Exit Strategies for Angel Investors

Northwest Energy Angels
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Qualifiers on This Presentation

- I was a technology entrepreneur
- And now I am a technology investor
- My comments are from that perspective
- Some aspects of financing and exit strategies are different for life science and energy companies
- I am not including ‘public market’ financial strategies until those markets recover

Angel Investing is Still New

- Friends and Family investors have always been an important part of the economy
- But organized angel investing is still new
- The early angel groups got started in 1997
- Angel investing today is where traditional Venture Capital investing was in the 1980s
- We are still discovering the best practices

Not The On-ramp to VC Funds

- Lots of what is written about angels describes us as a "freeway on-ramp" or farm team for traditional Venture Capital funds
- Some Angel groups said that explicitly
- Some Angel Funds were built on that strategy
- That hasn't worked.

Successful Investing

- I’ve learned (expensively) that successful investing requires two things:
- <u>Buying right</u> – investing in the right opportunities using the right structures, and
- <u>Exiting well</u> – getting my money back at a good price and in a reasonable time frame

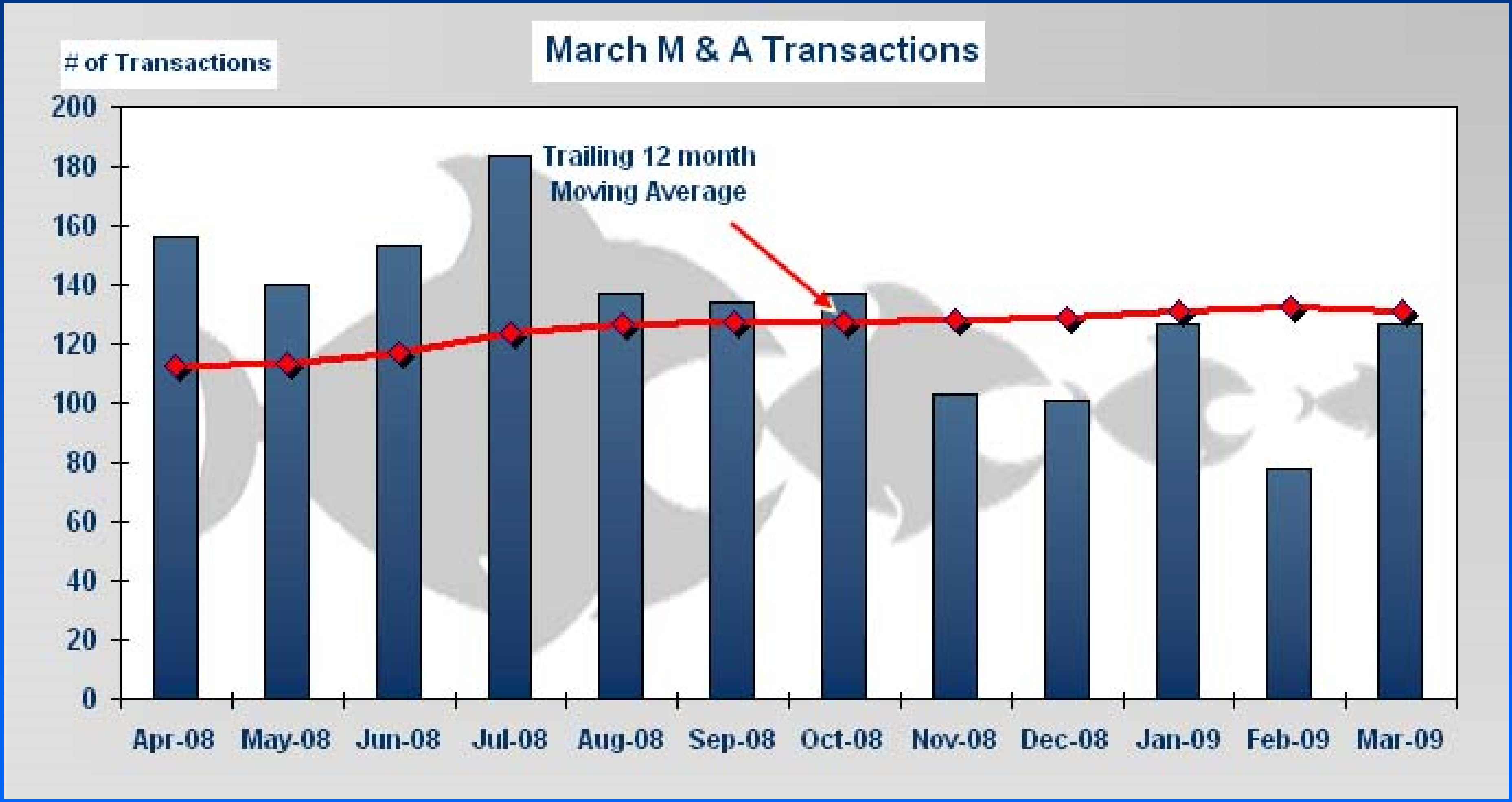
Lots of Doom and Gloom on Exits

- Lots written recently in the mainstream press about the bad news in exits
- IPOs have almost disappeared
- Total M&A transaction dollar volume has fallen by at least a third
- That's true, but it's only part of the story

