It’s The Angels’ Time

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By Basil Peters

The Economy

- Has changed
- A lot

Lehman Brothers Is Gone

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Max 18C, min 5C

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Lehman collapse sends shockwave round world

hares and oil prices plunge, thousands lose jobs

ry Duncan Economics Editor

ars of a global financial meltdown w yesterday as the world's biggest kruptcy plunged markets into moil.

nvestors were left reeling as the upt demise of the Lehman Broth- investment bank sparked the est shake-up on Wall Street in ades.

nother of US capitalism's biggest tutions, Merrill Lynch, is to be lowed by Bank of America in a billion takeover to save it from pse.

res fell as fear spread through nancial system. Central banks un- urgent measures amid concerns he world economy was entering gerous new phase. The Bank of nd injected £5 billion of emer- lending into money markets. 5,000 Lehman staff in Britain

Dow Jones industrial average was down 300 points, or 2.6 per cent. Sentiment was also bolstered by steep falls in oil prices, which dropped by more than $5 a barrel to $96, closing under $100 for the first time in six months and raising hopes that cheaper fuel would ease economic stresses on Western nations.

However, by close of trading the Dow had fallen by more than 500 points — its biggest one-day drop since the reopening after the September 11 attacks — as concerns mounted over the world's largest insurer. Shares in American International Group (AIG), which sponsors Manchester United, fell by 45 per cent after it made an unprecedented approach to the US Federal Reserve for $40 billion in emergency funding.

Last night the Fed asked Goldman Sachs and J P Morgan Chase, two of Wall Street's remaining big banks, to head a $75 billion emergency package to keep AIG afloat.

As central banks battled to stabilise the system, the Fed eased its rules for emergency lending further. It announced that it would accept company shares in return for crisis loans for the first time. In Frankfurt, the European Central Bank injected €30 billion in emergency funds into eurozone markets.

A group of ten global banks also attempted to foster calm

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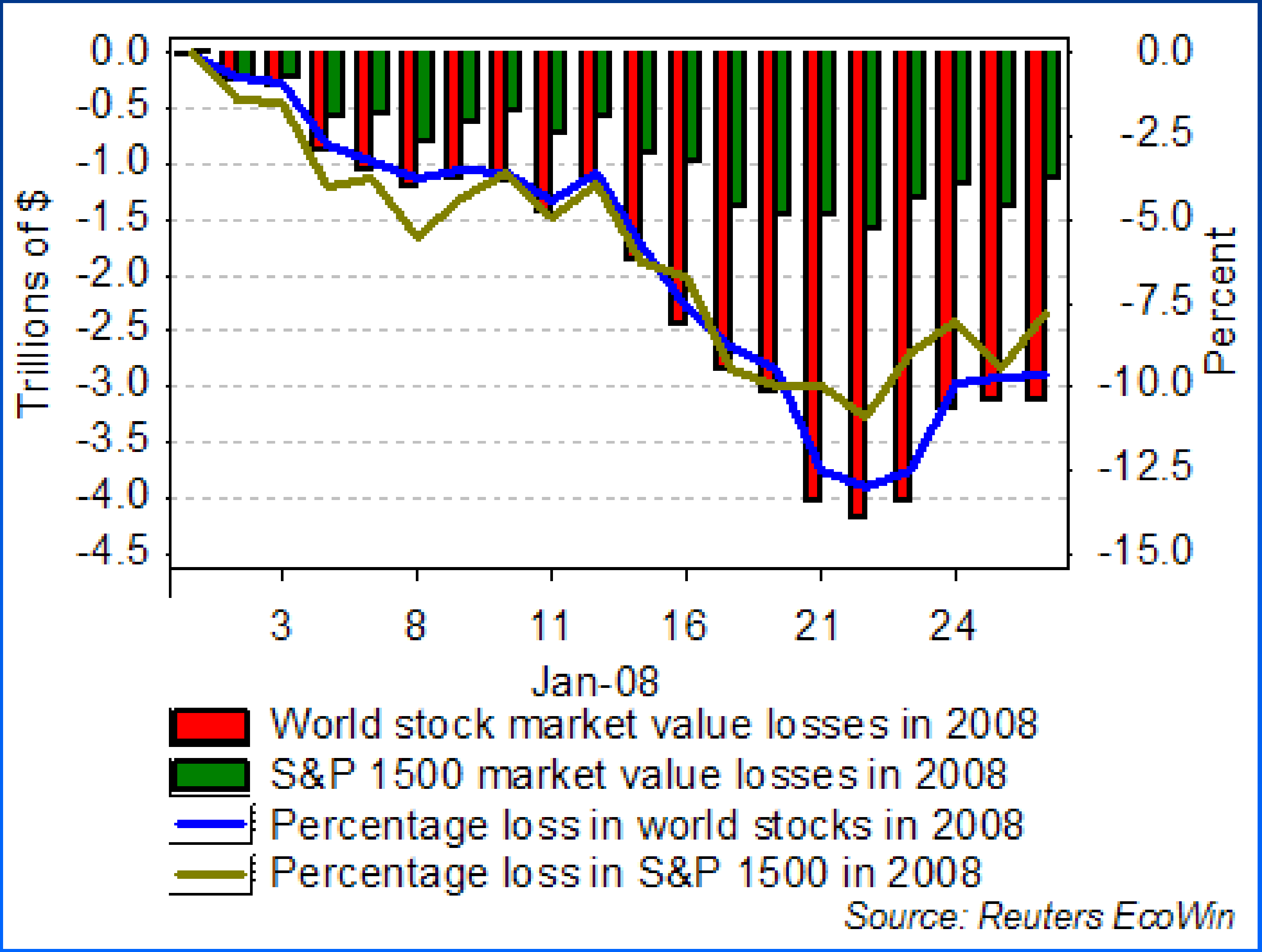
GM is Bankrupt

