
(REturns to Angel investors in Groups, 2007, Robert Wiltbank, 2014)
Only 15% > $50M
### M&A by Sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>Median Multiple of Invested Capital (MOIC)</th>
<th>Average Return MOIC</th>
<th>Median M&amp;A Realized</th>
<th>Median Equity Invested</th>
<th>Average Equity Invested</th>
<th>Average Funding Rounds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telecom, Messaging</td>
<td>2.5</td>
<td>4.1</td>
<td>$87,660,000</td>
<td>$21,830,000</td>
<td>$22,324,999</td>
<td>2.6</td>
</tr>
<tr>
<td>Energy/Cleantech</td>
<td>5.8</td>
<td>6.2</td>
<td>$343,400,000</td>
<td>$42,250,000</td>
<td>$58,002,194</td>
<td>4.2</td>
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<tr>
<td>B2C SW</td>
<td>5.9</td>
<td>5.9</td>
<td>$146,445,000</td>
<td>$18,000,000</td>
<td>$55,170,426</td>
<td>3.1</td>
</tr>
<tr>
<td>Fintech software</td>
<td>6.4</td>
<td>6.6</td>
<td>$105,465,000</td>
<td>$15,290,000</td>
<td>$34,582,222</td>
<td>2.4</td>
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<tr>
<td>Consumer software</td>
<td>6.5</td>
<td>7.9</td>
<td>$119,544,510</td>
<td>$10,500,000</td>
<td>$22,787,761</td>
<td>4.1</td>
</tr>
<tr>
<td>Medical Device</td>
<td>6.9</td>
<td>11.0</td>
<td>$150,942,857</td>
<td>$31,518,531</td>
<td>$34,687,912</td>
<td>4.1</td>
</tr>
<tr>
<td>Biotech</td>
<td>7.2</td>
<td>9.4</td>
<td>$429,051,724</td>
<td>$48,400,002</td>
<td>$58,919,981</td>
<td>3.5</td>
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<tr>
<td>Security software</td>
<td>7.4</td>
<td>8.9</td>
<td>$122,291,667</td>
<td>$11,524,995</td>
<td>$20,007,199</td>
<td>2.6</td>
</tr>
<tr>
<td>Media Infrastructure</td>
<td>7.4</td>
<td>7.4</td>
<td>$137,600,000</td>
<td>$26,140,000</td>
<td>$19,968,134</td>
<td>3.2</td>
</tr>
<tr>
<td>Marketing / Advertising / Customer Analytics</td>
<td>8.1</td>
<td>20.9</td>
<td>$161,049,429</td>
<td>$7,000,000</td>
<td>$15,235,600</td>
<td>3.0</td>
</tr>
<tr>
<td>Dev Tools / UI / Platform</td>
<td>9.1</td>
<td>11.2</td>
<td>$102,130,769</td>
<td>$9,000,000</td>
<td>$10,930,769</td>
<td>2.7</td>
</tr>
<tr>
<td>Cloud / Internet Services</td>
<td>9.3</td>
<td>8.4</td>
<td>$425,857,143</td>
<td>$38,400,000</td>
<td>$76,577,561</td>
<td>3.0</td>
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<tr>
<td>B2B</td>
<td>9.7</td>
<td>11.4</td>
<td>$173,600,000</td>
<td>$13,618,793</td>
<td>$68,194,109</td>
<td>2.8</td>
</tr>
<tr>
<td>Business (internal use) Software</td>
<td>10.6</td>
<td>15.3</td>
<td>$260,911,765</td>
<td>$10,340,000</td>
<td>$22,612,941</td>
<td>2.9</td>
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<tr>
<td>Consumer Hardware</td>
<td>11.6</td>
<td>38.9</td>
<td>$301,600,000</td>
<td>$47,800,000</td>
<td>$36,564,365</td>
<td>3.1</td>
</tr>
<tr>
<td>Storage/Data Center</td>
<td>13.4</td>
<td>13.6</td>
<td>$450,800,000</td>
<td>$25,000,000</td>
<td>$35,750,246</td>
<td>2.9</td>
</tr>
</tbody>
</table>

