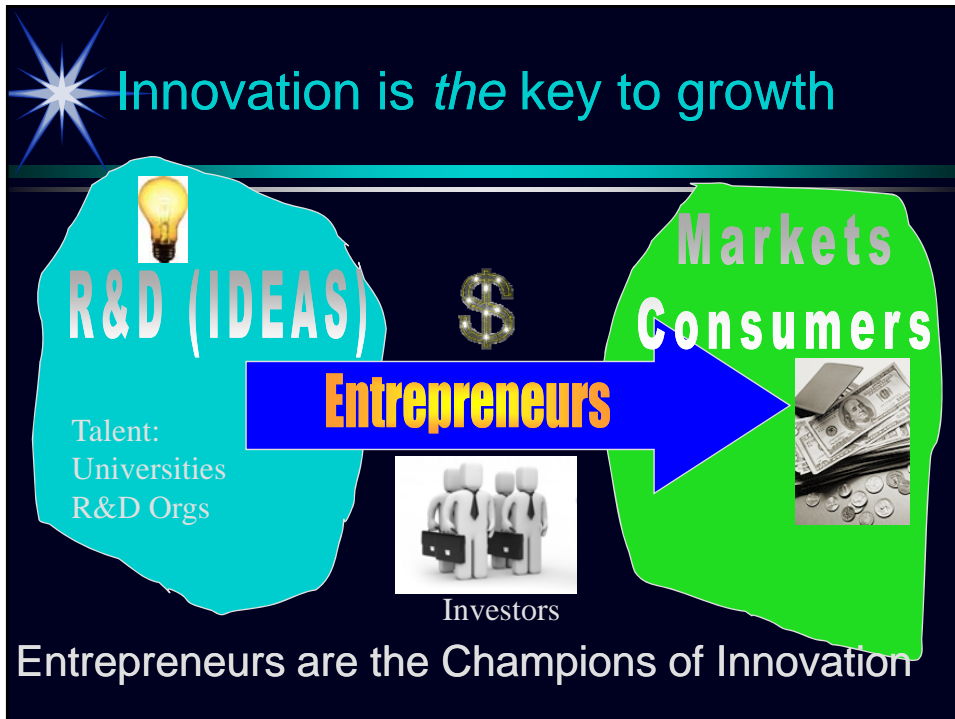


Connecting with Angel Investors

3 Apr 2013

SFU

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Innovation Office
Simon Fraser University



But First – What's the Business Case?

- What are you selling?
- Who will buy it? (and why?)
- How will you make money?
- What do you need to proceed?

- SEE FREE DOWNLOAD:

www.mikevolker.com



The Elevator Pitch

It's easy! Just fill in the blanks:

We, (Company) _____, are (doing?) _____ for
(who?) _____ who need (address what
pain?) _____ that unlike (existing
solutions) _____ will (do what?) _____ unlike
_____ (competitors). We will generate \$ ___ in sales
by _____ with a net profit margin of ___%

Example:

*We, Ace Corp, are making a personal GPS tracker for
parents who need to know where their children are that
unlike cell phones and other devices will, via a web browser,
provide real-time location, speed, and path information. We
will generate \$7.5M in sales in our first 3 years with 12%
Net Profit before tax..*



The Investor Pitch

It's easy! Just fill in the blanks:

We, (Company) _____, require (\$\$) _____ for
(what) _____ in return for ___% of the Company. Our
plan is to be acquired by (name some): _____ in
____(year) for \$ _____ million to give you an IRR of ___%.

Example:

*We, Ace Corp, require \$500K mainly for production tooling
& hiring sales staff in return for 30% common shares. Our
plan is to be acquired by Polycom for \$15M in 2017. This
will give you a 5X return in 5 years (ie IRR=38%).*



The Deck



➤ See NVBC Slides:

http://www.newventuresbc.com/docs/Volker_2012.pdf

➤ See VANTEC SLIDES:

<http://vantec.ca/pages/vantec-guidelines-for-entrepreneurs>



It's all about P&L:

What are you selling, who will buy it, how much will you make?

