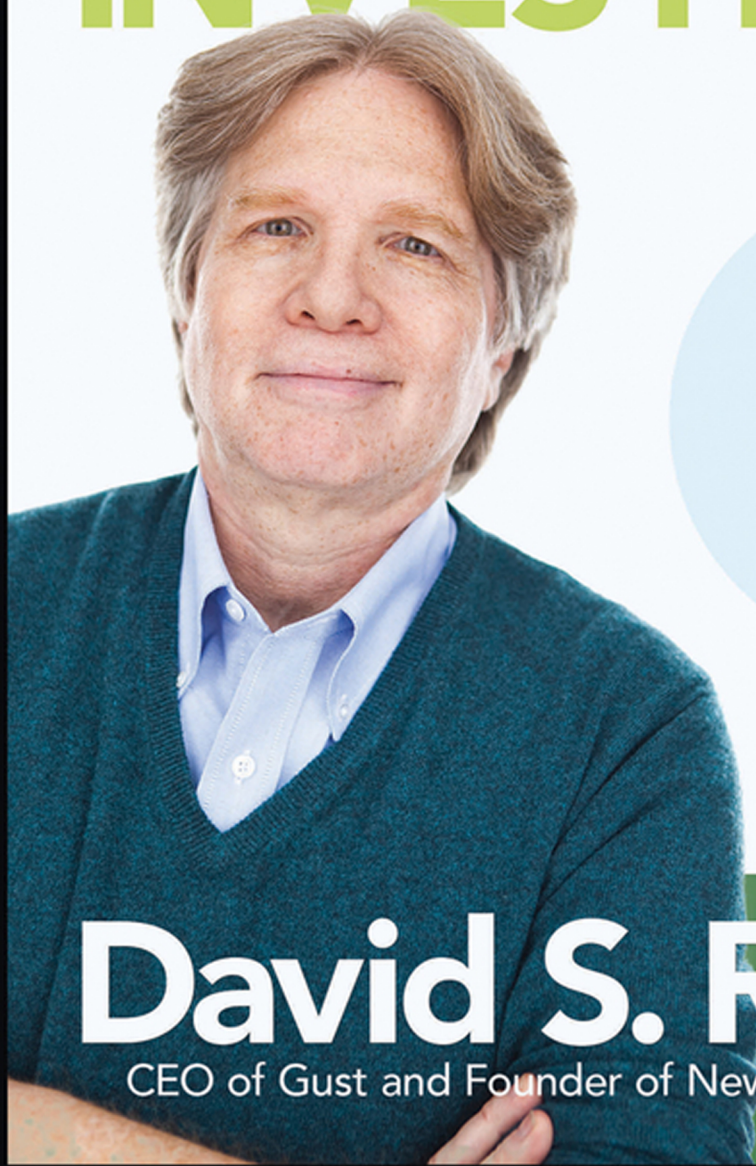


Foreword by Reid Hoffman
Angel Investor and Founder of LinkedIn

ANGEL INVESTING



THE



gust

GUIDE TO
Making Money
& Having Fun
Investing in
Startups

David S. Rose

CEO of Gust and Founder of New York Angels

Praise for *Angel Investing*

“As an angel investor and a longtime fan of David S. Rose, I was delighted to hear that he finally captured his wit and wisdom in the pages of a book. David is a born teacher—clear-minded, witty, and provocative, with amazing stories to illustrate every key idea and insight. Those gifts—as well as his unsurpassed knowledge of his field—are teaching me so much more about investing than I’ve learned over the years doing it! Read every page of *Angel Investing*.”

—**Barbara Corcoran**

Real estate mogul, *Shark Tank* star, angel investor

“From the secret economics of angel investing and the best methods for finding and picking tomorrow’s big winners to proven techniques for adding value to any business you invest in, *Angel Investing* provides readers with everything they need to know to get started in this fascinating, fun, and lucrative business arena.”

—**David Bach**

#1 *New York Times* best-selling author of *The Automatic Millionaire*
and *Start Late, Finish Rich*; angel investor

“This is the most comprehensive and readable guide to angel investing ever written. The chapter on valuation and expectations lays out a clear framework for understanding one of the least-known pitfalls in the angel world. And its emphasis on creating a win-win relationship with the entrepreneur is at the heart of being a long-term successful angel—and continuing to see the best deal flow. I recommend this book to anyone even *thinking* about making or receiving angel investments.”

