

# ANGEL WORKSHOP

## SESSION 4: DE-RISKING THROUGH DEAL TERMS



**STARTUP  
FUNDING**

+



**ONGOING  
SUPPORT**

=



**PHX EV  
ANGEL**



PRESENTED BY JAMES GOULKA  
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# 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

56 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
- Valued an Investment Opportunity

# RISK

- Government bonds = basis points
- Public common stock = stop loss
- Phoenix suburban RE = reuse
- Angel investments = total loss

# “LIFE DIDN'T WORK OUT THE WAY I PLANNED”

- Company #1: Software /Hardware Combo
  - \$4 million of very savvy investors
  - 100% loss
- Company #2: Consumer Application
  - TV Celebrity lead investor
  - 100% loss
- Company #3: Disease Diagnostic
  - Superb management team
  - 100% 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



# DE-RISK STRATEGY #2: STRUCTURING DEAL TERMS

- Money is safe before you hand it over
- Set conditions for life after investment
- Analogous to loan covenants
- More dynamic

# **PART A: ONGOING OPERATIONS**

# A SAY IN THE BUSINESS: GOVERNANCE BOARD SEAT

- Minority Shares but Majority Money
- Board = Real Business
- Not "yes people"
- Ideal is 5 members
  - 2 founders
  - 1 representing investors
  - 2 independent

# FINANCIAL PROBITY: COMMITTEES

- Board Compensation Committee
  - Investor director
  - Independent members
  - No insiders
- Audit Committee

# OTHER ADVISORY ROLES

- Board Observer
- Advisory Board Member
- Mentor / Advisor / Consultant have some de-risk value

# INFORMATION RIGHTS

- Periodic (ie quarterly or monthly) Reports
  - Financial Statements
  - Management Report
  - Management Dashboard
- Annual Budget

# PART B: FUTURE FINANCIAL TRANSACTIONS

- New Round of Financing
  - Higher price (“up round”)
  - Lower price (“down round”)
- Sale of Business
- IPO
- Failure

# FOR ALL BUT FAILURE: CONVERSION TO C CORP

- LLCs have their place in very early companies
- Institutional investors and acquirers are not interested in figuring out how to deal with “membership interests,” “revenue interests,” or other special characteristics of LLCs.



# GOOD NEWS: AN UP ROUND

- Maintain information rights
- Probably lose board seat; exchange for board observer
- Right of First Refusal (ROFR) to invest in new round
- Pro-rata Right to invest to keep % interest owned
- Buyout Option

# BAD NEWS: A DOWN ROUND

- Anti-Dilution: An adjustment to the price paid at the earlier round
- Rarely fully equal to the new price / share
- “Broad-based weighted average” is the norm
- Right of First Refusal to invest at lower price

# GREAT NEWS: SALE OF THE BUSINESS

- Vote by each class of securities holders to accept transaction on as-converted basis
- Automatic Conversion of securities at price offered
- Automatic trigger of warrants, if any
- Drag Along Right to prevent hold up by recalcitrant minor shareholders

# INCREDIBLE NEWS: IPO

- All same as for Sale of Business
- Registration Rights
- Piggy-Back Registration Rights given to later investors

# DISASTER: FAILURE

- Preference: The Term that is the meaning of "Preferred" Stock
- In a wind up, assets are distributed to the claim holders in accordance with US bankruptcy provisions:
  1. Taxes due
  2. Employee obligations
  3. Secured Creditors
  4. Unsecured Creditors
  5. Preferred Shareholders
  6. Common Shareholders

# THE PREFERENCE BOMB

- Preference Element #1: How many times your money back?
  - 1x is perceived as fair
  - See deals at up to 4x for the preferred holders
- Preference Element #2: Participating or Non-Participating
  - Non-participating means investor gets his preference and that is all
  - Participating means investor gets his preference and then shares pro rata in the residual
    - The bomb explodes in multiple rounds of funding
    - EVEN IN A SUCCESSFUL EXIT

# TERM SHEET

- The proposal from the Lead Investor incorporating these protections.
- IT IS NEGOTIATED
- Follow on investors accept these terms
- Investor documents conform to the Term Sheet

# ATI STANDARD TERM SHEET

- ATI Standard Term Sheet is found by going to:
- <https://arizonatechinvestors.com/Entrepreneurs/ApplicationProcess>
- And downloading it from the embedded link



# RECAP

- Opportunity to invest in a young tech company is a huge risk
- Demands a huge return = to that risk
- Can diminish actual risk by
  - Owning a diversified portfolio of angel investments
  - Diligence analysis
  - Deal Terms
  - Deep ongoing involvement

# NEXT SESSION: TRENDS AZ, SILICON VALLEY & U.S.

- Arizona offers exciting startups
  - It is NOT Silicon Valley
  - Silicon Valley is NOT the entire US
  - Angels are NOT the only investors in Startups
- Trends among these in 2018
- February 7, 2018
- Same Time, Same Place

# THE LAST SESSION

**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.