The Mortgage Crisis

Market Loses Trillions



Today's Crisis is Greece

Venture Capital Is In Trouble

- Many are writing that the traditional VC "model is broken" because:
  1. Today's VC funds are far too large
  2. Too few IPOs and big M&A exits
  3. Today's startups don't need as much money
  4. Big companies see VCs as competitors

Lots Doesn't Work Anymore

- Many big parts of the financial ecosystem
- That worked for many years
- Just don't work anymore
- The economy has changed
- The world has changed
- But it's not all bad news – especially for entrepreneurs and Angel investors

The Good News

- The lower costs of growing startups
- The huge cash reserves in the big companies
- And the numerous other M&A buyers
- The great market for $10 to 30 million exits
- Are combining to create a very good investment environment for
- Angel investors and entrepreneurs

Startups Have Changed

- Startups have also changed dramatically
- In three important ways:
  1. The amount of capital required
  2. How quickly they grow
  3. How fast they can exit

New Startup Economics

- It’ s amazing how little it costs to build a tech company today
- Back when I was an entrepreneur, hardware and software companies cost $10s millions
- That gave rise to the huge VC funds
- Today, entrepreneurs can build companies for $100,000s and in some cases $10,000s
- And it’s happening faster than ever before

Investing in Internet Time

- The internet has accelerated everything
- It allows entrepreneurs to market and sell to hundreds of millions of prospects in just days
- The internet has also accelerated almost every other aspect of the startup lifecycle
- From recruiting to product development
- Entrepreneurs now have “Weekenders” where they build entire companies in a weekend

Weekender Sold in 10 Days

- In 2009 when I wrote “Early Exits”
- I speculated that one day: “They’ll probably define an early exit as selling the company before the end of the weekender”
- That almost happened in November 2009
- A team of entrepreneurs in London built a business in one day and sold it online in ten days: www.24hour-startup.com <– great video
- Not an isolated example, see www.Flippa.com

