ACA Investor Insights Report 2020

First Annual

Action learnings from leading angels

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ACA Investor Insights Report 2020
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ACA Investor Insights Report 2020

A Letter to Our Community

Angel investors want to better understand how comprehensive investment data can help bend the investment outcome curve upwards.

The Angel Capital Association believes data will make us better investors. ACA is committed to helping angels make informed decisions that will improve investment outcomes. That is why we started the ACA Data Initiative

In support of ACA's Data Initiative, once a month ACA shares charts and commentary illustrating key learnings from analyzing data on angel investing and portfolio returns provided by leading ACA member groups. These monthly insights encourage angel groups, funds and individual angels to learn more about key trends in their industry and key influences on outcomes.

This annual summary conveniently consolidates our monthly data learnings. Read on and share your insights with us.

Thank you,

Rick Timmins

Rick Timmins

ACA Data Analytics Chair

ACA Investor Insights Report 2020
COVID-19

Early Covid-19 Feedback

This data insight relates to the current situation we are all facing. Between April 21 and May 1, the Angel Capital Association conducted a survey with 35 questions on the impact of the COVID-19 pandemic on their respective angel group and their portfolio companies.

This survey was sent to most of the angel groups that provided their 2019 investment data to the ACA as part of the ACA Data Initiative for the development and release of the Angel Funders Report. Over 70% of the angel groups answered the questions. The results of this survey were summarized and shared in a presentation to all attendees at ACA 2020 - The Summit of Angel Investing last week. Today we would like to highlight one chart for insights and comments.

Again, the responses to this survey were provided in late April. As part of this survey, angel groups were asked two questions:

1)What is your estimate of dollars invested January through April 2020 compared to January through April 2019?

And 2) Although it is early what is the estimate of your groups total year 2020 investments compared to total year 2019?

Insight continued on the next page.

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COVID-19

The results were summarized into the chart that accompanies this Data Insights. **As you can see, a full 51% of the groups believe their total investments will be down the first four months of 2020 compared to the first four months of 2019.** Only 13% expect them to be higher, while 36% expect no change in January through April investments.

When we asked the angel groups about their estimates for total year 2020 compared to total year 2019 investments, the figures are worse. **A total of 63% of angel groups, believed at the time of the survey, that their group investment figures would be down year over year.** In fact, 28% of the respondents believe their investments will be down between 21% and 40% or even more. Only 15% expect investments to be higher and 26% believe there will be no change.

Clearly angel groups expect this pandemic to have an impact in slowing down their members investing in start-ups for 2020. For comparison purposes one can look to the last major economic downturn during the 2008-2010 timeframe. During that time, the combination of angel/seed-stage investing and venture capital in A, B and C rounds investments declined 40%. The recovery from that downturn took a full six quarters.

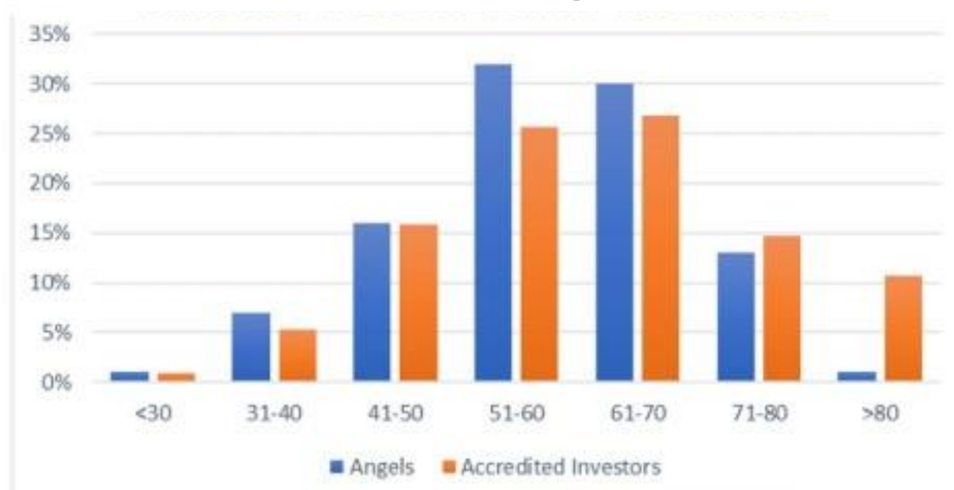
As you can see from past performance and current angel group thinking, angel investing will be challenged during this pandemic and we now have data to support this belief.