—**Howard L. Morgan**

Founding Partner, First Round Capital

“The world of entrepreneurial start-ups is where the most exciting and creative action is happening in today’s business world, which is why I was a strong supporter of the JOBS Act of 2012. No wonder millions of people are wondering how they can get involved as investors. There’s no better place to start than by reading David S. Rose’s *Angel Investing*.”

—**U.S. Senator Charles E. Schumer**

Senate Finance Committee

“David S. Rose’s *Angel Investing* is the best book on early stage investing ever written. His method of step-by-step explanation is better than any I have read in 20-plus years of professional angel investing. I will recommend this to every serious entrepreneur seeking investment as required reading before the effort.”

—**Dave Berkus**

Chairman Emeritus, Tech Coast Angels;
author of *Berkonomics*

“Only an angel who has backed more than 90 start-ups could possess the mastery to provide such illumination into our craft. David’s candor and insights will attract more investors to this entertaining and lucrative activity so essential to economic growth.”

—**John Huston**

Founder and Manager, The OhioTechAngel Funds

“*Angel Investing* is an engaging, easy read, full of real stories, hard numbers, actual cases, and a whole lot of good advice. David S. Rose brings tons of real-world knowledge to the subject that makes this required reading for every new angel.”

—**Tim Berry**

Author of *Business Plan Pro*;
entrepreneur and angel investor

“David S. Rose is one of the most insightful thinkers about the angel and venture investment markets. It’s rare that an investment leader with so much experience and success takes the time to share (systematically!) his knowledge so openly. Whether you are new to angel investing or someone with lots of experience, you will learn a ton from reading this book.”

—**Marc Bodnick**

Cofounder, Elevation Partners

“David S. Rose has distilled his vast knowledge into an easy-to-read yet comprehensive guide to angel investing. It is a must-read for all angel investors as well as for entrepreneurs seeking angel financing.”

—**Jeffrey Seltzer**

Managing Partner, Pierce Yates Ventures;
Former Deputy Chairman, CIBC World Markets;
angel investor

“Anyone with a checkbook can be an angel investor, but it takes insight to do it well. David S. Rose has written a terrific new book that will help would-be angels make money, rather than lose it. From explaining the value of diversification, to tips on evaluating deals, to offering up plans to attract good deals, Dave’s book will help you move from a money-losing amateur to a money-making professional angel. And if you’re an entrepreneur looking for angel money, you should read this book, too. It will help you understand what knowledgeable angels are seeking and how they will evaluate you.”

—**Scott Shane**

Author of *Fool’s Gold? The Truth Behind Angel Investing in America*

“Angel investing is a new global asset class, with cross-border investments in early stage companies fueling worldwide innovation. David S. Rose’s *Angel Investing* should be mandatory reading for every current and prospective business angel. It brings into one readable volume everything you need to know to join the start-up revolution, and clearly takes its place as the new standard textbook for our industry. I always recommend David’s classic TED talk on ‘How to Pitch a VC’ to every entrepreneur. Now I will recommend this book to all existing and potential angel investors!”

—**Paulo Andrez**

President, EBAN, the European Business Angel
and Early Stage Investors Network

“Lots of books explain fundamental theories of investing. David S. Rose’s *Angel Investing* does, too—but he also describes the on-the-ground reality of its frustrations and exhilarations, and he does it with candor, intelligence, and flair. This book is a must-read for anyone interested in this rapidly growing asset class.”

—**Joan Finsilver**

Former Managing Director, Brean Murray & Co.;
angel investor

“I only wish I’d had a translated edition of David’s observations when training overseas angels about the art of mentor capital. David tells it like it is, shares real-life stories, and packages the entire process in one book. I will encourage all my emerging angels to read it before writing their first check!”

—**John May**

Chair Emeritus, Angel Capital Association;
coauthor, *Every Business Needs an Angel*

“*Angel Investing* by David S. Rose is a how-to-invest book that is not merely informative and authoritative, but practical and enjoyable to read. Based on his many years running a reputable, leading angel group and his own portfolio of over 90 angel investments, David tells it like it is. He covers a great many things that other books don’t discuss, like ‘building your reputation’ and ‘the financial life of a start-up.’ I especially valued reading Chapter 6 and the ‘signs of a weak founder’: the long list of ‘unrealistics’ was spot on! Reading this book is like sitting across from David and listening to him share his lessons from his storied career as an angel.”