**Average M&A Value:** $277,345,485  
**Median M&A Value:** $100,000,000  
**Average Capital Raised:** $32,128,461  
**Median Capital Raised:** $15,550,000

**Source:** R. Weissman, data from Crunchbase Pro, Jan 2010 - June 2017 M&A with disclosed values (90% from 2014-2017)
## IPO BY SECTOR

<table>
<thead>
<tr>
<th>Sector</th>
<th>Median MOIC</th>
<th>Average MOIC</th>
<th>Median IPO Realized</th>
<th>Median Equity Invested</th>
<th>Average Equity Invested</th>
<th>Average # of Rounds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life Science</td>
<td>2.7</td>
<td>3.5</td>
<td>$242,232,501</td>
<td>$106,000,000</td>
<td>$130,343,261</td>
<td>5.4</td>
</tr>
<tr>
<td>Semiconductor</td>
<td>2.9</td>
<td>7.2</td>
<td>$95,068,700</td>
<td>$53,234,291</td>
<td>$51,772,785</td>
<td>4.3</td>
</tr>
<tr>
<td>Energy/Cleantech</td>
<td>3.9</td>
<td>6.0</td>
<td>$618,000,000</td>
<td>$186,190,000</td>
<td>$319,252,033</td>
<td>7.3</td>
</tr>
<tr>
<td><strong>Marketing / Advertising / Customer Analytics</strong></td>
<td>4.3</td>
<td>22.2</td>
<td>$392,779,254</td>
<td>$102,767,835</td>
<td>$274,016,687</td>
<td>6.4</td>
</tr>
<tr>
<td>Cloud &amp; Telecom</td>
<td>5.6</td>
<td>9.8</td>
<td>$552,000,000</td>
<td>$93,263,107</td>
<td>$163,407,739</td>
<td>6.5</td>
</tr>
<tr>
<td>Consumer software</td>
<td>6.2</td>
<td>14.3</td>
<td>$1,050,000,000</td>
<td>$182,578,178</td>
<td>$450,827,578</td>
<td>6.5</td>
</tr>
<tr>
<td><strong>Business (internal use) Software</strong></td>
<td>6.9</td>
<td>13.3</td>
<td>$554,750,375</td>
<td>$87,685,000</td>
<td>$89,859,756</td>
<td>5.4</td>
</tr>
<tr>
<td>Security software</td>
<td>7.4</td>
<td>8.9</td>
<td>$776,775,267</td>
<td>$85,500,000</td>
<td>$244,225,185</td>
<td>5.4</td>
</tr>
<tr>
<td>Fintech Software</td>
<td>8.5</td>
<td>8.0</td>
<td>$978,500,000</td>
<td>$210,275,000</td>
<td>$189,695,129</td>
<td>8.5</td>
</tr>
<tr>
<td><strong>Storage/Data Center</strong></td>
<td>13.0</td>
<td>13.0</td>
<td>$900,348,174</td>
<td>$102,767,835</td>
<td>$151,217,177</td>
<td>4.9</td>
</tr>
</tbody>
</table>

Average IPO Price: $1,612,365,342
Median IPO Price: $430,000,000
Average Capital Raised: $187,234,858
Median Capital Raised: $103,480,066

Source: R. Weissman, sampled data from Crunchbase Pro, IPOs Jan 2010 – June 2017
Median Multiple of Invested Capital (MOIC) by IPO Valuation (IPOs 2010 to 2017)

Source: R. Weissman, sampled data from Crunchbase Pro, IPOs 2010 - 2017
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WHAT IS AN ANGEL’S CAPITAL STRATEGY?