Author: Rick Timmins, Central Texas Angel Network
Publication Date: May 2020

Age Diversity Among Angel Investors

This insight addresses age diversity among angel investors. Angels makeup a subset of the accredited investor population. Their demographics, therefore, would be expected to represent that subset. Instead, data show that angels skew younger than the accredited investor population. The chart below shows that only 5% of accredited investors are in their 30s, while 7% of angels are the same age.

Accredited Investors Age Comparison

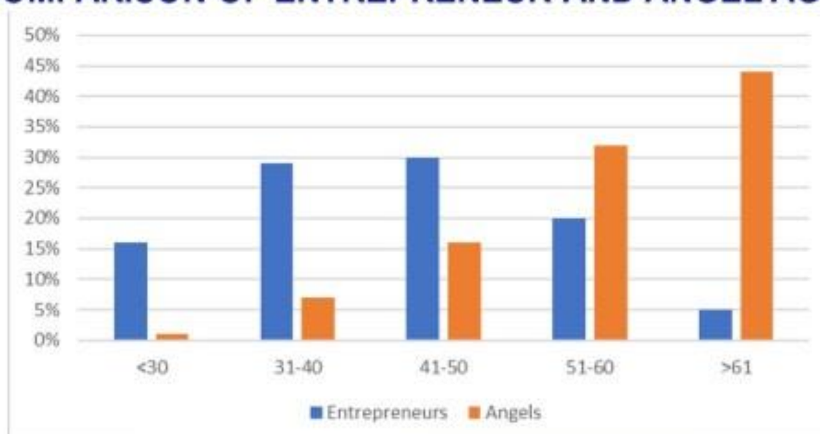


Most angel groups welcome this: if angels mirror the entrepreneur community, they can better relate to founders and will be more likely to work with their companies.

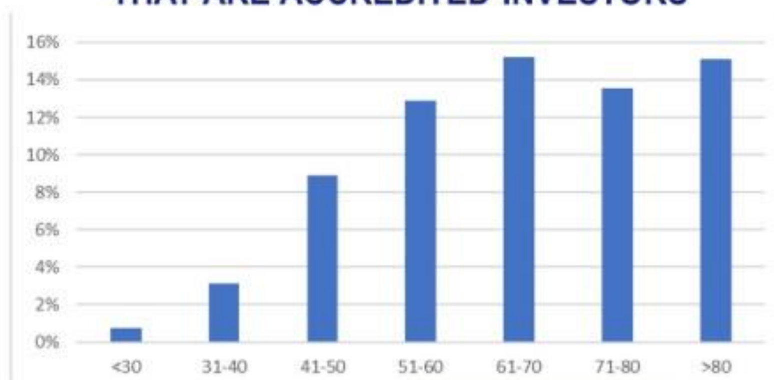
The data also shows we have a long way to go before angel and entrepreneur demographics are similar. Entrepreneurs are still much younger than the typical angel. The chart on the next page shows that while 29% of entrepreneurs are in their 30s, only 7% of angels are the same age.

Insight continued on the next page.

ACA Investor Insights Report 2020
Investor Profiles



The scarcity of young angels is understandable since only 3% of households in their 30s qualify as accredited investors. Young, accredited investors are hard to find, while young entrepreneurs are not. (see chart on following page)



The takeaway is that age diversity will be difficult to achieve. Since younger accredited investors are so scarce, angel groups looking to increase diversity need to make a concerted effort to identify, recruit, and train young, accredited investors and turn them into angels.