We Always Hear About The Big Exits

- The media always reports the really big exits
- From my neighborhood, it’s exits like Club Penguin’s $350 million sale to Disney or Bioware’s $800 million sale to EA
- Those exits aren’t happening very often now
- The ‘new’ big story is the large number of smaller exits

Small M&A Transactions



From: Current Environment for Exits by Brent Holliday, Capital West Partners

Most Exits Are Under $20 Million

- Mergerstat database shows the median price of private company acquisitions is under $25 million, when price is disclosed
- But the price is not disclosed in most smaller transactions
- I estimate the median price to be well under $20 million
- And probably below $15 million

Examples of These Exits

- Google bought Adscape for $23 million (now Adsense)
- Google bought Blogger for $20 million (rumored)
- Google bought Picasa for $5 million
- Yahoo bought Oddpost for $20 million (rumored)
- Ask Jeeves bought LiveJournal for $25 million
- Yahoo bought Flickr for $30 million (rumored)
- AOL bought Weblogs Inc for $25 million (rumored)
- Yahoo bought del.icio.us for $30 – 35 million (rumored)
- Google bought Writely for $10 million
- Google bought MeasureMap for less than $5 million
- Yahoo bought WebJay for around $1 million (rumored)
- Yahoo bought Jumpcut for $15 million (rumored)

Why This Is Happening Now

- One of my friends from a Fortune 500 company explained it this way:
  - We (big companies) know we aren’t good at new ideas or startups
  - We basically suck at building business from zero to $20 million in value
  - But we think of ourselves as really good at growing values from $20 million to $200 million or more

Under $20 Million Is Easy

- A company priced at $100 million is already out of our sweet spot
- $100 million also requires board approval
- But at $20 million, it’s really easy for me to get it approved just inside my division

- Many big companies are spending more on M&A than internal R&D
- Today, it’s the best way for them to grow

M&A Exits Are Happening Earlier

- Today it’s not uncommon for companies to be acquired just a couple of years from startup
- Club Penguin, in Kelowna, is a website for 6 to 14 year olds
- It was sold for $350 million cash <u>just two years from startup</u>
- YouTube was also 2 years old when it sold