—**Catherine Mott**

CEO/Founder, Blue Tree Allied Angels;
Past Chairman of the Board, Angel Capital Association

“David S. Rose explains the mysteries of angel investing in a clearly written, comprehensive guide full of great insights and stories. He has packed this book with everything you could possibly want to know about angel investing, gathered from his years of hands-on experience and research as one of the most active angel investors and angel evangelists in the country. I can attest that this book is what David has been practicing and preaching since I met him in 2002.”

—**Thomas Blum**

Partner, GC Andersen Partners; angel investor

“Superb! *Angel Investing* by David S. Rose is without a doubt one of the best books I have read on the subject of angel investing, venture capital, and entrepreneurship. It is easy to read and completely captivating—David’s real-world experience is compelling. He shows firsthand how to take the casual sport of angel investing to a whole new level, and make a real business out of it. There is a world of difference between managing a single investment and managing a whole angel portfolio. This unique book addresses everything, from the step-by-step process of due diligence, to negotiating win-win deals, to managing the most intangible—but most important—part of angel investing: your reputation. From every perspective, this is *the* book that every prospective angel should read before writing his or her first check.”

—**David Freshman**

Managing Principal, Innovation Ventures;
CEO, Early Stage East; Founding Member,
ARC Angel Fund

“David S. Rose’s book is great fun and a must-read for angels and would-be angels. For newbies it gives a very clear and simple explanation of the dynamics of angel investing, with a number of real-life anecdotes that drive the points home and make them unforgettable. For all investors, it gives a good sense of whether this asset class is something worth pursuing and whether one has the right skills and attitude for making angel investments. Whether you are already an investor or are looking to become one, this book covers in detail—and in a nonintimidating fashion—all you need to know to start putting money to work. Read it and start investing!”

—**Alessandro Piol**

Cofounder and Partner,
AlphaPrime Ventures and Vendanta Capital;
President, TiE New York

“Whether you are an angel investor or an impact investor, this riot of information and story will elevate your game. David takes us on a sometimes scary—but often hilarious—romp through the ins and outs of angel investing. Read it with caution, as this book is addictive!”

—**Lisa Kleissner**

Cofounder, Toniic, and Cofounder, Social-Impact International
President, KL Felicitas Foundation

“As David S. Rose points out, angel investing can be ‘as much fun as it is possible to have with your clothes on.’ But it isn’t for the faint of heart. Rose’s terrific book provides a sweeping guide for anyone interested in mastering the art of funding start-ups.”

—**Jeffrey Bussgang**

Author of *Mastering the VC Game*

“David S. Rose’s *Angel Investing* is a must-read for successful businesspeople on why they should be angels: you get to use your experiences and capital for maximum effect and have a blast doing it. It is also a must-read for entrepreneurs on why angels are important and what to look for from angel investors that goes well beyond the funding.”

—**Brad Higgins**

Managing Partner, SOS Ventures
Former CFO, U.S. Department of State

“Early stage investing involves both art and science, and David S. Rose’s *Angel Investing* brings together the best of both worlds. I’ve known and coinvested with David for many years, and he’s one of the most knowledgeable and straight-shooting people I’ve met in the business of early stage financing. His book is the ultimate how-to for this rapidly expanding field, written by someone who really knows what he’s talking about.”

—**Chris Fralic**

Partner, First Round Capital

“David S. Rose has written a comprehensive, practical guide to angel investing. It is an excellent resource for anyone interested in the world of start-up finance. *Angel Investing* distills the tumultuous, esoteric world of start-up investing into a clear, paint-by-numbers guide for would-be participants and interested observers.”

—**Thatcher Bell**

Managing Director, Draper Fisher Jurvetson Gotham Ventures

“For newly minted angels, *Angel Investing* is a must-read; for existing angels, a great refresher; for those in need of information and entertainment, David S. Rose packages the arcane into accessible language—and with a sense of humor that will have you read the entire book in one sitting. Thanks a lot, David—now existing angels will have more competition sourcing great deals. Where were you seven years ago when I needed to read this!?”

—**Joseph Ferrara**

Founder, Apparel Group International, angel investor

“David S. Rose has long been a staple in the angel world with a reputation for the highest integrity. While many will conclude this to be a must-read book for those considering angel investing, I'd also recommend this book to every entrepreneur before going out looking for capital. For the entrepreneur, David will bring you into the mind of potential investors and help you fashion the content of your pitch and the best ways to be persuasive.”