Author: Roberta Garvin, Boise Angel Alliance
Publication Date: November 2019

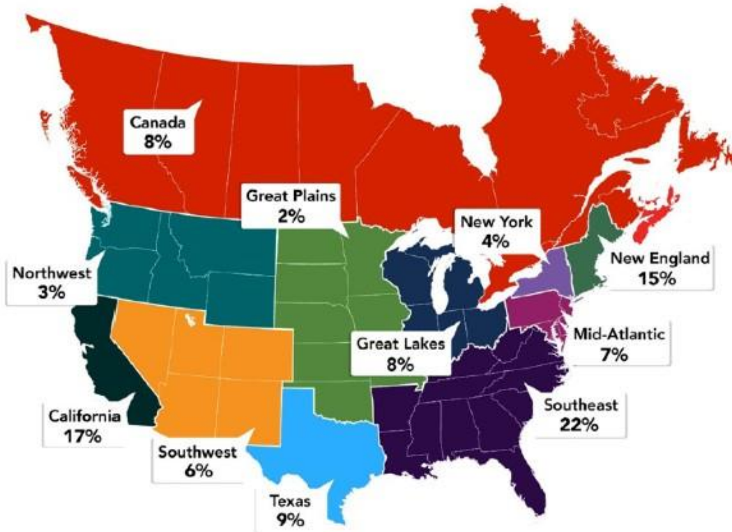
ACA Investor Insights Report 2020
Investor Profiles

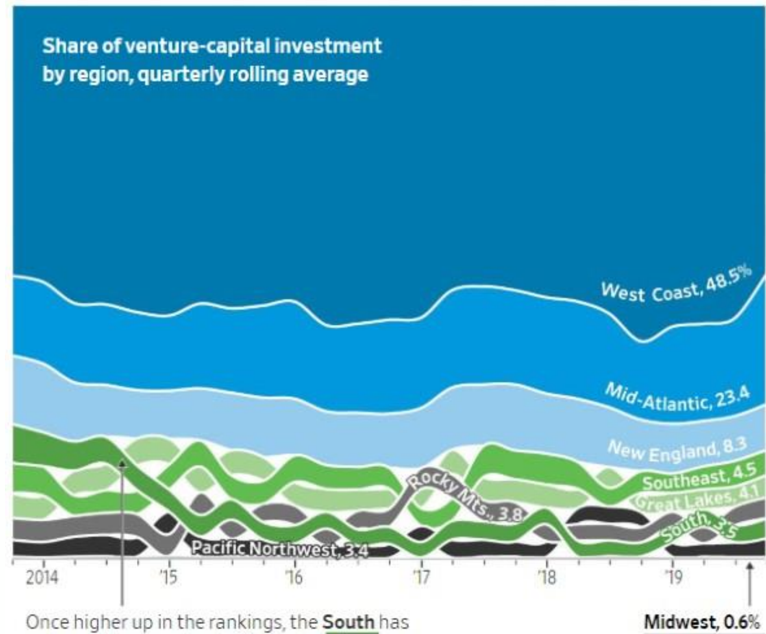
Angel Follow-On Rounds

How important is the need for follow on Venture Capital rounds? As we do due diligence on a company, we often see financials projections that include future rounds requiring VC-level investment. Many of us have seen companies struggle through that tough transition. Why is that, and what can we do as angels to increase the chances of getting funding?

Raw Data:

One reason that our angel investments have trouble attracting follow-on funding is because we're investing in different geographic areas than VC's are investing in.





Insight continued on the next page.

Comparing these two maps is tricky because the geographic region descriptions are somewhat different and less defined for the VC data. We also have to be careful to pull percentages from the VC graph from the same time period that angel data was collected (2018). Still, there are some big differences that appear:

- **Angels invest more in the SE and Texas** - 30% of angel investments are in the “Southeast”and “Texas”. Conversely, only about 8% of VC dollars are in a similar region (South and Southeast”).
- **Angels invest more in New England** - angels make 15% of their investments in New England, increase that to 19% if New York is included. Conversely, only about 8% of VC investments are made in the region.
- **VC firms invest more on the West Coast** - VC firms made well over 40% of their investments in West Coast companies. Angels only make about 20% of their investments there. The amount for angels would be lower if ID/MT/WY were removed; and 6% higher if what angels call “Southwest” is added. Even then, the proportion VCs invest would be significantly higher than angels.

Actionable Insight:

If angels want a better chance of seeing follow-on funding for their investments, they should focus on investing where VC’s are investing: the West Coast.

-or-

If angels want a better chance of getting VC dollars to their non-West Coast company (particularly from the South and New England), they need to do take action. Ideas could include making personal connections between specific VCs and companies, or helping the overall region get recognition as an area that produces great, investable startups.