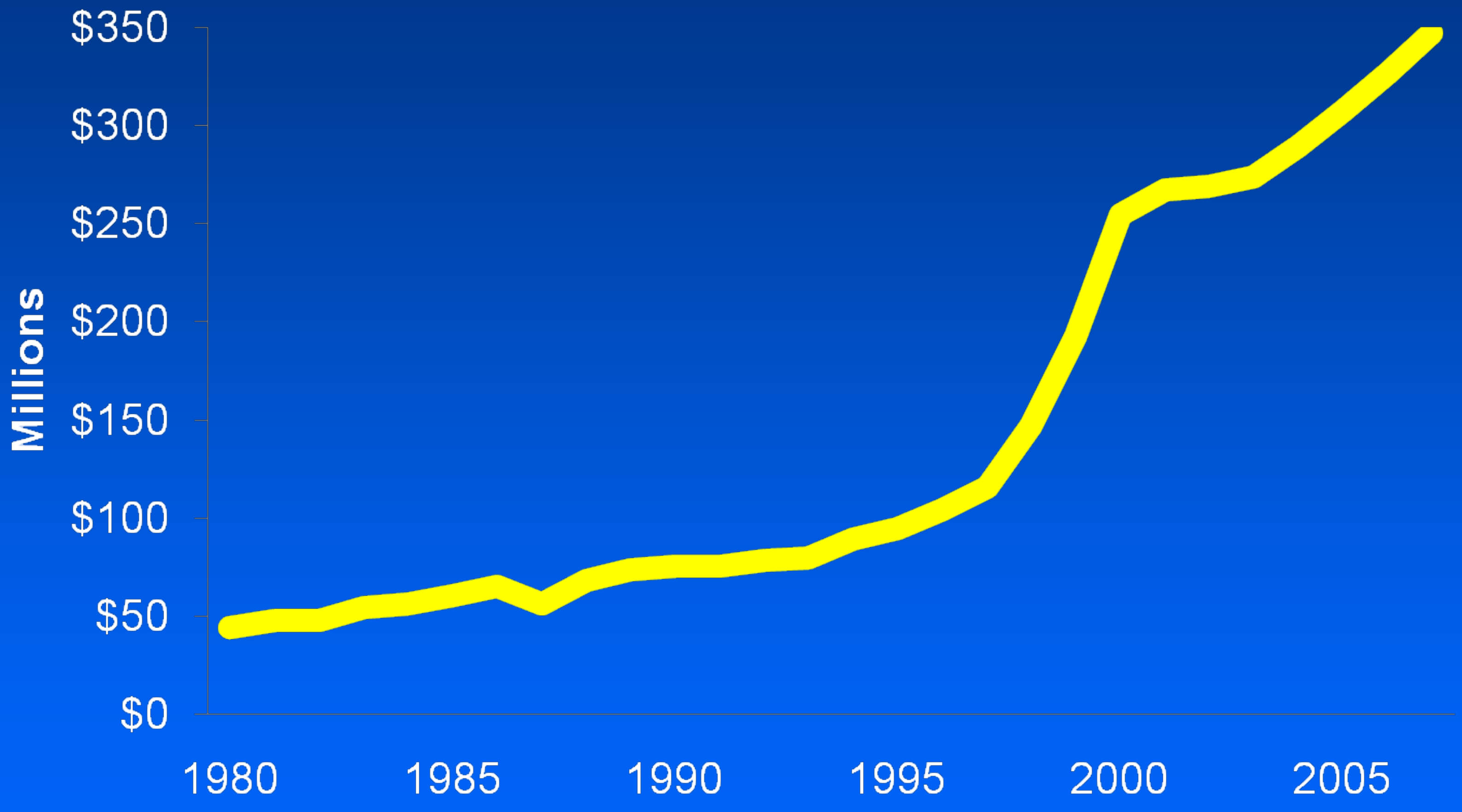
Venture Capital in Crisis

- There is also a lot in the press about how traditional Venture Capital is in crisis
- Big VC funds clearly aren’t working anymore
- Many believe the industry will shrink to less than half its current size
- I believe this is just a healthy correction
- What does that mean for Angels?

Angels and VCs - More Different

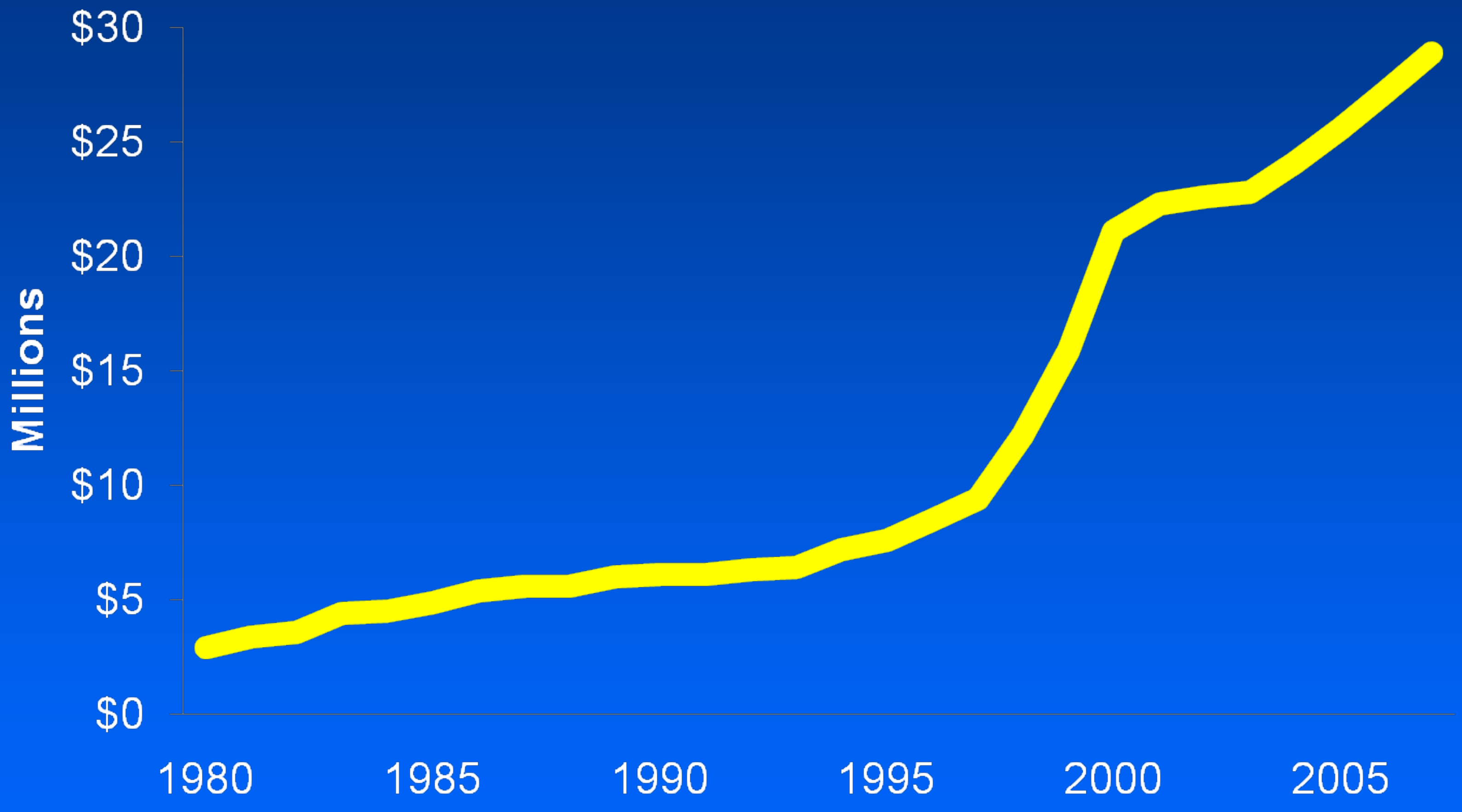
- This new environment is creating a clearer understanding of how different angels and traditional VCs really are
- From an exit perspective, there are three important differences:
  1. Minimum investment size
  2. Minimum return required
  3. Acceptable time to exit

