ANGEL WORKSHOP SESSION 3: IS THIS ONE WORTH IT?

STARTUP FUNDING + ONGOING SUPPORT = PHX EV ANGEL

PRESENTED BY JAMES GOULKA
DECEMBER 6, 2017

INTRODUCTION

➢ **Objective:** Add more Angel Investors in the East Valley

➢ **Who:** Accredited Investors who live or work in the East Valley

➢ **What:** 6 session primer on how to think about angel investing

➢ **When:** First Wednesday of each month

➢ **Where:** ASU Chandler Innovation Center, 249 E Chicago St

WHY WE'RE HERE

More Local Angel Investors

▼

More Local Capital for Local Startups

▼

Easier to Raise Money

▼

Spend Locally On:
Hiring, Buying Goods and Services, Occupying Space,
Creating Local Wealth for Local Investors

JIM GOULKA

➢ Leads Arizona Tech Investors

97 men and women
54 companies in 10 years

➢ Serial CEO in software & NASA tech transfer

➢ COO/CFO of $650 million publisher

➢ Private Equity finance

➢ Corporate finance

PREVIOUSLY

➢ Defined angel investors

➢ Discussed potential for huge gains

➢ Showed how to analyze new businesses

STARTUP SEEKING CAPITAL

➤ 1-2 year old business

➤ Management: Most are first time entrepreneurs

➤ Team: Incomplete

➤ Product: Prototype
                  May be a thing or may be electrons

➤ Disruptive: Requires customers to change behavior

➤ IP: Is there any?

➤ Capital: Limited to founder funding+friends+family

WHAT YOU KNOW

➤ Determined you like the company

   ➤ Management
   ➤ Market
   ➤ Product
   ➤ Growth prospects

➤ Lots of fish in this particular sea

➤ Your target return expectations

TARGET RETURN: PORTFOLIO

➢ Government bonds   = 2% +inflation

➢ Public common stock = 8% +inflation

➢ Phoenix suburban RE = 8% cap rate

➢ Angel investments   = >25% IRR

RISK

➢ Government bonds   = basis points

➢ Public common stock = stop loss

➢ Phoenix suburban RE = reuse

➢ Angel investments   = total loss

DE-RISK STRATEGY #1: PORTFOLIO OF INVESTMENTS

➤ Portfolio = 10 - 20 angel investments

➤ Typical Returns

  ➤ 1 - 2 make 10x your money

  ➤ 2 - 3 are total write-offs

  ➤ 5 - 7 return 1– 3x your money

PORTFOLIO RETURNS

➤ Assume 10 equal investments

    ➤ Made the same day
    ➤ Sold 5 years later on the same day

➤ 1 x 10x = 10

➤ 1 x   0x =   0   =   24.475% IRR = 3x

➤ 7 x 2.7x = 18.9

➤ 1 x   1x =   1

SINGLE INVESTMENT TARGET RETURN

➢ Investment Return in 5 Years =

   ➢ 58.5% IRR

   ➢ 10 x your investment amount

OPPORTUNITY

➢ Interesting Company is an asset

➢ Investor buys a piece of an asset

➢ The piece is securities issued by the company

➢ Exact form of security is addressed in next month's session

PRICE (f) VALUATION

➢ Price per share = derived from deal

➢ Value of business drives the deal

➢ Total enterprise value as measure

➢ Return @ disposition of business (IPO or sale)

➢ Your return = your share of disposition

VALUING THE ENTERPRISE

➢ Pre-Money Valuation =
Valuation before investment

➢ Post-Money Valuation =
Pre-money Valuation + New invested dollars

VALUATION FOUNDATION

➢ History…………Little or no enterprise history

➢ Trends…………Emerging

➢ Markets………We always have these

COME AT VALUATION OBLIQUELY

➢ Art more than science

➢ Apply a set of 4 tools

➢ Ref's Call: Completed Pass or Not?
(aka Gut Check)