-or-

Attract some of the many existing Silicon Valley startups that are looking to move to other areas (As discussed in Shayndi Raice’s recent WSJ article). Some of those companies are on VC’s radars, and when they move in, they’ll bring the VC’s attention and dollars. (“Startups Pitch Tech Hubs Far From Silicon Valley”, WSJ Mar 8, 2020).

Author: Roberta Garvin, Boise Angel Alliance
Publication Date: March 2020

ACA Investor Insights Report 2020
Valuations

Valuation Trends

No one would dispute that valuations have been on the rise in recent years. But it takes data and analysis to understand the forces at play and anticipate the future directions.

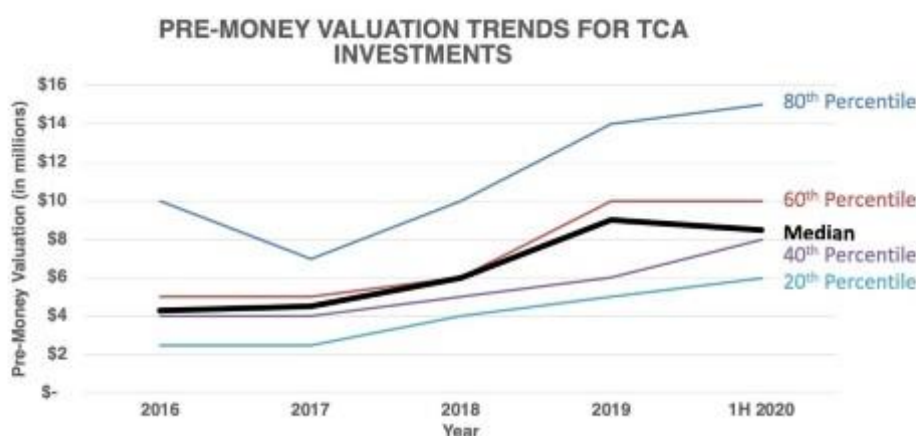
Tech Coast Angels is fortunate in funding each year about 50 companies (including follow-ons)—and hence there is a reasonably robust set of data points. Since 2016, TCA has found that the median valuations on those deals have been trending up along with the data that has been released across all angel groups (by Pitchbook and now ACA with its Angel Funders Report, although TCA deals are at about a 50% premium that seems due to its geography (California):

Source: Tech Coast Angels, Pitchbook, ACA Angel Funders Report

Insight continued on the next page.

ACA Investor Insights Report 2020
Valuations

The first level of insight comes from looking at the distribution of valuations over time, showing that the increases have been largely across that whole distribution. However, the biggest percentage increase in median valuation from 2016 – 2020 has been in the lower (20 percentile) deals which have seen almost 240% increase in valuation from compared to 190% the median valuation and 150% for higher (the 80th percentile) deals. This does not bode well for future "home runs" because those outsized outcomes typically start with a low valuation – for example, TCA just had a 47x-79x exit last week (Companion Medical) that started at a $1.8 million valuation:



Mix is important in understanding these trends. Much of the increase in 2019 valuations was due to follow-on round valuations surging in that year:

It's no secret that valuations tend to drop at the current downcycle stage of investment– last seen in 2002-2003 and 2008-2010. Surprisingly, TCA's median valuation in the first half of 2020 was down only 6%. To try and understand the future direction, TCA did a survey of its members in May 2020 which revealed that the expectation of declines in the near future is much higher, see chart on next page:

Insight continued on the next page.

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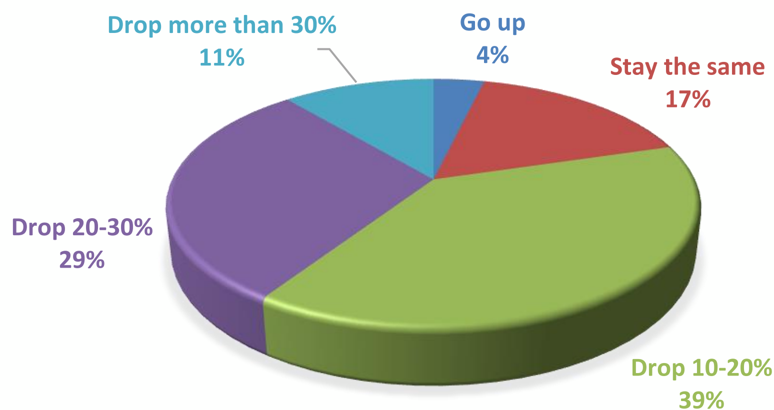
Valuations