Size of Average VC Firms



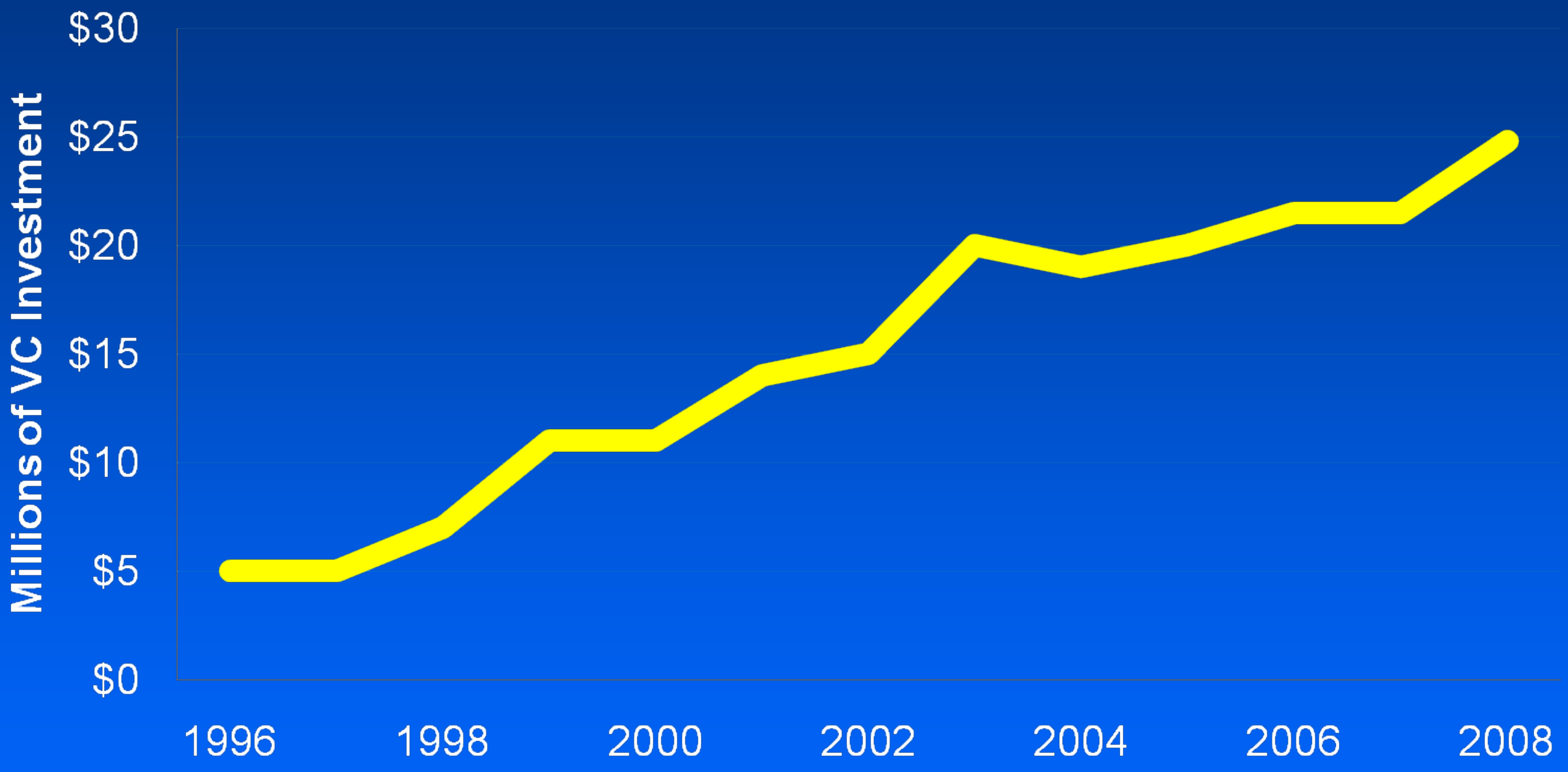
Source: US National Venture Capital Association, Thomson Financial