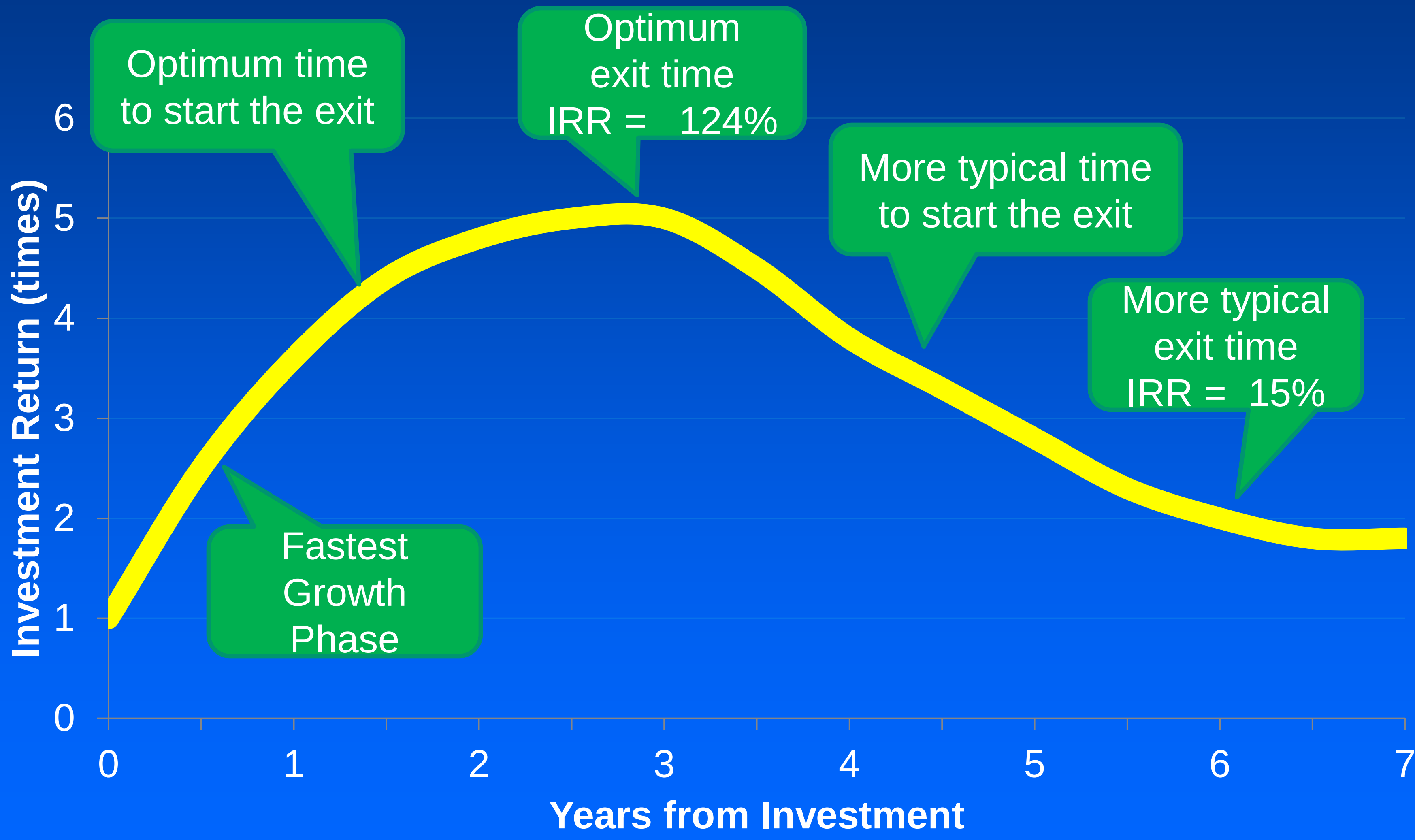
How Early Can You Sell?

- A common misunderstanding about M&A exits is that you have to grow the company to be profitable
- Or grow it to be larger than $X millions of revenue
- The real threshold is to ‘prove the business model’
- For example, prove what a customer is worth and what they cost to acquire

It's Often The Optimum Time

- As soon as you prove the model is often the best time to sell
- Always better to sell on an upward trend
- Sell on the promise not the reality
- Often when you can get the best price
- Very often 'stuff happens'
- Most entrepreneurs wait too long to start

Don’t “Ride It Over the Top”



Exits Can Be Early and Big

- Flickr sold for $30 million at 1.5 years old
- Delicious sold for $30+million 2 years from startup
- Club Penguin for $350 million at 2 years old
- YouTube sold for $1.6 billion at 2 years old
- Playfish sold for $275 million at 2 years old
- Mint sold for $170 million at 3 years old
- AdMob sold for $750 million at 3.5 years old