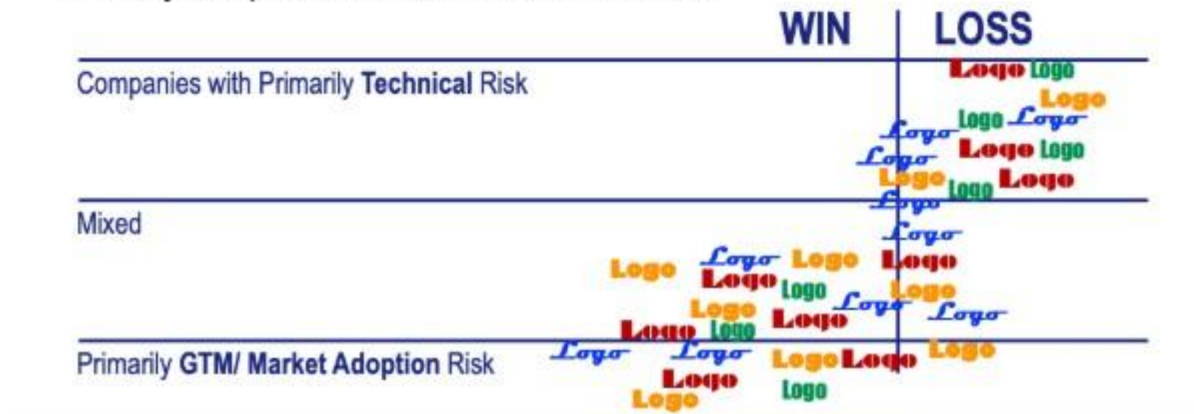
Source: Survey in May 2020 of Tech Coast Angels Members

So, it's good advice to entrepreneurs to be realistic about valuation and not to dwell on past averages. It's a new world. Any investment will be hard, and overpricing can be fatal.

Author: John Harbison, Tech Coast Angels
Publication Date: August 2020

Risk/Outcomes Correlation

This insight reflects on the topic of risk in relation to outcomes. When Launchpad conducted a study of their exits, one of the surprising findings was that they tended to do better when they invested at the point of market entry, rather than in the product building phase. The product building phase is associated with greater technical risk. In theory that should be off-set by lower valuations, but because of the realities of making founder economics work, the valuations did not make up for the increased risk. For more on early stage valuations, see this series on Start-Up Valuations.



Author: Christopher Mirabile, Launchpad Venture Group

Publication Date: September 2019

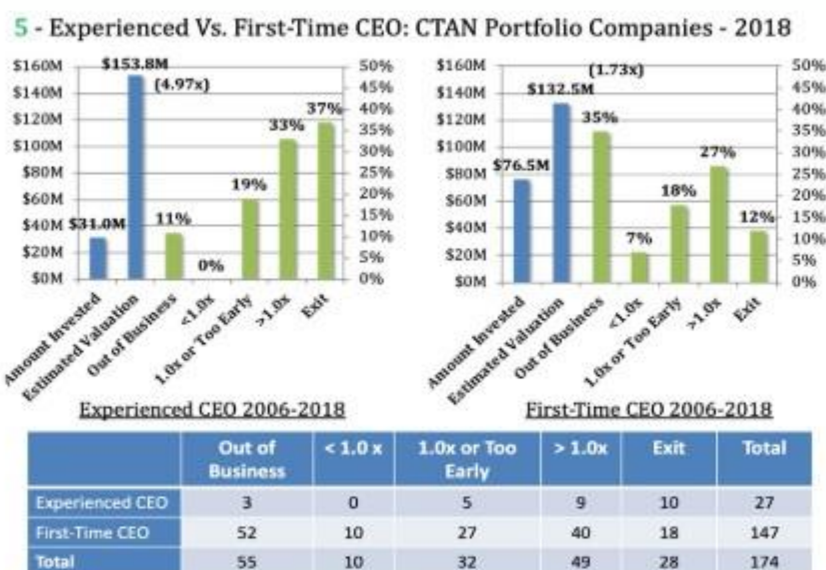
ACA Investor Insights Report 2020
Investment Strategy & Screening/Due Diligence