Average Capital per VC Principle



Source: US National Venture Capital Association, Thomson Financial

VC Investment Prior to M&A Exit



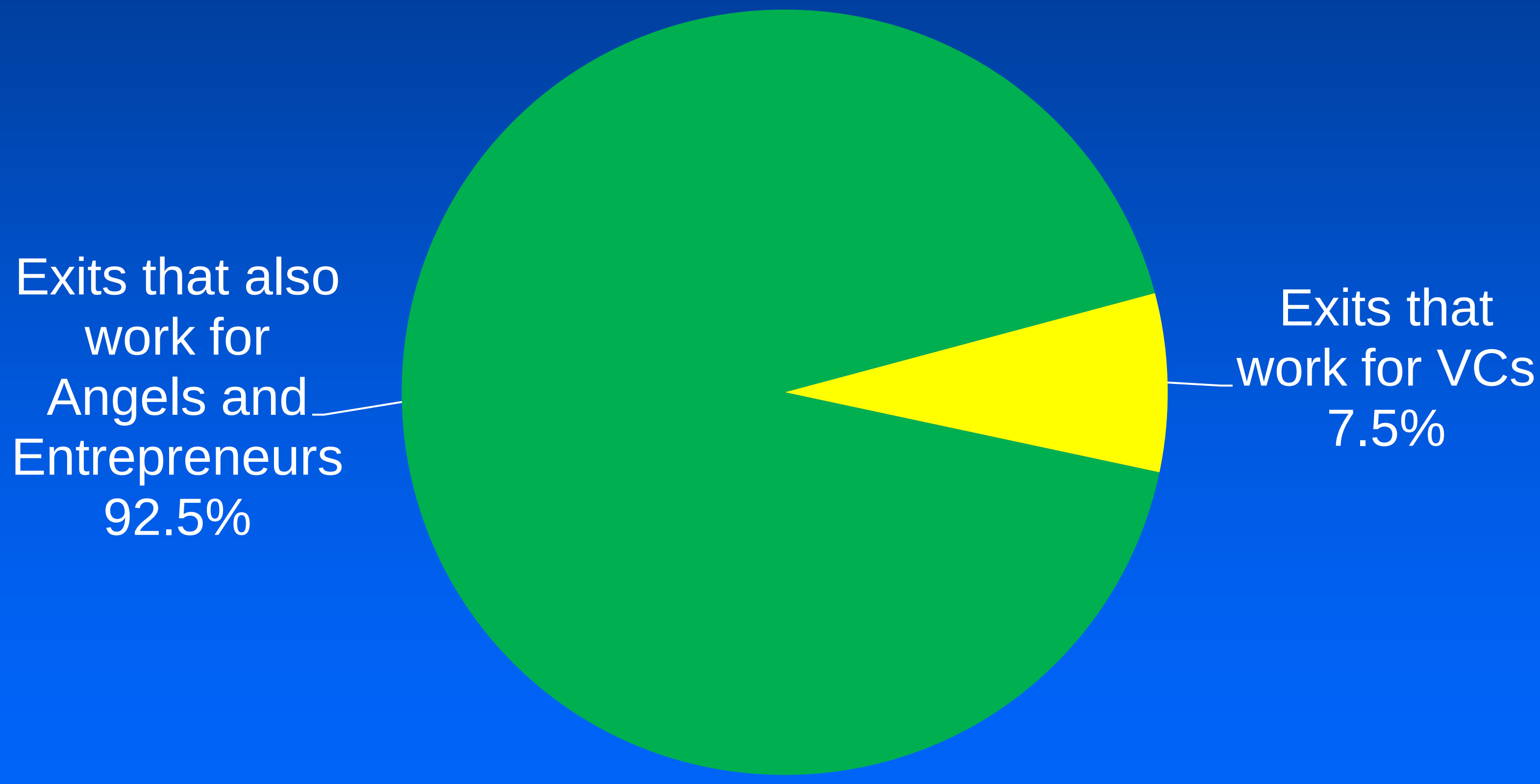
Amount of VC investment prior to M&A exit in millions. 2008 data for Q1
Source: Jeffries Broadview, Dow Jones VentureSource

VC Fund Math

- VC funds have gotten larger and larger
- Can’t write a cheque for under $5 million
- Traditional funds only invest money once
- All fund returns come from 20% of deals
- A VC fund needs a 20% annual return
- Simple math shows that the winners have to produce an <u>average 30x return</u>