—**Andrew Weinreich**

Serial entrepreneur, inventor of social networking,
Founder of SixDegrees, Joltage, I Stand For, MeetMoi, Xtify

“David S. Rose is one part iconic investor, one part eccentric entrepreneur, and one part stand-up comic. *Angel Investing* is required reading for anyone who is thinking about becoming an angel or raising money with them. David answers all the questions about investing that everyone is afraid to admit that they don't really get ... in simple, straightforward, and downright delightful prose. The result is an oxymoron: an entertaining textbook that is actually understandable and jam-packed with information you can really use.”

—**Patty Meagher**

Founder, Stamford Innovation Center

“As an entrepreneur in whom David S. Rose has invested, I have seen him live by the rules he shares in the pages of *Angel Investing*. From a seed idea to a profitable company, he has provided invaluable counsel and thoughtful support during the often choppy waters of a startup journey, bringing his unique passion and enthusiasm, informed by integrity and experience. In this book he lays out the rules of the road for making smart early-stage investments and gives would-be investors the tools to define their goals in this emerging asset class. Whether you are an investor or an entrepreneur, David is unquestionably the guide you want to have at your side throughout your journey.”

—**Steven Rosenbaum**

Founder and CEO, Magnify Networks;
Entrepreneur-at-Large of the City of New York;
Author of *Curation Nation* and *Curate This!*

ANGEL INVESTING



THE GUST GUIDE TO MAKING
MONEY AND HAVING FUN
INVESTING IN STARTUPS

DAVID S. ROSE

WILEY

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Dedicated to the memory of David Rose (1892–1986)
Entrepreneur, Innovation Catalyst, Philanthropist, Angel Investor

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Foreword

A LITTLE MORE than a decade ago, in the Fall of 2002, the company I worked for, PayPal, had just been acquired by eBay. In the wake of this deal, I was considering a long vacation. PayPal had been successful, but countless dot-coms had recently failed; many people felt that the consumer Internet boom was over.

But I began sensing opportunity. The entire online ecosystem was evolving. The Internet was becoming ubiquitous, increasingly integrated into everyday life. And real identity was beginning to play a more prominent role in the online world.

As real identity became a more important aspect of the Internet, so too did the connections between people. In the early days of the web, content was primary. But as we started shifting from the Information Age into a new era—the Network Age—relationships were taking precedence. Information was still critical, but people were starting to rely more and more on other people to make sense of the vast amounts of content available to them. Networks were starting to frame everything.

Once I began to fully see the import of this shift, I decided to lean all the way into Web 2.0 and the beginnings of the Network Age. To capitalize on how the Network Age would transform the world of work, I founded LinkedIn. But I didn't focus my attentions on only the professional side. I also became an angel investor to invest in the social aspects of the Network Age, backing such companies as Digg,

Facebook, Flickr, Last.fm, Ning, Six Apart, and Zynga. Over the course of a decade, I made angel investments in more than 100 companies.

Several of these companies generated significant returns. But I hadn't invested in Flickr or Facebook hoping to make a quick score. As David S. Rose will tell you in the book you are about to read, successful angel investors are usually the ones who take a long-term view of things. I felt as strongly as I did about the companies I invested in because I sensed that we were in the midst of a technological and cultural shift that was going to play out not just over months, or even years, but rather over decades. And these companies were creating platforms, products, and services that promised to be increasingly relevant as hundreds of millions of people started integrating the Internet more fully into their lives.

Picking winners on the stock market, where companies have established track records and there is a large body of information about them at hand, is hard. Picking winners when a company is little more than a few hundred lines of code is orders of magnitude more difficult. If you want to be a successful angel, you have to have an appetite for risk and the ability to accept failure. More importantly, though, you have to be curious. And studious. You have to want to know everything you can possibly know about an emerging technology and the entrepreneur who wants to bring that technology to market. If you're a new angel, identify mentors, develop allies, and start building the networks of trust that will ultimately inform your deal-making.

Picking up this book is a good start. David is an experienced angel himself, with investments in more than 90 companies. He's lectured at top schools, taught TED attendees how to pitch a VC, and created Gust.com, a platform for connecting angel investors with entrepreneurs. Let your education begin!

—Reid Hoffman

Introduction

How I Became An Angel Investor

ONE DAY DURING my junior year in college, I received a letter from my great-uncle, Dave, inviting me to join him for lunch in New York the following month. It seemed that a few of his close friends would be joining us, which was a bit disappointing, because I enjoyed talking one on one with Uncle Dave. But imagine my surprise when the other three guests arrived and it turned out that every one of them was a Nobel Laureate! How did an immigrant, who grew up in poverty on the Lower East Side of New York City and ended his formal schooling after the ninth grade, end up with friends like this? He was an extraordinary man, an entrepreneur ... and an angel investor.