(Profit & Loss & CASH FLOW)

Why you and your team?
(Passion & Leadership)



| | MONTH#1 | MONTH#2 | MONTH#3 | ... | FYTOT: |
|--|---------|---------|---------|-----|----------|
| GROSS REVENUE (\$): | 11200 | 27720 | 54886 | ... | 2162713 |
| COST OF GOODS SOLD: | 7680 | 19008 | 37636 | ... | 1483003 |
| GROSS MARGIN: | 3520 | 8712 | 17250 | ... | 679710 |
| EXPENSES: | | | | | |
| Sales: | 9060 | 8167 | 12222 | ... | 199954 |
| R&D: | 1100 | 867 | 1022 | ... | 92044 |
| G&A: | 1100 | 1267 | 1322 | ... | 93944 |
| TOTAL EXPENSES: | 11260 | 10300 | 14567 | ... | 385942 |
| NET PROFIT (BI): | -7740 | -1588 | 2683 | ... | 293768 |
| (The following rows have been added for CASHFLOW purposes..) | | | | | |
| CASH FLOW #1 (\$): | | | | | Month#7: |
| Open Balance: | 0 | -7680 | -26748 | ... | |
| + Cash from Sales: | 0 | 11200 | 27720 | ... | |
| - Cash re Expenses: | 0 | -11260 | -10300 | ... | |
| - Cash for Prodn: | -7680 | -19008 | -37636 | ... | |
| = Closing Cash: | -7680 | -26748 | -46964 | ... | -106384 |

THIS is a cashflow forecast

This?

- receive production supplies 3 months (not 1 month) before shipping
- receive payment from customers in 2 months (not 1 month)

Cashflow#2 rows now replace the Cashflow#1 rows to produce the following spreadsheet details:

| | | | | | Month#10: |
|---------------------|--------|---------|---------|-----|-----------|
| CASH FLOW #2 (\$): | | | | | |
| Open Balance: | -26688 | -64324 | -142651 | ... | |
| + Cash from Sales: | 0 | 0 | 11200 | ... | |
| - Cash re Expenses: | 0 | -11260 | -10300 | ... | |
| - Cash for Prodn: | -37636 | -67067 | -97750 | ... | |
| = Closing Cash: | -64324 | -142651 | -239501 | ... | -721842 |

Or This?



Business Plan Reality Checks

- Beware the Hockey Stick Curve!
Fact: 0.5% of startups (8,849 in US)
achieved \$50 million sales in 6 years
- Define the Market Precisely:
Kiss of Death:
“we will get 1% of the market”
Goal:
Own Your Market (read Regis McKenna)



SOURCES (Life is a Rainbow)

(refer to: hitechbc.com - “Money Links”)

- **GOLD**
“free” money - grants, handouts
e.g. SR&ED, IRAP, IC, WD, Suppliers, Customers
- **GREEN**
“patient, growth” capital
e.g. Love Money, Angels, VC’s, Public
- **RED**
“debt” capital
e.g. Banks, Debentures, Leases, credit cards



Leverage Your Resources...

Financial Strategy:

Use Equity Capital for Sales & Operations
(salaries and non-asset expenses)

Leverage your R&D Dollars
(mainly technical salaries)

Use debt for Asset financing
(don't buy it if you can finance/lease it)



Getting Popular: The “Note”

www.mikevolker.com/ConvertibleNotesDiscussion.pdf

ATLAS ACCELERATOR **Convertible Notes**
Author: RM Ciol, Managing Director
April 2012 (revised)

Convertible Notes, When to Use Them, How to Structure Them and Why Investors Hate Them

Ahhh, convertible notes. So easy to use, such a comfortable way to avoid the “U” discussion (valuation), so simple to understand. But why aren't they universally loved?