92% of Exits Don't Work for VCs

VCs Need Exits over $100 million

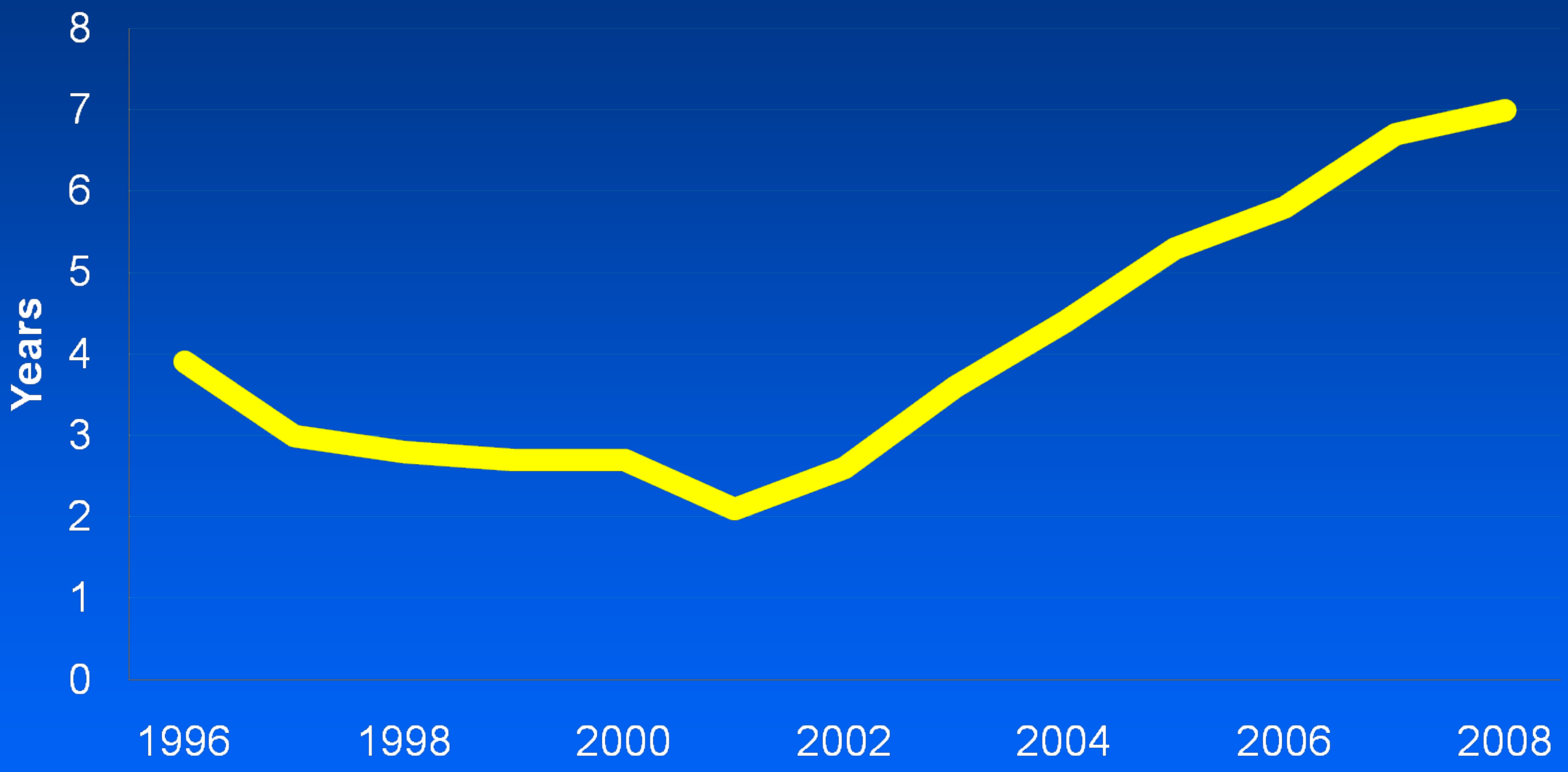


Data from Mergerstat

Additional Years to VC Exit

To achieve a minimally acceptable VC fund return of 20% per year and assuming all of the returns are from 20% of investments