VENTURE CAPITAL METHOD

➢ Know Anticipated ROI: 58.5% IRR

Years		IRR								
		2	3	4	5	6	7	8	9	10
Multiple										
1	X	0%	0%	0%	0%	0%	0%	0%	0%	0%
2	X	41%	26%	19%	15%	12%	10%	9%	8%	7%
3	X	73%	44%	32%	25%	20%	17%	15%	13%	12%
4	X	100%	59%	41%	32%	26%	22%	19%	17%	15%
5	X	124%	71%	50%	38%	31%	26%	22%	20%	17%
6	X	145%	82%	57%	43%	35%	29%	25%	22%	20%
7	X	165%	91%	63%	48%	38%	32%	28%	24%	21%
8	X	183%	100%	68%	52%	41%	35%	30%	26%	23%
9	X	200%	108%	73%	55%	44%	37%	32%	28%	25%
10	X	216%	115%	78%	58%	47%	39%	33%	29%	26%
11	X	232%	122%	82%	62%	49%	41%	35%	31%	27%
12	X	246%	129%	86%	64%	51%	43%	36%	32%	28%

VENTURE CAPITAL METHOD

➢ Determine Terminal Value at Exit

    ➢ Research for comparable companies

    ➢ Research for comparables' valuation multiples

PUBLIC MARKET VALUATIONS

Current & Forward Market Multiples

	Median TEV/Revenue		Median TEV/EBITDA	
	LTM	NTM	LTM	NTM
Application Software				
Customer Relationship Management (CRM) & Customer Engagement	6.0x	5.0x	55.5x	31.2x
Accounting & Enterprise Resource Planning (ERP)	4.7x	4.5x	21.6x	15.4x
Supply Chain Management (SCM) & Logistics	4.5x	4.2x	24.0x	22.4x
HR & Workforce Management	5.8x	4.7x	21.5x	29.3x
Education Technology	2.0x	3.1x	13.1x	24.2x
Industrial & Automation Software	2.1x	1.9x	14.5x	11.4x
Business Intelligence & Data	5.1x	4.1x	15.8x	23.7x
Design & Engineering Software	5.3x	5.1x	21.7x	14.9x
EMS / Infrastructure Software				
Security Software	4.0x	3.8x	26.2x	18.0x
System and Network Management Software	3.7x	3.1x	12.8x	11.5x
Platform / OS	3.5x	4.2x	11.8x	11.5x
Financial Solutions				
Banking Solutions	5.7x	5.4x	17.2x	14.4x
Capital Market & Investment Solutions	5.9x	5.4x	17.1x	14.2x
Consumer Data & Analytics	5.3x	5.0x	16.4x	15.1x
Payment Processing	3.2x	3.2x	14.7x	13.1x
Insurance Solutions	6.6x	6.4x	17.9x	15.5x
Online & Digital Media				
Digital Advertising & Marketing	1.1x	3.0x	22.8x	9.4x
Digital Media & Video	2.7x	2.6x	14.1x	12.2x
Digital Advertising Agencies & Service Providers	1.5x	1.3x	9.6x	9.2x
Online Retail & Marketplaces	2.7x	2.4x	25.3x	15.7x
Digital Gaming	3.6x	3.4x	15.9x	10.2x
Social Media	6.1x	4.9x	28.9x	14.3x
Digital Commerce Solutions	1.3x	1.2x	16.2x	10.9x
Other Digital Companies	3.4x	3.3x	15.3x	11.7x
Tech Enabled Business Services				
IT Services, Integration & Consulting	1.6x	1.4x	11.6x	10.3x
Business Process Management (BPM)	2.6x	2.3x	15.1x	12.6x
Data Center Hosting & Services	6.3x	5.0x	23.1x	16.2x
Call Center	0.9x	0.9x	8.2x	8.6x

Medians				
Application Software	4.8x	4.2x	18.8x	16.2x
EMS / Infrastructure Software	3.9x	3.4x	16.5x	14.8x
Financial Solutions	5.2x	5.1x	16.5x	14.8x
Online & Digital Media	2.9x	2.6x	17.8x	11.9x
Tech Enabled Business Services	2.1x	1.9x	12.3x	10.5x

VC METHOD MATH

➤ Assume: SaaS Business Comps Valued at 5 x Revenue

➤ Projected Revenues of $10 M in Year 5

➤ Terminal Value = 5 x $10 M = $50 M

➤ Assume: Required IRR is 58.5%

➤ Assume: No dilution (no future funding)