A Golden Era For Entrepreneurs

- There has never been a time before when
- It was so easy for entrepreneurs to create
- Such valuable companies
- On so little capital, and
- Sell them so early
- For so much money
- All of which is excellent news for Angels

Successful Investing

- I’ve learned (expensively) that successful investing requires two things:

1. Investing Right:
    - In the right companies
    - At the right valuation
    - With the right terms
2. Exiting Well
    - At a good price
    - In a reasonable time

More $ and More ☺

- We spend a lot of time on the investing part
- I believe Angel investors and entrepreneurs
- Would have:
  1. More Fun, and
  2. Make More Money
- If we focused more on our exits

Changes in Exits

- The biggest part of the recent changes in early stage investing is exits
- Big IPOs are very rare
- Big M&A transactions aren't happening very often anymore
- The big news is the large number of small and medium sized M&A exits – under $30 million

Big IPOs Are Very Rare

- There have been very few big tech IPOs
- Not just for the past few years, since the mortgage crisis
- There have been very few since the tech equity bubble burst in 2000
- And it’s not likely that the IPO market will ever return to what it was in America
- Until Sarbanes Oxley is repealed or modified

What About Big M&A Exits?

- The media distorts our perception by focusing on the multi-billion dollar M&A deals, like
- YouTube and Skype
- The dirty secret is those huge transactions rarely work anymore
- And corporate America is figuring that out
- Huge M&As aren’t happening as often either

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

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 businesses 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 to buy
- $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
- It's also what their shareholders want

Google Wants Even Earlier Exits

- I was surprised recently to learn just how early Google wants to do acquisitions
- Charles Rim one of the top Google M&A guys:
- “90% plus of our transactions are small transactions. … less than 20 people, less than $20 million and that is truly the sweet spot”
- “we do prefer companies that are pre-revenue”
- http://www.angelblog.net/Google_Wants_Even_Earlier_Exits_Than_in_Early_Exits.html

Big Companies Have Cash

- Many big companies have so much cash that it’s a problem – shareholders complain
- Google has $20 billion
- eBay has $5 billion
- Amazon has $3 billion
- Yahoo has $3 billion
- Microsoft has $35 billion
- Apple has $25 billion

Big Companies = VC Competitors

- Another fascinating new development
- Big company corporate development and M&A teams now consider VCs their competitors
- Big companies have lots of cash
- And don’t see VCs as adding a lot of value
- They know VCs will hold on for huge exits
- So their strategy is to acquire the good companies before the VCs can invest

Lots of Other M&A Buyers

- The most familiar buyers are Fortune 500 companies
- But medium sized companies are also aggressive buyers – especially public ones
- Private Equity funds are also coming back into the market now that debt is available
- Also many individuals not ready to retire
- The M&A market under $30 million is healthy

Angels Are Beneficial Investors

- Entrepreneurs are having a good time
- Most still need investors
- Many are starting to really appreciate Angels
- We have always believed we were better choices than traditional VCs
- And just in the past few years we have some excellent academic research to prove it

Angels or VCs But Not Both

- Fascinating new research May 2008 from the University of Maryland Business School
- 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”
- I believe current data would favor the angels

Angels, VCs and IPOs

- 2009 research report by Jeffrey Sohl from the University of New Hampshire
- Analyzed 665 IPOs from 2001 to 2007
- 13% had only angels, 33% only VCs, 16% both
- VC backed firms had “higher underpricing”
- “Angels’ incentives are more closely aligned with pre-IPO shareholders”
- “managers may prefer to obtain early stage financing from Angel investors”

More Validating Research

- April 2010 research report by Kerr and Lerner from the Harvard Business School
- Assisted by James Geshwiler, Warren Hanselman, Richard Sudek and John May
- “Angel funded firms are significantly more likely to survive at least four years and to raise additional financing”
- “Angel funded firms are also more likely to show improved venture performance and growth”

Angel Syndication

- Just a couple of years ago, the conventional wisdom was that angel investment topped out at around $2 million per company
- ACEF and ACA started talking about co-investment just a couple of years ago
- Now I regularly see groups of angels investing <u>$5 million to $10 million</u>
- More than enough <u>for 99% of today's startups</u>