Convertible notes are generally unable to overcome their fundamental shortfall in the inadequate return they offer to investors. Let's think about the annualized return most investors seek. Investors set out to achieve about a 10x return in their successful early-stage deals. It takes about four to five years to get that return so about 2x per year is required on average.

Another rule of thumb we hear is the steady 10% of 50% per year. This appears to be a reasonable goal for many investors and, with compounding, achieves about an 8x return over five years.

So, here's the problem – notes just can't offer returns that equity can. In the rest of the banking/investment world, creditors gain a more secure position than equity but that's cold comfort to a startup investor. Having been around many failed startups, I can attest to the surprisingly limited value of the remnants of a failure – PCs sold on eBay, IP that nobody wants – it's disappointing. If you invest with a convertible note in an early-stage company, you're taking all the risk of an equity investor.

Investors who buy convertible notes as first money in start-ups without a clear plan (e.g. company is in diligence with the investors for the next round) to trigger the conversion are taking all the risk an equity investor would take but without the reward. In the discussion on terms below, you'll see that note authors can address the consideration problem.

True convertibles are different. This is a convertible note issued when the note will likely convert in under nine months. They're particularly appropriate when the issuer needs to extend cash-flow negative operations for a few months while diligence is concluded or while the business completes a transition to profitability. In cases where you can see a clear path to conversion, investing in a note is just added consideration for an investment you'll make anyway. This is a great reason to invest in a note.



Innovation Incentives (B.C.)

- SRED tax credits: up to 68% - Good as Cash!
- NRC-IRAP, ICE Fund, STDC, NSERC I2I, etc
- 30% VCC Tax Credit (Combine with RRSPs)
- Example: Fusion Energy Ventures (VCC) Inc



What's An Angel?

ANGEL: a term borrowed from Broadway
(successful “stars” helping “starlets”)

Key characteristics of Angels:

1. Been there, done that (entrepreneur, CEO)
2. Invests Own Capital, \$25K-\$1M+ (no agents, no OPM)
3. Millionaire (excl. home) legal term: “Accredited Investor”
4. FAST!
5. Minority, 1% of population





What about the other 99%?

That's why

CROWDFUNDING is such a HOT TOPIC

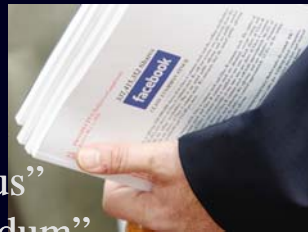


The Law (BC Securities Comm)

It is **ILLEGAL** to sell shares to anyone unless...

- they are close friends/family
- they are accredited (angels)
- they will invest at least \$150K
- you go public with a "Prospectus"
- you use an "Offering Memorandum"

only permitted in a few Provinces
this is very close to permitting crowdfunding
(equity crowdfunding is still illegal)



But, Gambling is OK



But, you can't gamble on a less risky new venture!
FACT: 3 of 4 ventures fail, so why bet on them?
(when you can get one in a million? haha)

Non-Equity Crowdfunding is OK

The image shows a screenshot of a Kickstarter project page for 'Pebble: E-Paper Watch for iPhone and Android' by Pebble Technology. The page includes a navigation bar with 'KICKSTARTER', 'What is Kickstarter?', 'Discover great projects', 'Start your project', a search bar, and 'HELP SIGN UP LOG IN'. The project title is 'Pebble: E-Paper Watch for iPhone and Android' by Pebble Technology. It shows 'Home', 'Updates 20', 'Backers 68,929', and 'Comments 8,393'. A green banner states 'Funded! This project successfully raised its funding goal on May 18.' Below this, there are three smartwatches: a grey one showing '28:56', '4.08mi', and '7:05'; a red one showing 'twelve thirty five'; and a black one showing a clock face. A 'PLAY' button is overlaid on the red watch. To the right, a funding progress bar shows '68,929 backers', '\$10,266,845 pledged of \$100,000 goal', and '0 seconds to go'. The project is by Pebble Technology.

What about Venture Capital?