VC METHOD MATH

➢ Post-money Valuation at investment =

➢ Terminal Value (in year 5) / ROI for 5 years =

➢ $50 M / 58.5% (power of 5) =

➢ $5 Million

VC METHOD CONCLUSION

➢ Post-money Valuation = $5 Million

➢ Pre-money Valuation = Post-money less New Investment

➢ Assume New Investment = $1 Million

➢ New Investment buys 20% of company

SCORE CARD METHOD

➢ Objective: Define Pre-money valuation

➢ Start: Identify median valuations for comparable companies in domain / region e.g. $ 2 M

➢ Evaluate specific business in comparison to the median

  ➢ 6 categories
  ➢ Weigh categories
  ➢ Score strength

SCORE CARD METHOD

	Weight	Factor	
Average Company Valuation			$2,000,000
Team	30%	200%	0.60
Opportunity Size	25%	200%	0.50
Product/Technology	15%	150%	0.22.5
Competitive Environment	10%	100%	0.10
Marketing/Sales Partnerships	10%	200%	0.20
Need for additional investment	5%	100%	0.05
Other factors	5%	100%	0.05
Total Weight			1.7300
Medial Value x Total Weight			
Scorecard Adjusted Valuation			$3,460,000

RISK FACTOR METHOD

➢ Objective: Define Pre-money valuation

➢ Start: Identify median valuations for comparable companies in domain / region e.g. $ 2 M

➢ Evaluate specific risk types

    ➢Assign + or – Depending upon risk
    ➢Use increments of $100,000
    ➢Range is + or - $300,000 max

RISK FACTOR METHOD

Technology Risk		+2
Execution Risk		+2
Market Risk		+2
Competitive Risk		=2
Financial Risk		0
Politcal/Legal/Regulatory Risk		+1
Economic/funding Risk		+2
Social		+1
Partner/Supplier Risks		0
Management		+3
Aggregate Risk Factor		11
Risk Adjustment		$1,100,000-
Comparable Value Assumption for your industry/stage		$2,000,000
Current Risk Adjusted Value		$3,100,000

MARKET FACTORS METHOD

➢ Local Pricing Market Factor: Addressed

➢ Comparable Fundings

     ➢ Milestones in the domain / industry
     ➢ Similar deals in domain
     ➢ Local investor competition / enthusiasm

➢ Domain Expertise

➢ Additional Funding Round Calculations

SUMMARIZE

➢ Array the alternative methods

➢ Calculate Mean Valuation

➢ Determine

    ➢ What you really want

    ➢ How high a valuation you will accept

    ➢ Impact of future rounds

NEGOTIATE

➢ "I've never seen a valuation that was too low"

➢ Base Horner, Desert Angels

➢ "That's way too low"

➢ Every Entrepreneur

➢ Lawyer advising entrepreneur

EXPERIENCE

➢ Every deal ATI liked but failed to fund was due to:

  ➢ Entrepreneurs demanding a valuation that was too high
  ➢ Governance (to be addressed next time)

➢ Overvalued companies

  ➢ Never found funding
  ➢ Found some, but slowly, which curtailed growth
  ➢ Experienced down rounds subsequently

LESSONS LEARNED

➢ ATI has never regretted walking away from any opportunity due to an excessive valuation.

➢ ATI has regretted investing in opportunities at too high a valuation.

NEXT SESSION: SETTING THE TERMS

➤ Once you've invested, you're in for a long time.

➤ Learn how to set Deal Terms to ameliorate the risks of illiquidity, uncertain business execution, and time. Done well, Deal Terms can significantly reduce risk, while keeping the potential return at the full nominal rate.

➤ January 10, 2018

➤ Same time and place

FUTURE SESSIONS:

FEB. 7, 2018
Trends in Investing, with a Nod to Venture Capital

Startups are emerging in Arizona in software, semiconductors, medical devices and other fields all the time. Arizona is not Silicon Valley and Silicon Valley is not the entire U.S. Some trends apply everywhere; others are localized, and all of them matter. Learn which comparisons are important and which are not. And learn how angels and VCs are dependent upon each other...to a point.

MARCH 7, 2018
Angel Investing – Doing It

Individuals invest as angels in several ways: alone or together in groups sharing intelligence. They can be active or passive. They can have a little of each. Learn the differences and how to take action that suits you.