How Experienced CEO's are Outperforming First-Time CEO's

Does experience impact the performance of seasoned CEO's versus first-time CEO's? The Central Texas Angel Network (CTAN) tracks 83 metrics on every investment that is made by members. CTAN's definition of an experienced CEO is someone that was previously a CEO or co-CEO of a start-up. It does not count for this metric if they were the CTO, VP of Sales or other key positions of a previous start-up. Only those holding the title of CEO are counted.

Of CTAN's 174 investments in 12 years, 27 individuals meet this criteria. **The performance of experienced CEO's versus first-time CEO's is very different.** The experienced CEO's have a current portfolio valuation multiple of 4.97x versus 1.73x for first-time CEO's, or a difference of 287%!

Only 11% of experienced CEO companies have gone out of business versus 35% of first-time CEO companies. Finally, **37% of experienced CEO's have already produced an exit for CTAN investors versus only 12% for first-time CEO companies.** This is key metric that we all know is important but now we have data to support this basic premise.



	Out of Business	< 1.0 x	1.0x or Too Early	> 1.0x	Exit	Total
Experienced CEO	3	0	5	9	10	27
First-Time CEO	52	10	27	40	18	147
Total	55	10	32	49	28	174

Author: Rick Timmins, Central Texas Angel Network
Publication Date: October 2019

How Due Diligence Process Impacts Returns

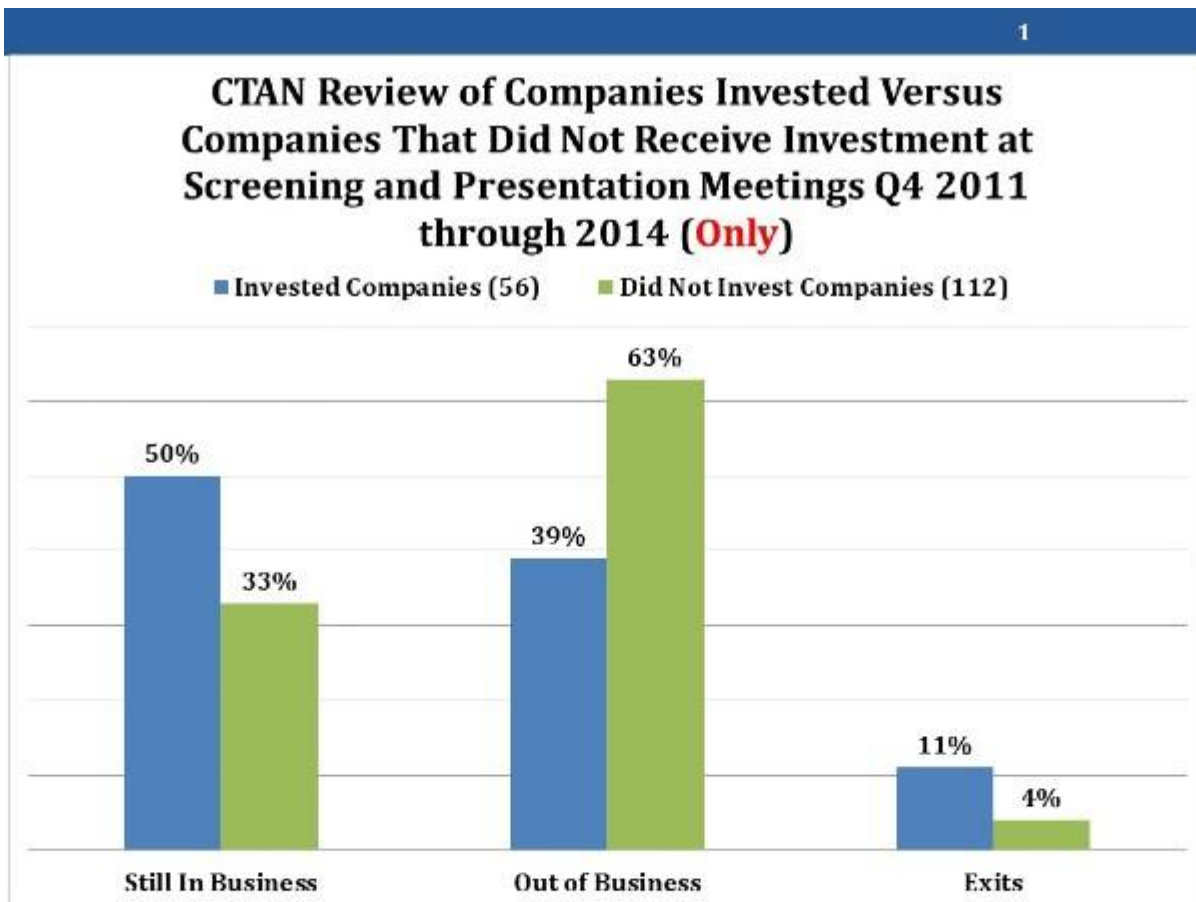
Many of us have seen a study published several years ago by Rob Wiltbank in which he stated that the ROI for companies receiving low diligence (<20 hours) was 1.1x versus the ROI for companies receiving higher due diligence (>20 hours) was 5.9x.