As an industrious entrepreneur, he founded several companies with his older brother Sam (my grandfather), including one that is still going strong nearly a century later. As a generous philanthropist, he contributed time and money to a host of worthwhile causes.

But the most interesting thing to me about Uncle Dave was his propensity for finding and supporting a wide range of technological innovation. It turns out that this boy from the streets, with little technical education but boundless energy and curiosity, had met with Albert Einstein, and was the closest of friends with Vladimir Zworykin (inventor of the television tube) and Nobel winners like Rosalyn Yalow and I. I. Rabi. He described himself as an innovation catalyst decades before the term *angel investor* was coined. He would learn of a potentially

exciting new technical development, bring it to the attention of an appropriate scientist or university, and provide the seed funding that would enable them to research and commercialize it.

He was the primary supporter behind the development of the portable artificial kidney developed by Dr. Willem Kolff (who invented the artificial heart); the hyperbaric operating unit at Mt. Sinai Hospital; vascular stapling for rapid surgery; and the Foundation for Medical Technology, one of the leading funders of new medical instrumentation. Did I mention that he also personally invented through-the-wall air conditioning for high-rise residential construction? Or that the graduate student intern working on one of his projects was Yossi Vardi ... who went on to become the youngest ever Israeli Minister of Development, and today is one of the world's leading angel investors?

The inspiration that David Rose provided for me was carried on in turn by my father, Daniel Rose, who won Ernst & Young's Entrepreneur of the Year award when he was in his seventies, and who to this day is developing new projects and investing in new ventures well into his eighties. Their legacy has given me a unique perspective on the financing and development of entrepreneurship. While I am not alone in being a third-generation entrepreneur, I do believe that I may well be the world's only third-generation angel investor!

With these role models in front of me, after finishing my MBA in the early 1980s, I cofounded my first technology-related business with Dr. Peter Garrity, one of my business-school professors. By that time I was fully engaged in my day job of real estate development, but continued to start tech companies on the side. One of them developed enough traction in the nascent wireless communications space that I finally transitioned into the tech world full-time.

Thanks to an amazing amount of luck, my first business managed to get funding from a top-tier venture capital fund in the early 1990s, and eventually grew into a multinational, Internet-based communications company with 120 people on staff. But when the dot-com crash came along with the new millennium and wiped out a decade's worth of effort, my long-suffering spouse suggested that I take a vacation from entrepreneurship and get a real job.

So I became an angel investor.

The result is that over the past 15 years I have had just about as much fun as it is possible to have with your clothes on. Ten years ago I founded New York Angels, which today is the most active angel

group in the world. I've invested in over 90 innovative companies, and had exits—making millions of dollars—from acquisitions by companies like Google, Facebook, Amazon, Intel, CBS, Kodak, and others. Along the way I've met some of the most extraordinary entrepreneurs and investors in the business (many of whom I will introduce to you later in these pages) and had the opportunity to teach and mentor hundreds of others through my lectures at Yale, Harvard, Columbia, and other business schools, as well as my TED talks on pitching to investors, which have been viewed over a million times. I founded the Finance, Entrepreneurship & Economics program at Singularity University, was named Mentor of the Year by NYU's Stern School of Business, Patriarch of Silicon Alley by *Red Herring* magazine, New York's Archangel by *Forbes*, and received an honorary doctorate from Stevens Institute of Technology.

After all this, my wonderful spouse finally relented and let me get back into the entrepreneurial business, which allowed me to found Gust.com, the online platform that today powers the global angel investing industry and has been used to track over \$2 billion in early-stage angel and seed funding.

These experiences on both sides of the entrepreneurial finance table have provided me with a unique, birds' eye view of the world of early-stage investing, and made it clear that angel investing has moved from being a casual sport of the super rich to a legitimate asset class for everyone with a level of assets or income that would qualify them as an accredited investor.

Why Angel Investing Is About to Take Off

There is a major change sweeping through the world of business that began in the twentieth century and took off in the twenty-first, but whose full import has yet to sink in. Advances in technology are accelerating at an extraordinary rate, and the effect will be to turn upside down virtually everything that we think we know about business and finance. Every year, the power of technology is doubling at the same time its cost is being halved, and every year technology is being applied to an ever-increasing number of new industries. As a result, it is not an exaggeration to state that any company designed for success in the twentieth century is doomed to failure in the twenty-first. This is a great opportunity for people who have a sizeable amount of capital to invest

(usually north of \$100,000) and are willing and able to take prudent risks with a portion of it—angel investors!

