Siding with the Angels
Business angel investing – promising outcomes and effective strategies

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MONTLAKES CAPITAL
Angel Investing Distribution of Returns

US: Overall Multiple: 2.6X
UK: Overall Multiple: 2.2X
**Distribution of Returns by Venture Investment**

Overall Multiple: 2.6X
Avg. Holding Period: 3.5 years

Blue bars: % of exits in that Category
Green Bars: $'s returned in that Category

- Hold: 3.0 yrs.
- Hold: 3.3 yrs.
- Hold: 4.6 yrs.
- Hold: 4.9 yrs.
- Hold: 6.0 yrs.
Outcomes Split by Industry Expertise

60% better multiple for deals related to industry expertise
Outcomes Split by Due Diligence

Percent of Exits

Multiple Category

- <1X
- 1X to 5X
- 5X to 10X
- 10X to 30X
- >30X

2X better multiple for 20+ due diligence

Less Than 20 Hours
20+ Hours
Follow-On Investment from Same Angel Investor

30% of deals had follow on investments.

No $3.6X$ (3.3 years)

Yes $1.4X$ (3.9 years)

Follow-On Investment from Same Angel Investor

- $30\%$ of deals had follow on investments.
- No $3.6X$ (3.3 years)
- Yes $1.4X$ (3.9 years)
Venture Capital Involvement

35% of deals took on VC investment at some point
Diligence in the Angel fund

– Key Uncertainties

– Who can we talk with?

– So far:
  • Early yes Expertise Affordable Loss Competitive Position

– Going Forward:
  • Milestones 1 / 3 / 5 Investment Thesis

– Build our own model:
  • identify the relative drivers of the business and next best choices.

– Identify the risks we own
Details in Due Diligence

• **Transaction Economics vs. Macro Economics**

  - Price
  - Cost
  - Contribution Margin
  - T.A.M.
  - Predicted Market shares
  - Historical Data
  - Comparables
  - Cost of Customer Acq
  - Customer ROI
  - Key Target List

• **Cash to Cash cycles & Capital Intensity**

  - Longest lead time supply
  - Production cycle
  - Sales Cycle
  - Order/Shipment gap
  - Days in AP
Returns to Invested Capital

- Smaller venture deals do get to exits
- The returns to those deals are quite attractive

<table>
<thead>
<tr>
<th>Paid In Capital Range</th>
<th>Deal Count</th>
<th>Median Price</th>
<th>Median Paid in Capital</th>
<th>Median Multiple</th>
<th>Sum of Price</th>
<th>Sum Paid in Capital</th>
<th>Aggregate Multiple</th>
<th>Aggregate Profit</th>
<th>Profit $'s per deal</th>
<th>ROI</th>
<th>Hypothetical ROI</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5M-$100M</td>
<td>322</td>
<td>60.2</td>
<td>14.0</td>
<td>3.5</td>
<td>34,914</td>
<td>8,260</td>
<td>4.2</td>
<td>26,654</td>
<td>82.8</td>
<td>20%</td>
<td>30% failure rate</td>
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<td>under $5M</td>
<td>1,359</td>
<td>10.3</td>
<td>0.2</td>
<td>53.6</td>
<td>35,741</td>
<td>931</td>
<td>38.4</td>
<td>34,810</td>
<td>25.6</td>
<td>48%</td>
<td>70% failure rate</td>
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<td>Whole Sample</td>
<td>1,530</td>
<td>14.8</td>
<td>0.5</td>
<td>24.5</td>
<td>70,655</td>
<td>9,192</td>
<td>7.7</td>
<td>61,463</td>
<td>40.2</td>
<td>29%</td>
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</table>

Includes ONLY deals with a MULTIPLE OF AT LEAST 1
Includes ONLY deals with complete data (70% of transactions)

ROI equates if 3 and 7 year holding periods
ROI equates if smaller deals fail 91% of the time
Selecting ventures for investment

Investors prefer opportunities:
- in large and fast growing markets
- with customers lined up waiting to repeatedly buy a high margin product
- where no powerful competitors exist
- with the potential to ‘keep others out’ of the market
- led by experts in the field who have prior entrepreneurial success

The problem is the sequence; prioritization
- i.e. insightful market research to demonstrate market potential, or win a great beta customer?
- i.e. win a new great team member, or finish the prototype to demonstrate claims?
### Staged Decisions in Angel Investing

<table>
<thead>
<tr>
<th>Dependent Variable</th>
<th>DD1</th>
<th>DD3</th>
<th>DDP2</th>
<th>Funded</th>
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<tbody>
<tr>
<td>Constant</td>
<td>-2.16</td>
<td>-3.41</td>
<td>0.10</td>
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<td>0.00</td>
<td>0.50</td>
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<tr>
<td>Inv Entre</td>
<td>0.52</td>
<td>0.42</td>
<td>0.09</td>
<td>0.05</td>
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<td>Eval Control</td>
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<td>Prediction Emphasis</td>
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<td>0.05</td>
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<tr>
<td>Control Emphasis</td>
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<td>0.00</td>
<td>0.50</td>
<td>0.00</td>
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</table>

- Angels use predictive information more than they think
  - Especially early in the process
- This shifts as we approach actual investment decisions
- Investors with more Entre Experience Prefer Non-Predictive Info.

*Note: N = 2156, Adj R2 = .040
N = 2383, Adj R2 = .455
N = 2109, Adj R2 = .409
N = 2283, Adj R2 = .046
N = 2156, Adj R2 = .040*
Cognitive Matching between VC’s and Entre’s

Conjoint analysis of VC investment evaluation.

Simultaneous manipulation of preferences

Economics: Hi Potential vs. Moderate
Social Capital: Strong rep and Referrals vs. Moderate
Entre Mindset: Effectual vs. Causal

1. The match between VC’s and Entre’s significantly increased funding

2. Social Capital and Match were jointly as ‘powerful’ as the economics
Early stage investing perspectives

– Select ventures that appear most capable of influencing critical market elements.
   
   *Create and influence localized markets OR*
   *Compete in large growing markets*

– Emphasize the current means and capabilities of the venture rather than on plans for acquiring the “best” means to reach their original goals.
   
   *Adjust goals to use current means OR*
   *Acquire means critical to insightful goals*

– Encourage the venture to make smaller investments that get to cash flow positive rather than investing in the resources suggested by market research to “hit plan.”
   
   *Overhead trails growth OR*
   *Pre-position assets to time great opportunity*

– Avoid prediction as the basis for investment decisions.
   
   *Emphasize affordable loss OR*
   *Maximize expected values*