Time from VC Financing to M&A Exit

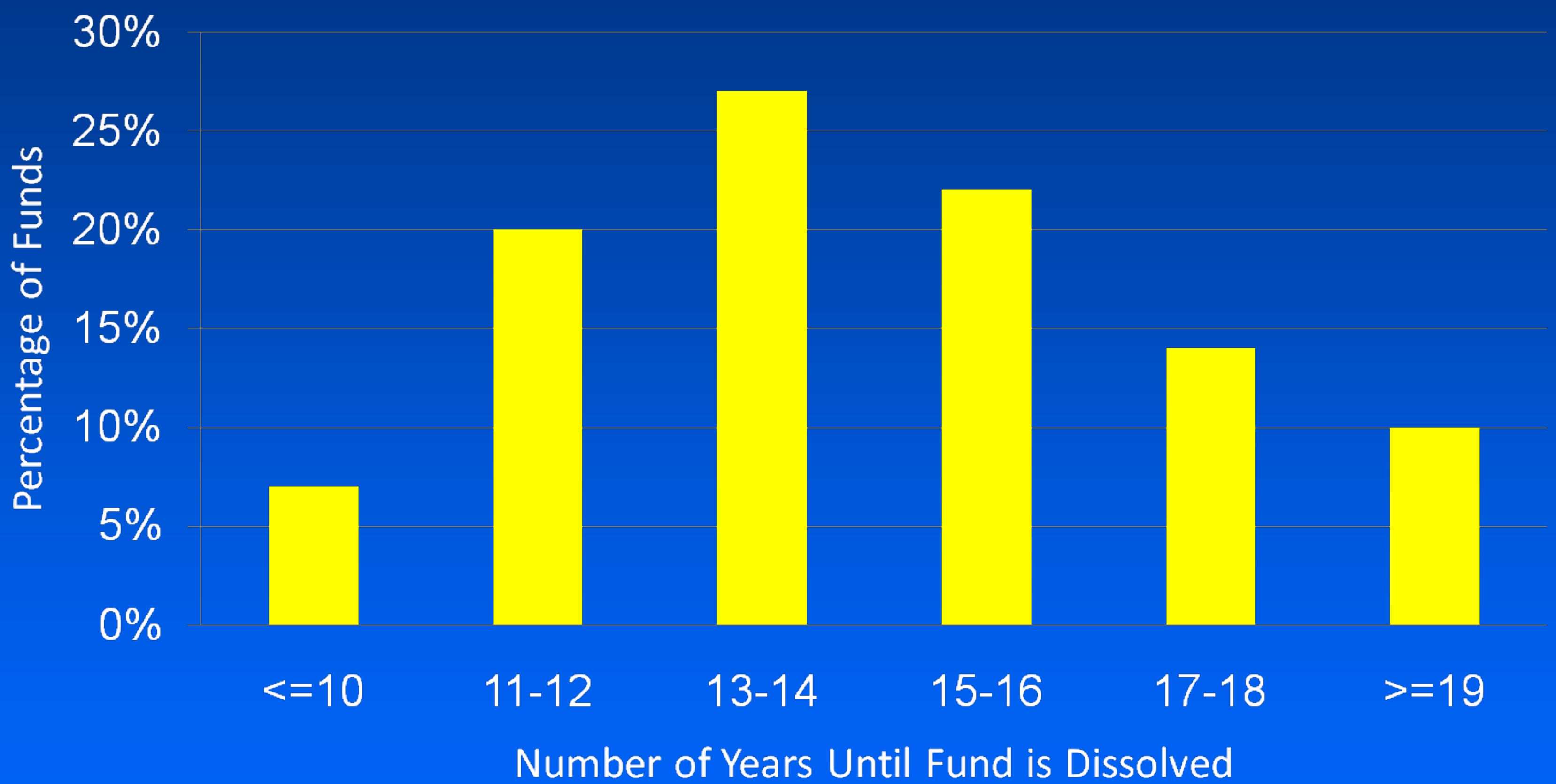


Median Time from initial VC financing to exit in years. 2008 data for Q1.
Source: Jeffries Broadview, Dow Jones VentureSource