- * Much less capital available – reserved mainly for later stage
- * Emergence of Super Angels (e.g. megamillionaires)
- * Formation of StartUp Funds
 - eg GreenAngel (TSX-V)
 - WUTIF
 - E-Fund
- * It's not for you
(not yet, anyway)



Who invests in these funds?

GreenAngel (TSX-V): www.greenangelenergy.ca (pubco)

WUTIF: www.wutif.ca (offering memo)

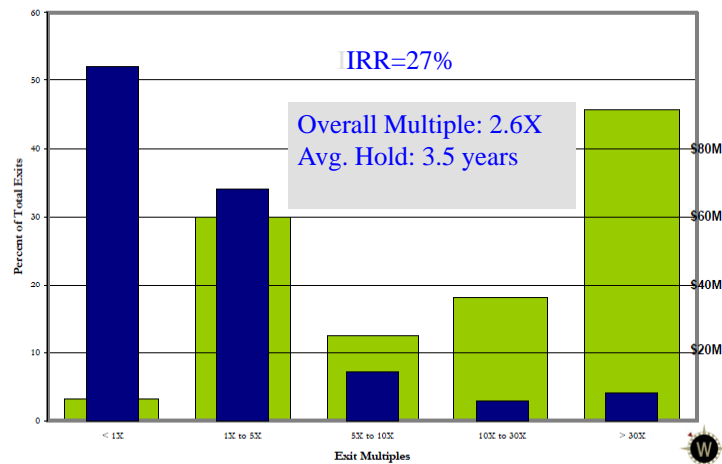
E-Fund: www.e-fund.ca (angels only)

WHY? ANGEL RETURNS?

THESE ARE A FORM OF CROWDFUNDING

Angel Investing 101

Distribution of Returns by Venture Investment



Study by Rob Wiltbank, Willamette Univ.

What Angels Want

(or...how to stand out from the crowd)

- Fun
- Interesting Opportunity
- A willing protégé
- To use their resources & connections
- Attractive Return:
10X to >>100X
- 3 I's: Intensity, Integrity, Immediacy (in the person)
- 3 G's: Goodness, Greatness, Greed (in the company)
- An "EXIT" – a way to cash in and get out!



The Angel Network (VANTEC.ca)

Check it out:

www.vantec.ca



New in B.C.: Keiretsu Forum

www.keiretsuforum.com

The screenshot shows the Keiretsu Forum website with the following content:

KEIRETSU FORUM
"Great Association With Quality Deal Flow"

Home | Contact | FAQ

About Us | For Investors | Calendar | Apply to Present | Sponsors | Portfolio | Charitable | Academy | Career

Keiretsu Forum is the world's largest angel investor network, with 1,000 accredited investor members throughout twenty-one chapters on three continents. Since Keiretsu Forum's founding in 2000, its members have invested over \$400m in companies in technology, consumer products, healthcare/sciences, real estate and other segments with high growth potential. Forum members collaborate in the due diligence, but make individual investment decisions, with rounds in the range of \$250k-\$2m. Keiretsu Forum's community is strengthened through education on angel investing, as well as charitable giving. Forum members have donated over \$1m to over 100 non-profit organizations.

Keiretsu Forum Chapters:

- Barcelona
- Boise
- Beijing
- Bellevue/Eastside
- East Bay (Founding Chapter)
- Istanbul, Turkey
- London
- Los Angeles
- Madrid
- Mid-Atlantic
- Orange Co.
- Paris
- Portland
- New York/Tri State
- North Bay
- San Diego
- San Francisco
- Seattle/Northwest
- Silicon Valley
- Westlake Village



Valuation Rules of Thumb

- Revenue multiple (too broad; industry specific) and/or Cash Flow (usually not applicable to startups)
- Based on size of round: 3X to 4X investment (\$500K Round implies a \$1.5M-\$2M valuation)
- Exit Value (Negotiate 1/10 to 1/30 of Exit Value)
- Based on IP and other assets



Valuations

Dividing the Pie:

Even more difficult than the investment valuation question is the start up cap table.