Consider just a few examples: commercial airlines, retail book-sellers, higher education, agriculture, music and entertainment, consumer electronics, even the urban taxi business. In every case, an existing industry is being completely upended by changes in technology, regulations, and/or marketplaces; 443 of today's *Fortune* 500 companies were not even on the list when it was first compiled in 1955. The result is that the biggest, most valuable companies of tomorrow are just being formed today, but there is no way for public-stock-market investors to participate during the explosive growth phase of their value creation.

There is, however, a way for *private* investors to take part, by investing in—and supporting—a company from its very beginnings. And this form of investment can be extraordinarily lucrative. When Ben Silberman approached New York Angels in April 2009, seeking a small investment in his interactive mobile catalog idea, he valued his company at \$2.5 million. Today, just over four years later, Pinterest is valued at \$3.8 billion—an increase of 152,000 percent. As you can imagine, angel investors such as my friends Brian Cohen and Bill Lohse, who had the foresight (and faith) to participate in that initial-funding round, have done very, very well. Compare that to public-market investors who bought Facebook at the IPO price of \$38. As of this writing, they would have seen a value increase of 76 percent. That's a difference of 2,000 times between seed and IPO investors.

The combination of advancing technology, changing federal regulations, rapidly dropping startup costs, and new online investment platforms means that it is now possible for any serious investor to undertake angel investing the right way ... and that is what this book is all about. I start at the very beginning and walk you through the market, the theory, and the practice of investing directly into early-stage companies. While there's no doubt that the flip side of a high-return asset class such as startups is a high risk of losing money, by taking a careful, professional approach over the long term, statistics show that you are likely to generate higher returns than virtually any other traditional asset class. And if you're at all like me, you may well have a great deal of fun along the way!

PART



The Basics of Angel Investing

1

The 25 Percent Annual Return Why Everyone with Six Figures to Invest Should Consider Angel Investing

ANGEL INVESTING in the past few years has moved from an arcane backwater of the financial world to a business arena that receives coverage in mainstream newspapers and hit television shows such as ABC's *Shark Tank*. Today, any sophisticated investor with a portfolio of alternate assets should consider direct, early-stage investments in private companies as one potential component of that portfolio. Why? Because multiple studies* have shown that over the long run, carefully

*Robert Wiltbank and Warren Boeker, "Returns to Angel Investors in Groups," Ewing Marion Kauffman Foundation and Angel Capital Education Foundation, November 1, 2007; Ramon DeGennaro and Gerald Dwyer, "Expected Returns to Angel Investors," Federal Reserve Bank of Atlanta, March 2009; Luis Villalobos and William Payne, "Startup Pre-Money Valuation: The Keystone to Return on Investment," Ewing Marion Kauffman Foundation, 2007; Jeffrey Sohl, "The Angel Investor Market in 2007: Mixed Signs of Growth," Center for Venture Research, University of New Hampshire, 2008; Jeffrey Sohl, "The Angel Investor Market in 2008: A Down Year in Investment Dollars But Not in Deals," Center for Venture Research, University of New Hampshire, 2009; Colin Mason and Richard Harrison, "Is It Worth It? The Rates of Return From Informal Venture Capital Investments," *Journal of Business Venturing* 17 (2002): 211–236; Robert Wiltbank, "Siding with the Angels: Business Angel Investing—Promising Outcomes and Effective Strategies," British Business Angels Association and NESTA, May 2009.

selected and managed portfolios of personal angel investments—even those without a giant hit such as Pinterest—produce an average annual return of over 25 percent. Compared to average annual returns of 1 percent from bank accounts, 3 percent from bonds, 7 percent from stocks, 10 percent from hedge funds, and even 15 percent from top-tier venture capital funds, that is an impressive number. See Figure 1.1.

