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ANGEL INVESTING WHY, WHY NOT AND HOW

A 5000 FOOT OVERVIEW

Presentation to the Metro Chapter of the
Michigan Business Brokers Association

January 7, 2016

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Why Not ---

- Angel Investing Not For Everyone—It's Risky
 - Those that aren't accredited investors.
 - Those that are not comfortable losing their investment.
 - Those that are not comfortable having the money in that investment tied up for an extended period of time.
 - Returns are high when successful but losses can be expected.
 - Need to think of this in terms of portfolio risk.



What it is

- **Seed Stage Investing**
 - The idea stage with a business plan and a well thought out idea but no product developed or market contact.
 - Developing minimum viable product.
- **Startup Investing**
 - Near go to market stage about to sell to the consumer.
- **A Round (First Stage) and B Round Second Stage**
 - Not profitable or cash flow positive but poised for growth. Money for growth. Angels often not involved in later rounds



Ways to Participate In Angel Investing

- Individually—Lots of risk unless you know what you are doing.
- As part of an angel group
 - Lower risk. The group votes and you invest or not.
 - Ann Arbor Angels, Blue Water Angels, Great Lakes Angels, etc.
- As an investor in a fund
 - Michigan Angel Fund, Grand Angels Fund.
 - Less at risk, deals vetted by experts.
 - Many deals in the fund spreads risk.

Ways to Participate In Angel Investing

- As an Investor in a VC Fund
 - Big investment personally.
 - You have no input in the investments. The VC chooses the deals.
- Invest your time – coach, volunteer, attend events
 - Help companies by joining groups like the New Enterprise Forum.
 - Help out as a mentor where needed.
 - Accelerate Michigan, Michigan Growth Capital Symposium, ACE 16 (Annual Collaboration for Entrepreneurship, Jan 26), etc.



How

- What constitutes an investable company?
 - As a supreme court justice said when asked about pornography, “ I’ll know it when I see it.”
 - The company has not made any money, it may not have generated any revenue and its business plan shows no profit or cash flow for years.
 - So why invest? For the return, the fun and the chance to help a company grow.



How--What the Investor Must Understand

- Problem/Solution

- The company has a product/solution that solves a major problem.
- The product/solution has a potentially large market. Can it grow and scale rapidly? Retrosense
- The product or solution is disruptive to the marketplace. Uber, Genominon, ContentOro
- The company's product or solution has technology, IP that is patented, protectable or scalable to the point that with proper investment the company can capture a large percentage of its market. Genominon, Agentjet

How--What the Investor Must Understand

- How does the company make money and who are the customers?
 - Razor and Blade Model
 - Subscription service or product. VNN, Sirius Radio
 - Product Sale -- Algal Scientific
 - Freemium or subscription, Pandora with ads or without



How--What the Investor Must Understand

- What is the go to market strategy?
 - Where is the beach head market that they attack first?
 - How does it grow from there?
 - Example: Varsity News Network VNN



How--What the Investor Must Understand

- Competition
 - How is the problem solved now and who is doing it?
 - Who are other potential or existing solution providers?
 - Why is the company better, cheaper, faster, etc.?



How--What the Investor Must Understand

- The Founding Team
 - Relevant related experience
 - Contacts to the market
 - Prior successful exits
 - Understands the strengths and weakness of the current team and who they need to add in order to grow. Are the current team qualified to grow the company and take it to its successful exit?
 - Advisors



How--What the Investor Must Understand

- Financials

- Do the summary financials and projections make sense?
- Are revenue projections logical?
- Are all costs and margins realistic?
- Is the company likely to make the money projected?
- Is the company realistic in the money/capital it will need to grow?

How--What the Investor Must Understand

- Capital Needed
 - How much do they need?
 - When do they need it?
 - What will they use it for?
 - When will they need more money and how much?



How--What the Investor Must Understand

- Exit

- When and how?
- Probably a purchase of the company, IPOs are unlikely.
- Who will purchase?
- Similar purchases recently. What are they?
- When profitable or cash flow positive or sooner? Depends on industry.



Investing Considerations

- Investors Required Returns
 - Seed Stage
 - Concept Exploration: 80% and Up
 - Start Up Stage
 - Commencing Operations: 50 - 70%
 - First Stage
 - Unprofitable Going Concern: 40 - 60%
 - Second Stage
 - Growth of (Profitable) Going Concern: 30 - 50%
 - Bridge
 - Carry through IPO: 20 – 35%
- Why?



Investing Considerations

- Valuation

- A function of the cash flow (or not) of the business when the exit will occur.
- What is normal for companies in this industry?
- What are typical prices for companies in the industry?
- When is the exit and at what stage is the business in at the time of the capital raise?



Investing Considerations

- Valuation Thanks to Professor Brophy at UM Ross School of Business for this example:

| Example | Year | Amount | Net Income |
|---------|------|----------|---------------|
| | 0 | \$1.5 mm | |
| | 2 | \$1.0 mm | |
| | 4 | \$1.0 mm | |
| Exit | 5 | | \$2.5 mm |

Valuation

- Assume that all \$3.5MM is raised in year one. What will the investor require to get a 50% return in 5 years?
- What is the post money value of the company on exit?
 - Assume that a typical multiple for this type of company is 15 times earnings or ebitda.
 - Thus $\$2.5\text{MM} \times 15$ is $\$37.5\text{MM}$.