“Typical” Cap Table

| CAP TABLE | | | | | |
|---------------|------------|--------------|--------------|----------|-------|
| | StartUp | Angel Round | VC Round | Exit | Gain |
| Founders/Mgmt | \$0 (100%) | \$0 (75%) | \$0 (37%) | \$11.25M | 1000X |
| Angels | | \$250K (25%) | \$250K (12%) | \$3.75M | 15X |
| VCs | | | \$3M (50%) | \$15M | 5X |
| Market Cap | \$0 | \$1M | \$6M | \$30M | |

XL template on <http://wutif.wordpress.com/entrepreneurs/>



The Terms Sheet?

- **Offering:**
Common vs Conv Deb vs Prefs
- **Valuation:**
Trading cash for futures
Use accretive approach for performance
- **Vesting for founders:**
50% Linear over 3-4 yrs
50% on liquidity event
- **Capital & Structure:**
avoid options – use trust shares
- **Governance:**
board rep/independence
- **Shareholders Agreement:**
standardize

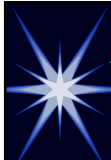
| A) Terms of Offering for WUTIF | |
|--------------------------------|---|
| Company: | Company Inc. (the "Company") |
| Offering: | 10,000 Shares at \$1.00 per unit, each unit consisting of one Common Share without par value and a Warrant to purchase one additional common share at a price of \$1.25 on or before two years from the date of issue. |
| Price per Unit: | \$0.00 |
| Amount: | \$100,000.00 |
| Offering Jurisdiction: | The Offering will be sold in the Province of British Columbia. |
| Tax Credits: | Company is an Eligible Business Corporation and an Eligible Small Business under the terms of the British Columbia "Venture Capital Corporations" ("VCC") Act. |
| Exemptions: | The Offering will utilize all appropriate and available exemptions from prospectus requirements. |
| Closing: | Closing shall take place within 60 days (55 days of the date when Company has raised, subsequent to Sept 15, 2004, additional financing of \$150,000 and has provided evidence of such financing satisfactory to WUTIF. |
| Anti-Dilution: | Holder of this round of common shares, as well as investors in all previous rounds of common and preferred shares in Company, will be protected with normal industry standard anti-dilution provisions until December 31, 2005. |
| Audit Requirements: | Company shall provide audited financial statements beginning from the year ended December 31, 2004. |
| Board Participation: | WUTIF shall be entitled to nominate one director on the Board of Directors. |
| Voting: | Each common share will be entitled to one vote. |
| Dividend: | No provision has been made for the payment of any dividend for the foreseeable future. |

See mikevolker.com for sample.



Venture Capital Method

- Investment \$1 million
- Exit Year 5th year
- Revenue (Yr 5) \$20 million
- Net Profit (Yr 5) \$2 million (10%)
- P/E (industry) 15X
- Company Value \$30 million
- ROI Req'd 60% (i.e.10X)
- Exit Proceeds \$10 million (10 X \$1 m)
- % ownership 33%
- Pre-\$\$ Valuation \$2 million. (\$3M post)



Valuations are Market Driven

- Exit Values drive current valuations
- Wiltbank Survey: 2.6X in 3.5 years (28% IRR)

MULTIPLES vs IRR:

2X in 5 years = 15%

5X in 5 years = 38%

10X in 5 years = 58%

10X in 10 years = 26%

50X in 10 years = 48%

100x in 5 years = 151%



Recent Trends

- valuations are lower than most people believe (only 36.4% are valued at more than \$1 million)
- pre-money valuations are inching up again from \$1-\$2 million to \$2-\$3 million. Median Value at \$2.7M up from \$2.5M (last 2 Qtrs)
- Of all companies, about 60% of start-ups survive to age 3 and roughly 35% survive to age 10 (Kauffman Foundation)
- 3 out of 4 venture-backed firms in the U.S. don't return investors' capital (Shikhar Ghosh, Harvard Bus. School)



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