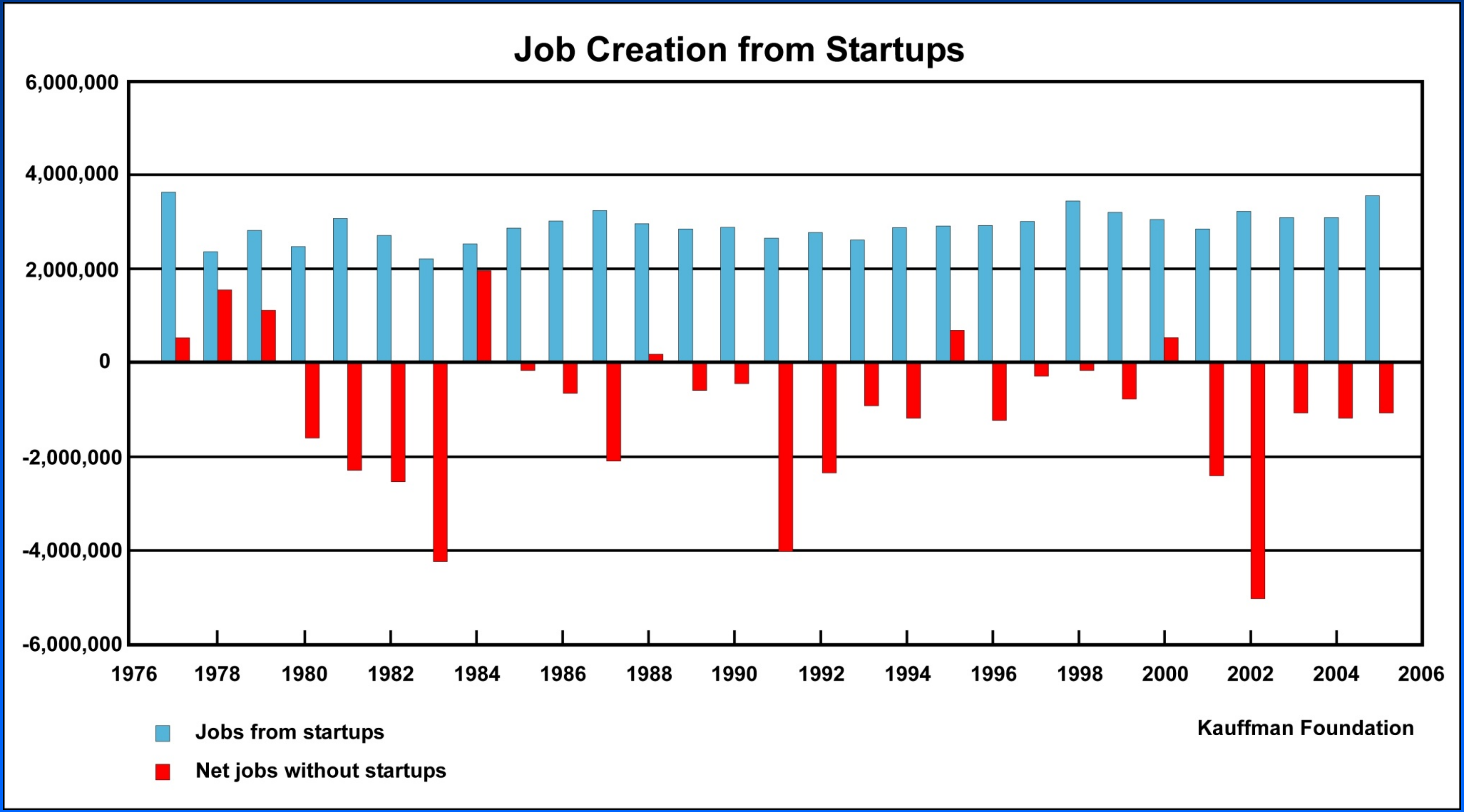
Why Syndication is Working

- Syndication is starting to work
- I think it’s impressive and encouraging
- The reasons:
  1. The ACEF educating us
  2. The ACA connecting us
  3. Angelsoft helping us share information

Who Actually Finances Startups?