• Returns goal: 10x to 30x
• Reasonable valuation ensuring decent initial ownership (15% to 30%)
• Consider reserving capital (2x to 3x initial investment) for 1 to 2 additional follow-on rounds (but be aware of follow-on pros and cons)
• Sensitivity to capital efficient company business model
• Sensitivity to Liquidation Preferences
• Extreme sensitivity to down rounds and pay to play
• Ideally, little or no venture capital, if possible
  • If venture $ needed in multiple rounds, 20% can become 5% equity at exit
# Modeling Our Returns—Losing Scenario

“Back of the envelope” estimate—Can we make $$

<table>
<thead>
<tr>
<th>Factor</th>
<th>Source/Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>How much are we <strong>investing as a class</strong>?</td>
<td>$1.5M</td>
</tr>
<tr>
<td>Estimate the company’s <strong>revenues at exit ($M)</strong></td>
<td>$30</td>
</tr>
<tr>
<td>What is the industry’s <strong>valuation multiple</strong>?</td>
<td>4x</td>
</tr>
<tr>
<td>How much will the company be <strong>worth at exit</strong>?</td>
<td>$30M * 4 = $120M</td>
</tr>
<tr>
<td>Pre Money / Post Money Valuation: $ (m)</td>
<td>$8.5 / $10</td>
</tr>
<tr>
<td>How much will our series <strong>own initially</strong>?</td>
<td>15%</td>
</tr>
<tr>
<td>How much will we <strong>own at exit</strong>?</td>
<td>6%</td>
</tr>
<tr>
<td>What is our share of exit $</td>
<td>7.2</td>
</tr>
<tr>
<td>How much <strong>additional capital</strong> will our series invest?</td>
<td>$1M</td>
</tr>
<tr>
<td>What is our <strong>multiple of invested capital</strong> (MOIC)</td>
<td>2.88</td>
</tr>
</tbody>
</table>
### Modeling Our Returns—Better Scenario

"Back of the envelope" estimate—Can we make $$

<table>
<thead>
<tr>
<th>Factor</th>
<th>Source/Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>How much are we investing as a class?</td>
<td>$1.5M                             Term Sheet</td>
</tr>
<tr>
<td>Estimate the company’s revenues at exit (SM)</td>
<td>$30                              Business plan and comparables</td>
</tr>
<tr>
<td>What is the industry’s valuation multiple?</td>
<td>4x                                Price/Sales Multiples from Yahoo! finance as factored by revenue growth rates, gross margin and related considerations</td>
</tr>
<tr>
<td>How much will the company be worth at exit?</td>
<td>$30M * 4 = $120M Revenues at exit * EV/revenue multiple for sector (Yahoo! Finance)</td>
</tr>
<tr>
<td>Pre Money / Post Money Valuation: $ (m)</td>
<td>$4.5 / $6 Post-money = $7.5M</td>
</tr>
<tr>
<td>How much will our series own initially?</td>
<td>25% Current Valuation from Term Sheet</td>
</tr>
<tr>
<td>How much will we own at exit?</td>
<td>15% Assume 60% dilution because of business plan capital forecast, validated by high capital needs of companies in sector</td>
</tr>
<tr>
<td>What is our share of exit $</td>
<td>18 % ownership at exit</td>
</tr>
<tr>
<td>How much additional capital will our series invest?</td>
<td>$1M</td>
</tr>
<tr>
<td>What is our multiple of invested capital (MOIC)</td>
<td>7.2  Cash out ($18M) / cash in ($2.5M)</td>
</tr>
</tbody>
</table>
### TTM REVENUE MULTIPLES, Q4 2016

**SOURCE: SOFTWARE EQUITY GROUP**

<table>
<thead>
<tr>
<th>Category</th>
<th>Q4 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mobile Solutions &amp; Content</td>
<td>1.3x</td>
</tr>
<tr>
<td>Billing and Service Management</td>
<td>1.9x</td>
</tr>
<tr>
<td>Healthcare Software</td>
<td>1.9x</td>
</tr>
<tr>
<td>Gaming</td>
<td>2x</td>
</tr>
<tr>
<td>Storage, Data Management, Integration</td>
<td>2.1x</td>
</tr>
<tr>
<td>Networking &amp; Performance Management</td>
<td>2.3x</td>
</tr>
<tr>
<td>Dev Platforms</td>
<td>2.3x</td>
</tr>
<tr>
<td>Systems Management</td>
<td>2.9x</td>
</tr>
<tr>
<td>BI/Analytics</td>
<td>3x</td>
</tr>
<tr>
<td>Engineering &amp; PLM</td>
<td>3.3x</td>
</tr>
<tr>
<td>Security</td>
<td>3.3x</td>
</tr>
<tr>
<td>Finance &amp; Accounting</td>
<td>3.7x</td>
</tr>
<tr>
<td>IT</td>
<td>4x</td>
</tr>
<tr>
<td>ERP</td>
<td>4x</td>
</tr>
<tr>
<td>Finance as a Vertical</td>
<td>4.4x</td>
</tr>
<tr>
<td>Other Vertical</td>
<td>4.4x</td>
</tr>
<tr>
<td><strong>Median for all software</strong></td>
<td>3.1x</td>
</tr>
</tbody>
</table>
IMPLICATIONS OF THE STARTUP’S BUSINESS MODEL FOR CAPITAL