Valuation

- How much of the company must the investor own at exit to realize a 50% return on investment?
- Determine the future value of \$3.5MM invested today at a 50% return at the end of 5 years. It is \$26,578,125, thus the investor if investing 3.5%MM today would want 70.88% of the stock in the company.
- $\$26,578,125 / \$37,500,000 = 70.88\%$



Valuation

- This is not a good deal for the investor or the founder.
- Too much risk for the investor, no flexibility and more money at risk for the whole time frame.
- From founder's perspective s/he is giving up too much money and loses flexibility too. What if s/he needs to make changes and if company isn't working as planned?



Valuation

- So what do they do?
 - Raise the funds when needed.
 - More work for the founder but gives up less of the company.
 - Gives founder more flexibility.
 - Better for the investor..
 - Can tie future investments to reaching milestones
 - like proof of technology,
 - proof of concept,
 - proof of market size
 - or an event that reduces or eliminates the risk of failure.



Valuation

- Let's assume that the money is invested when needed and that because of that, the investor needs a 40% return for round 2 and a 25% return for round 3.

| Round | Year | Amount | Required Return | Value |
|-------|------|----------|-----------------|-----------|
| 1 | 0 | \$1.5 mm | 50.0% | |
| 2 | 2 | \$1.0 mm | 40.0% | |
| 3 | 4 | \$1.0 mm | 25.0% | |
| Exit | 5 | | | \$37.5 mm |

Valuation

- Using the same approach as above the founder would give up:

30.4% round 1

7.3% round 2

3.3% round 3.

Better for everyone.



Valuation

- Considerations to the above
 - What if the exit date will be later when round 2 and 3 are done?
 - What if the company's ebitda will be less at the proposed exit?
 - This will result in the share amount that the founder will give up being more and the share price will be less - a down round.



Forms of Investment

- Company normally a C corp or converted to a C at time of the A Round
- Often preferred stock convertible into common
- Sometimes convertible debt as that avoids valuation issues for very early investments. The investor typically will convert to the same form of stock that the next investment takes.



Resources

- Resources for Entrepreneurs:
 - SBDC Tech team,
 - Smart Zones like Spark, Automation Alley, Tech Town Detroit and Macomb Oakland Incubator.
 - NEF,
 - Bizdom.

Resources for Investors

- Go to www.michiganvca.org.
- Start Up angles.org,
- NEF (Learn to coach) www.newenterpriseforum.org



Questions

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Example Companies From The Michigan Angel Fund Portfolio www.miangelfund.com



[GENOMENON](#) develops software tools to rapidly and autonomously prioritize data points for decision-making, revolutionizing the way genetic diagnoses and discoveries are made. Our company's suite of diagnostic and discovery tools enable physicians and researchers to quickly and accurately identify disease-causing variants from genomic-sequencing datasets. GENOMENON software speeds discovery work and diagnosis by allowing rapid, automated, and accurate analysis of next-generation sequencing data.

Funding: MAF led Seed round of \$800,000 in August 2015

Example Companies From The Michigan Angel Fund Portfolio www.miangelfund.com



- [Varsity News Network](#) increases exposure and recognition for high school athletes, and empowers students interested in media to gain experience in the field. In sports and advanced education, VNN pushes the boundaries in two of the most important areas to the high school experience. In the process, VNN helps schools raise money to support educational athletics.
- VNN's platform enables high school Athletic Directors to manage critical communication, and creates media coverage for athletics in the process. This platform aggregates local high school audiences across one system for all their sports information, creating a single channel through which brands, vendors, and products reach individual scholastic communities, at scale.
Funding: MAF participated in the B round in February 2014 led by Arsenal Ventures and North Coast. Also participated in the extended B round of insiders in 2015.

Example Companies From The Michigan Angel Fund Portfolio www.miangelfund.com



- ContentOro delivers the largest volume of unique, professionally written and edited content available today; written by real authors, with real expertise, and covering nearly any subject that is important to your business. Let us help you find, engage, entertain and enlighten your clients with better content. Be found by search engines, create unique one-of-a-kind integrated marketing campaigns by having more complete information than your competition. Empower Social Media Campaigns. Quality content is critical to making any of these things happen and ContentOro can deliver unique content, relevant to your customers and in a way that can improve your business today.
- **Funding:** MAF led a small Seed in June 2015.

Example Companies From The Michigan Angel Fund Portfolio www.miangelfund.com



- [AgentJet](#) is the most powerful real estate lead platform on the planet.
- Our agents experience the Agentjet difference everyday. Unlike other systems, the Agentjet real estate lead generation platform was birthed by veteran agents actively working in the trenches. Through years of real-world development and innovation, the Agentjet platform has evolved into a system with effective proprietary functionality that can't be found elsewhere.
- **Funding:** MAF led Seed round of \$2 million with first close in July, 2015. Round is still open.