- The majority of entrepreneurs still believe traditional VCs finance most startups
- Probably due to the NVCA’s PR program and lobbying efforts
- The data shows that Angel Investors finance 27x more startups than traditional Venture Capital Funds
- More at: www.AngelBlog.net/Angels_Finance_27_Times_More_Start-ups_Than_VCs.html

Startups Create ALL The Jobs



Our 21st Century Economy

- What works today:
  1. Startups innovate and create jobs
  2. Angels, Friends and Family finance them
  3. Big companies, and others, buy them early
  4. The buyers then grow the business
  5. Entrepreneurs and Angels recycle the gains

Let’s Be Honest With Ourselves

- Lot’s of you are thinking it
- OK, I am going to say it…
- Yes, most angels have lost money
- The best data we have shows that the majority of angel investors have yet to make a return
- But that is not surprising

Why Most Angels Have Lost $

- Learning to be a successful investor is not easy!
- How many of us have invested in convertible notes when it should have been equity?
- How many have used a ‘heavy pref’ term sheet?
- How many have simply paid valuations that were too high?
- How many have encouraged VCs to follow on when that wasn’t the best strategy?
- How many exited far too late?

Why That's All Changing Now

- Just in the last few years, that's all changed
- I remember just 5 to 10 years ago seeing lots of entrepreneurs pitching pre-revenue pre-money valuations at $5 or 10 million
- Even worse, I remember many of us angels investing at those valuations
- The big change?
- The ACEF and Angel Groups = <u>Angel Education</u>

What Angels Used To Think

- In the past, most angel investors would:
  1. Find a company
  2. Write a check
  3. Hope a Venture Capital fund followed
  4. Wait 10 to 15 years for an exit
- That might have worked in the ‘90s
- But it doesn’t work anymore

‘New’ Angel Model

- Find promising companies, do due diligence
- Check the founders alignment on the exit
- Term sheet designed to facilitate the exit
- Possibly syndicate with other groups
- Ensure they won’t accidentally take VC money
- Work with the company as a financial partner
- Exit in 3 to 5 years

Angel Investing Is Still New

- Organized angel investing is still quite new
- The early angel groups started around 1994 - 97
- Angel investing today is where traditional Venture Capital was in the early 1980s
- We are still discovering the best practices
- Still don’t have anywhere near enough hard data
- That’s why meetings like this, and associations like the ACA and ACEF are so important

Angels are Much Smarter Today

- I still remember the first time I watched Bill Payne present the ACEF Power of Angel Investing
- It wasn’t until I’d seen that presentation two or three times that all of the lights finally went on
- And I can see the difference in my fellow angels
- We are much more sophisticated than we were just a few years ago
- And much easier to co-invest with

Angels are Making More Money

- Not having better data is very frustrating
- If we had the data, I am confident we could see our investment returns increasing – especially for angels who belong to groups
- I just know these better decisions are <u>already</u> leading to better results in our portfolios
- It will take a while for there to be enough data for us to measure the improvements
- In the meantime, let’s keep getting better

The Professional Angel

- At the Northwest ACA Regional meeting in Seattle in March
- Dan Rosen, the Chair of the Alliance of Angels, said something that stuck with me
- Before his talk, he introduced himself
- A “Professional Angel Investor”
- And I think a very good term to describe what we are all working to be part of here

The Enormous Opportunity

- Only 3 to 4 % of Angel investors belong to an angel group
- We've all seen that statistic
- I've seen it myself in local cap tables
- I'm convinced that when get the data we'll see that <u>Angels who belong to groups make much better investment decisions</u>
- I think the big opportunity is connecting us all
- And helping everyone learn to be better investors

What You Can Do To Help

- Invite more angels to join your groups
- Commit some time to contribute your groups
- Encourage your groups to host ACEF education events
- Get involved with syndication and learn from other groups
- Encourage other groups, funds and angels to join the ACA

What We Are Doing Is Important

- It’s angels, not VCs, that finance today’s startups
- These startups will provide the jobs for our children and our grand children
- The economy needs more, and better, Angels
- We are making a difference
- We saw how many here are from outside the US
- What’s happening here is important for the future
- Not just in America – but all around the world

Thank you