The Case of SaaS: Upside Down Business/Cash Model

- Front-end loaded expenses (sales and customer on-boarding)
- Back-end loaded revenues (often collected over 3 years)
- Voracious appetite for cash
- And the faster the growth, the more the need for cash
- **SaaS companies often consume $100M before exit**

"Here’s where we went for broke, and here’s where we went broke."

© Mark Anderson

www.andretoons.com
SaaS: Sectors have different levels of attractiveness

Source: Software Industry Group, 2017
WHY SAAS MULTIPLES VARY

SOURCE: SAAS CAPITAL

<table>
<thead>
<tr>
<th>Revenue Multiple</th>
<th>2.0x</th>
<th>4.0x</th>
<th>6.0x</th>
<th>8.0x</th>
<th>10.0x</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Company Multiple at Time of Event</td>
<td></td>
<td></td>
<td>6.1x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private Company Discount</td>
<td></td>
<td>(1.3x)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private Company Multiple</td>
<td></td>
<td></td>
<td>4.8x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Growth Rate if Revenue &lt;$5M</td>
<td></td>
<td></td>
<td></td>
<td>&lt;50%</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>50% - 60%</td>
<td>&gt;75%</td>
<td></td>
</tr>
<tr>
<td>Growth Rate if Revenue &gt;$5M</td>
<td></td>
<td></td>
<td></td>
<td>&lt;35%</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>35% - 50%</td>
<td>&gt;60%</td>
<td></td>
</tr>
<tr>
<td>Total Addressable Market</td>
<td></td>
<td></td>
<td></td>
<td>&lt;$1.0 billion</td>
<td></td>
</tr>
<tr>
<td>Net Retention Rate</td>
<td></td>
<td></td>
<td></td>
<td>&lt;80%</td>
<td>&gt;100%</td>
</tr>
<tr>
<td>Gross Margin</td>
<td></td>
<td></td>
<td></td>
<td>&lt;75%</td>
<td>&gt;85%</td>
</tr>
<tr>
<td>Payback Period</td>
<td></td>
<td></td>
<td></td>
<td>&gt;12 months</td>
<td>&lt;12 mos</td>
</tr>
</tbody>
</table>
WHAT HAS TO HAPPEN FOR AN ANGEL TO MAKE $? 

• Company has to execute well without a crushing down round 
• Company (and investors) need to understand the metrics that create underlying value 
• Company, ideally, should have multiple exit opportunities 
• Company has to be in a sector with stable or growing valuation multiples 
• Company has to be capital efficient without taking on massive debt or crushing liquidation preferences
WHAT IS A VC’S CAPITAL STRATEGY?

• Returns goal:
  • Early stage: 5x to 20x+
  • Later stage: 2x to 3x

• Fear or Greed?
  • Fear: protect downside with multiple Preferences and dividends
  • Greed: let upside (M&A/IPO) drive returns (plus limited Preferences)

• Deal Capital Forecast: How do we plan to deploy capital over the life of the investment?
• Each fund has a follow-on reserve, a total capital per deal target and a follow-on strategy
• Estimate of minimum ownership / acceptable dilution at exit
• Returns analysis done prior to investing and at each key inflection point
• Quarterly analysis of key financing risks

Interview VCs who are considering investing to understand their model
## CAPITAL STRATEGIES ARE NECESSARILY MISALIGNED