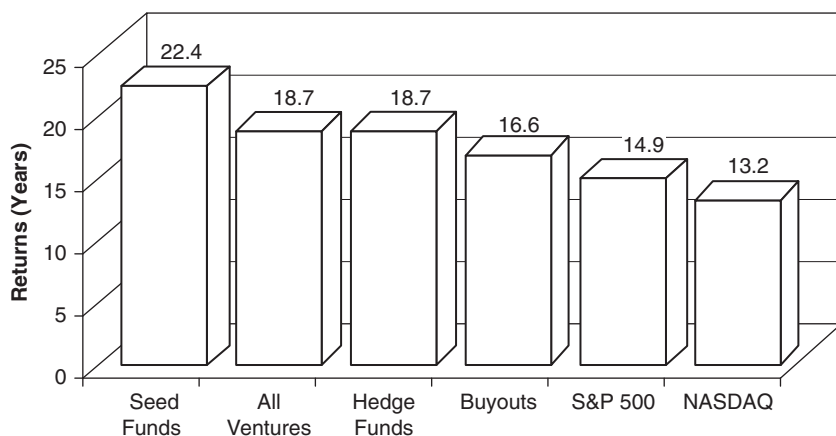


Figure 1.1 Alternative Asset Returns

Wiltbank study (Rob Wiltbank, Willamette University): Angel IRR = 27 percent or 2.6x in 3.5 years.

Sources: Venture Economics; HFRI Equity Hedge Index.

What is even more interesting about angel investing is that, unlike sitting back and clipping coupons, or reading the stock listings in the daily paper, being involved as a part owner of an exciting startup company can be a great deal of fun. You get a ringside seat at a venture that is out to change the world, direct access to company CEOs who may become the corporate magnates of tomorrow, and early access to the latest products and services before they become generally available. You may even have the opportunity to advise and mentor a company as it develops, pivots, and changes its business plan in response to real market experience.

By now, this must sound too good to be true: outsized returns and having fun—what's not to like? But here is the sobering reality: a large majority of self-proclaimed angel investors actually *lose* money, rather than make anything at all! How can these two facts be reconciled?

Simple: those 25 percent-plus returns are “over the long run, on carefully selected and managed portfolios of angel investments.” In practice, however, most people who call themselves angel investors do not carefully select or manage their investments, do not take a long-term view, and do not have a clue about how to approach angel investing as a serious part of an alternative-asset portfolio. But you want to understand how to engage in angel investing as a serious part of your investment allocation. So let’s begin with the basics.

What Exactly Is Angel Investing?

Angel investing is when individual people (as opposed to professionally-managed investment funds, corporations, governments, or other institutions) invest their personal capital in an early-stage company—often known as a startup. Angel investors are individuals who invest their own money, typically in small amounts, and typically very early in the life cycle of a company.

Angels find investment opportunities through referrals from people they know (such as CEOs of companies in which they’ve already invested), through attending regional or national events at which early stage companies launch their products, by being approached directly by ambitious entrepreneurs, through joining with other angel investors in organized angel groups, or, increasingly, by participating in reputable online early-stage investment platforms such as Gust. All of these techniques for identifying angel-investment opportunities, and many others, will be described in greater detail in Chapter 5.

The fact that angel investors use their money to back companies they hope will grow and bring them significant profit is not, in itself, unusual. Most mainstream investors do the same. They invest in blue-chip companies like Apple, Google, GE, and Coca-Cola, or in mutual funds that support an array of companies, hoping their money will grow as these businesses grow. The crucial difference between these mainstream investors and angel investors is that angels invest in startups—companies that are relatively new, small, and privately held (rather than publicly traded in a marketplace like the New York Stock Exchange or NASDAQ). Because these companies are like tiny plants, striving to become giant trees, the first investments in them by angels and others are often referred to as *seed investments*.

Unlike public companies, startups are often little known. They generally do not appear on the cover of *Forbes* or *Fortune*, and you won't hear them talked about by stock analysts on cable TV or even by your favorite broker. So understanding what these startup businesses are like, where to find them, and how to identify those with significant growth potential, is one of the keys to being a successful angel investor.

The world of startups and the ways in which angels and startups work together is a fascinating topic—and one in which change is constant. The stage at which an angel would typically begin supporting a startup with a cash investment has changed over the last few years as a direct result of the decreasing cost of starting up a scalable company using current technology. In the past, when the only way to get a company going was to spend cash, early investors would often have no alternative to “taking a flyer” and supporting an entrepreneur who had only a vision and a plan.

But today, with technology providing startup businesses with virtually free hosting, bandwidth, tools, and marketing (or at least free enough to get you started), the bar for a company to be considered fundable has been raised because it is so easy for anyone to get started. Since the large majority of opportunities with which angel investors are presented already have something going for them (a finished product, initial customers or users, perhaps even revenue), it is challenging for entrepreneurs with only an idea. Why should an angel take the added execution risk if he or she doesn't have to? Derek Sivers, an entrepreneur, writer, and frequent speaker at the TED conferences, summed up the idea versus execution relationship in a seminal blog post from which I've borrowed this eye-opening table for Figure 1.2.