What That Means for Angels

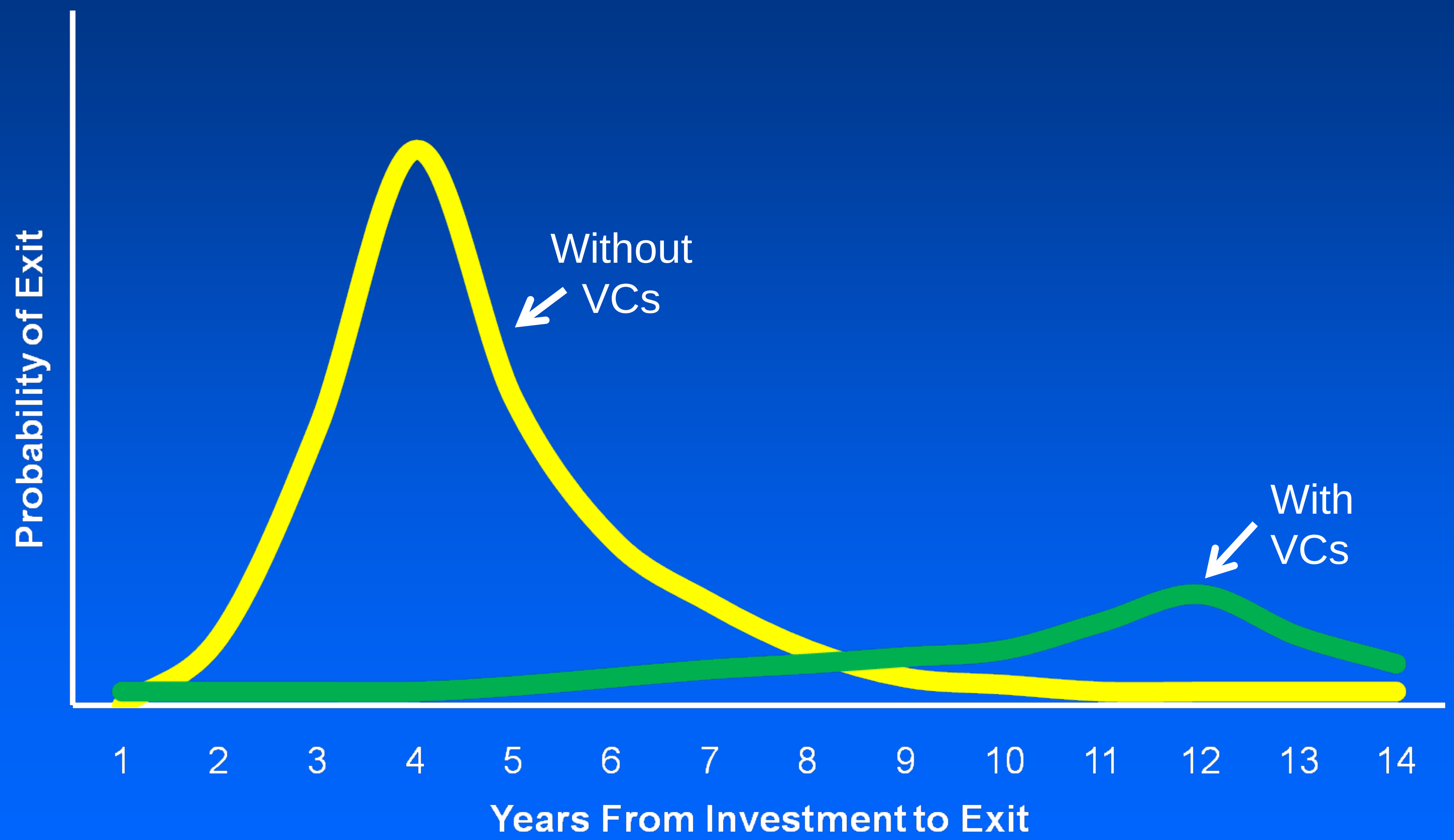
- A median of 7 years doesn’t sound so bad
- But the reality is quite a bit worse
- It’s 7 years across, A, B and C rounds
- A simple model suggests that equates to about 10 years longer for the angels
- At first glance that doesn’t seem possible
- Aren’t most VC funds 10 years?

Lifetime of IT VC Funds



Source: Adams Street Partners 2006 analysis of funds then dissolved. The chart shows the year a 10 year fund was actually dissolved.

Exits Without and With VCs



Angel Investor Math

- Investments as small as $25,000 can make sense
- Returns as low as 300% over a few years are attractive
- Can easily reinvest the gains
- Exit objectives much more aligned with entrepreneurs than traditional VCs

Investor Time Horizons

- VCs can wait a decade or more - and often need to for their math to work
- Angels today increasingly want an exit in 3 to 5 years
- Especially in today’s economy
- Is a fundamental incompatibility between angels and VCs in today’s exit environment

What Happens When VCs Invest

New insights from Wiltbank Data

Source: Robert Wiltbank, Ph.D Willamette University with Funding from the Kauffman Foundation

Angels or VCs But Not Both

- Fascinating new research May 2008
- Unique historical database of 182 Series A deals from the bankrupt Brobeck law firm
- "outcomes are inferior when angels and VCs co-invest relative to when VCs invest alone."
- Angels alone "as likely as the VC-backed firms to have successful liquidity events"
- Optimum is '<u>Angels or VCs but not both</u>'

Angel or VC Checklist

	Angels	VCs
Amount of capital required to prove the business model	Under $5 million	Over $5 million
Years before being able to exit	2 to 5 years	Over 10 to 12 years
Most likely value of the company at the time of the optimum exit	Under $50 million	Over $100 million
Willingness to relinquish control of important financial decisions	Not always required	Almost always required

Resources

- www.Early-Exits.com – book on exit strategies for entrepreneurs
- www.AngelBlog.net – blog for entrepreneurs and angel investors
- www.BasilPeters.com – for this PowerPoint and videos of previous talks