<table>
<thead>
<tr>
<th>Company Capital Strategy</th>
<th>VC Strategy</th>
<th>Angel Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Valuation</strong></td>
<td>Low enough to make money and entice later investors</td>
<td>Low at Angel round, steady increase at later rounds</td>
</tr>
<tr>
<td><strong>Liquidation Preferences</strong></td>
<td>A primary downside protection</td>
<td>Don’t set a precedent enabling a large Preference stack</td>
</tr>
<tr>
<td><strong>Future Financing</strong></td>
<td>Yes: we need to deploy significant capital and back our winners</td>
<td>We hope this is a capital efficient company so that future capital needs are conservative</td>
</tr>
<tr>
<td><strong>Participate in Future Financing?</strong></td>
<td>Yes, and we’re not averse to recapping (and crushing Angels)</td>
<td>Possibly… until our pro-rata becomes unaffordable or unavailable. Weak anti-dilution protection</td>
</tr>
<tr>
<td><strong>Returns Goal</strong></td>
<td>5x-20x+ depending on whether early or late stage VC</td>
<td>10x to 20x+ reward for earliest stage risk</td>
</tr>
<tr>
<td><strong>Exits</strong></td>
<td>Early investor: either M&amp;A or IPO is fine Later investor: we’d better get a nice multiple of our Series C, D, E… price</td>
<td>Near term exits are safer. Longer term exits have more upside but more risk of dilution or cram down along the way</td>
</tr>
</tbody>
</table>

- **Valuation**: As high as possible
- **Liquidation Preferences**: Not if we can help it! Management may demand an exit carveout if preferences smother common
- **Future Financing**: Yes! We need to survive and scale
- **Participate in Future Financing?**: We will ask for an option refresh to counter dilution at each round
- **Returns Goal**: Make our 20% equity pool worth a fortune
- **Exits**: We’re going for the gold—would love an IPO (which also eliminates those pesky preferences) Will accept a high value M&A
AGENDA

1. Introduction: The Rationale for Raising Capital
2. Capital Risk and Capital Models
3. Understanding Your Capital Model by Modeling Your Outcomes
4. Issues to Consider
5. The Agony and the Ecstasy
6. Lessons for Angels
## M&A OR IPO?

<table>
<thead>
<tr>
<th></th>
<th>M&amp;A</th>
<th>IPO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median Invested Equity</td>
<td>$15,550,000</td>
<td>$103,480,066</td>
</tr>
<tr>
<td>Average Invested Equity</td>
<td>$32,128,461</td>
<td>$187,234,858</td>
</tr>
<tr>
<td>Median Value Realized</td>
<td>$100,000,000</td>
<td>$430,000,000</td>
</tr>
<tr>
<td>Average Value Realized</td>
<td>$277,345,485</td>
<td>$1,612,365,342</td>
</tr>
<tr>
<td>MOIC (Medians)</td>
<td>6.5x</td>
<td>4.1x</td>
</tr>
</tbody>
</table>

### Pros
- Manageable Capital Risk
- Higher Return Potential
- Preferences Eliminated

### Cons
- Lower Return Potential
- More Opportunity for Capital Disruption Along Journey
- More financing rounds

**Source:** Raw Data from Crunchbase Pro, excluding non-disclosed M&A transactions and IPO data lacking prior investment information
DEALING WITH VC RISK

The Problem:
• Natural adversaries? Partners? Frenemies?
• The more venture capital raised, the greater the dilution, down round, & pay-to-play risks
• There’s no such thing as a prior round protection. Our angel terms are easily renegotiated and abrogated by later round investors
• VCs love building companies on other people’s money and on recaps
• VC capital strategy sometimes focuses on capital deployment; Angels emphasize capital efficiency. A natural mis-alignment

Remedies:
• Build syndication networks
  • Introduce VCs to your investee company
  • VCs (often) protect angels where there’s a long-term relationship and mutual value-add
• Look for VC buyout opportunities
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A TALE OF UNVARNISHED GREED (MINE)

• 2009: Invested in a radical, small business and consumer, 2 sided business model company in a very hot market. One I knew well. Very reasonable terms.