Because of this, many companies in their earliest stages are unable to attract financing from angels and other professional investors. Consequently, so-called Friends and Family rounds of investment are the most common way (other than the founder's own capital) to fund a startup, and account for nearly a third of all financings. (A further explanation in more detail of the various stages of financing a startup is in Chapter 4.) Friends and Family investors do not base their investment on the merits of the business, but rather on their support for the entrepreneur. By contrast, the professional angel investor focuses on the long-term strengths and prospects of the business, in much the

Ideas Are Just a Multiplier of Execution			
It's so funny when I hear people being so protective of ideas. (People who want me to sign an NDA to tell me the simplest idea.) To me, ideas are worth nothing unless executed. They are just a multiplier. Execution is worth millions:			
Awful idea =	-1	No execution =	\$1
Weak idea =	1	Weak execution =	\$1,000
So-so idea =	5	So-so execution =	\$10,000
Good idea =	10	Good execution =	\$100,000
Great idea =	15	Great execution =	\$1,000,000
Brilliant idea =	20	Brilliant execution =	\$10,000,000
To make a business, you need to multiply the two. The most brilliant idea, with no execution, is worth \$20. The most brilliant idea takes great execution to be worth \$20,000,000. That's why I don't want to hear people's ideas. I'm not interested until I see their execution.			
			—Derek Sivers

Figure 1.2 Ideas versus Execution

Source: Derek Sivers, <http://sivers.org/multiply>.

same way a mainstream investor picks stocks based on an evaluation of the strengths and prospects of the companies issuing those stocks.

As with investors in public company stocks, angels are part-owners of the companies in which they invest. The difference is that \$10,000 invested in Google might buy you 10 shares of stock, representing one 33-millionth of the company. That same \$10,000 invested in a promising startup might buy you 10,000 shares of stock, representing a full 1 percent of the company's ownership.

With that low a cost of entry, it is fair to ask if one angel ever becomes the majority owner of a startup. The short answer is virtually never. While there are, indeed, individuals who have put \$1 million or more into one company, the vast majority of serious angel investors play with much smaller numbers. This is because investing at the seed and early stages of a company's life cycle is risky—the large majority of such investments fail completely. Angels therefore try to invest in at least 20 to 80 companies, thereby limiting the amount that will be lost on any one.

The average individual angel puts in about \$25,000 per company, typically with 5 or 10 angels joining together to make up the investment round. (Many angels participate in angel groups or syndicates of various kinds. It's a very effective way to pool insights, ideas,

connections, and other resources, and it enables angels to invest more powerfully than they could as individuals.) A 2009 survey* showed that the average total round size for an angel group is about \$275,000 ... although increasingly groups are joining together to syndicate deals in order to raise larger rounds.

Outside of that context, the range is wide, with solo angels investing anywhere from \$5,000 to \$500,000 (or more) in a given company. “Super Angels,” a misnomer usually applied to experienced investors who manage micro-venture funds, seem to average about \$100,000 to \$200,000 per investment. It is only when you get into the territory in which venture capital funds operate that you’ll find early-stage investments getting close to \$1 million from a single source.

So, in a nutshell, an angel investor is a private individual who invests significant, but modest sums, usually in five figures, in a variety of startup businesses. These investments collectively form a *portfolio* that, over time, will likely include both winners and losers. The key to being a successful angel is to have enough winners to more than offset the losers.

Can You Really Make 25 Percent a Year?

The essence of successful angel investing begins with recognizing and accepting one hard fact: your chance of making a profit by investing in startups is somewhere between very, very slim and almost negligible if you’re talking about investing a very small amount in one company. Those odds increase significantly once you diversify your investments (even if they are relatively small) in dozens of companies.

Why is this the case? It is because a majority of all new, angel-backed companies fail completely, so if you invest in only one company, the odds are that you will *lose all your money*, not just “not make a profit.” But when a company succeeds, it has the chance to *really* succeed, and return many times the initial investment. This is known as a “hits business.”

So how much of a return does an average angel investor earn?

The data needed to answer this question doesn’t really exist. because (1) there is no such thing as an *average* angel investor, and

*2009 ACA Angel Group Confidence Survey.