• Focus: get consumer eyeballs and monetize them via advertising and other indirect (non-consumer pay) revenue

• I participated in two rounds

• Company had metrics success — one 1 of every 6 US residents used the product. Focus on consumer metrics, not bottom-line profit meant a constant need for capital. (10+ rounds)

• Round 9 led by a top brand VC at a valuation of 30x+ my cost. (Visions of buying islands in Greece.) Company became a Unicorn-let.

• Offered the chance to sell my shares a private buyer at 17x my investment—but I “smartly” declined

• By round 11 (8 years after angel round), the market changed:
  • Unicorns were being slaughtered
  • VC sentiment shifted from ‘get big fast’ to ‘get profitable NOW!,’ and from small to mid-tier business. Oops!

• By round 12, Unicorn capital was hard to raise; company recapped at a fraction of its prior value.

• Most likely outcome—M&A—will reduce my former, projected 100x return to 2x due to the large senior preference stack.

• Too much capital can be deadly to angels.
A MORE JUDICIOUS EXAMPLE

• Taulia: Financial services, B2B company
• Told a great story with strong early customers
• Highly competitive, $3.2M Series A syndication deal
• $8.5M Series B, seven months later.
• Series B offered a Series A buyout at 5x Series A price
• Sold half my stake
• 4 years later, raised $27M at $200M valuation
• US White House recommended product to US small businesses everywhere
• Today: have already received 2.5x my $ and still have a valuable stake at exit
MAKING M&A APPEALING TO BUYERS

• 90% of exits since 1990 have been M&A
  • Private equity buyouts are increasing
  • M&A often creates longer-term value than IPO
• The larger the desired outcome, the fewer the buyers
• 85% of Angel exits < $50M (US)
• IPO processes often trigger high value M&A
• Use business development as a “cover” for M&A solicitation
• “We pay what a company is worth to us, not to your investors” – Microsoft
M&A ISSUES

• Threatened stakeholder litigation is a deal killer—clean up your:
  • IP
  • Cap Table
  • Contracts with consultants and advisors
  • Carveouts
  • Buyer Sandbagging
• Board, not CEO, must control exit negotiations—CEO misalignment
• Price, Material Adverse Change (MAC), employee retention
• Escrow, indemnification & division of the spoils are typical deal killers
• Rats crawl out of the woodwork
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ONE RISK MITIGATION STRATEGY: EARLY ANGEL BUYOUT

- **Incubator**
  - $25K - $100K

- **Angels**
  - $0.25M - $2M

- **Series A VC**
  - $2M - $5M

- **Series B VC**
  - $5M - $15M

- **Series C, Corp. VC**
  - $10M - $25M

- **Later Stage VC or PE**
  - $$25M - $150M

- **Joint Development Partner**

- **Venture Debt**

- **Potential VC Buyout**

- **IPO**

- **M&A**

- **PE**
YOUR PERSONAL ANGEL CAPITAL STRATEGY MAY BE DIFFERENT FROM YOUR STARTUP’S STRATEGY

✓ What is in the best interest of a startup or its later stage investors may not be in your best interest. Deal with conflicts of interest responsibly

✓ Cultivate VC partnership to protect your angel equity

✓ An early exit reduces risk of later dilution or cram down
• Model your returns regularly
• Understand your investee company’s capital model and management’s capital strategy
• Don’t confuse your capital strategy with your startup or the follow-on VC’s strategy
• Identify potential mis-alignments and use your collegial Board relations (outside the Boardroom, please!) to help resolve them. Angel Board memberships/observers are critical.
• Actively monitor metrics and milestones
• Capital efficient deals are an angel’s best friend
• Scale your investment to likely sector returns
• Be vigilant: the more rounds (and funding), the greater the risk of your dilution
• Consider reserving $2 - $3 for every $1 invested—but beware that this is debateable!
• VC buyouts are your friend
• Help select follow-on VCs and partner with them, show your value to avoid VC cram down
• Syndicate with other angel groups to reduce VC capital risks
WEISSMAN@BANDANGELS.COM