An angel organization gathered data from their own screening process in conjunction with their due diligence (DD) process to demonstrate that impact of these activities to their members. The Central Texas Angel Network (CTAN) has a process in which members vote for companies to come to an initial Screening Meeting where initial DD on the company is performed. If enough votes are obtained for a company at that meeting they move to the Presentation Meeting and more DD is performed. The total of the DD after this event is less than 20 hours. If enough votes are obtained after the Presentation Meeting much more DD is performed (averages between 30-40 hours) by member volunteers and an Investment Director. After successful DD, members are asked to soft circle potential investments.

CTAN tracked their data for just over three years from Q4, 2011 through 2014 and reviewed this data in late 2018 so that outcomes could be analyzed. The data showed that 112 companies went through this process in this timeframe and did not receive funding while 56 companies went through the process, including extensive DD and did receive funding. In the case of companies with more DD and funding, 50% were still in business while only 33% of the companies with much less DD and no funding were still in business. Only 39% of higher DD and funded companies were out of business while 63% of companies with less DD and no funding were already out of business. Finally, 11% of companies with more DD had already exited successfully while it was significantly less at 4% with companies with less DD.

Insight continued on the next page.

ACA Investor Insights Report 2020
Investment Strategy & Screening/Due Diligence



This data shared with CTAN members, helps them understand the importance of good due diligence embedded in the various meetings and the overall process that CTAN members utilize to make decisions to invest in start-up companies. There are two variables at work in this study: 1) significant due diligence on all companies with combined member investments of $200k or more, which is the majority of the 56 investments, and 2) the actual investment by members. **This data helps support the belief that more due diligence can help increase the likelihood of successful outcomes of angel investors.**

Author: Rick Timmins, Central Texas Angel Network
Publication Date: October 2019

ACA Investor Insights Report 2020
Investment Strategy & Screening/Due Diligence

Is Follow-On Investing Beneficial for Angels

Angel investors often ask themselves—is doing follow-on investing a good form of investing in addition to investing in seed rounds?

The Central Texas Angel Network (CTAN) works to gather data around member follow-on investing. Companies were evaluated that have obtained follow-on funding in their portfolio of companies that have either had an exit or have gone out of business. In their portfolio of 174 companies in which members have made an investment from 2006 through 2018, there were a total of 29 exits and 55 companies that have gone out of business.

Source: Central Texas Angel Network, 2006-2018, includes Exits and Shutdowns

Members have made follow-on investments in 17 of 29 companies with exits or 59% of the exited companies. In the case of out of business companies, follow-on funding was done in 17 of the 55 companies or 31% of the time. Clearly members are making far more follow-on investments with companies that have exited successfully compared to those that shut down with no exit. The internal rate of return (IRR) on exited companies was also considered.

The IRR on total exited companies was 50% (when combined with out of business companies the overall IRR is 29%). However if you look at the IRR with companies with follow-on funds (17 companies), the IRR is 54% and in the case of exited companies with no follow-ons (12 companies), the IRR is 11%.

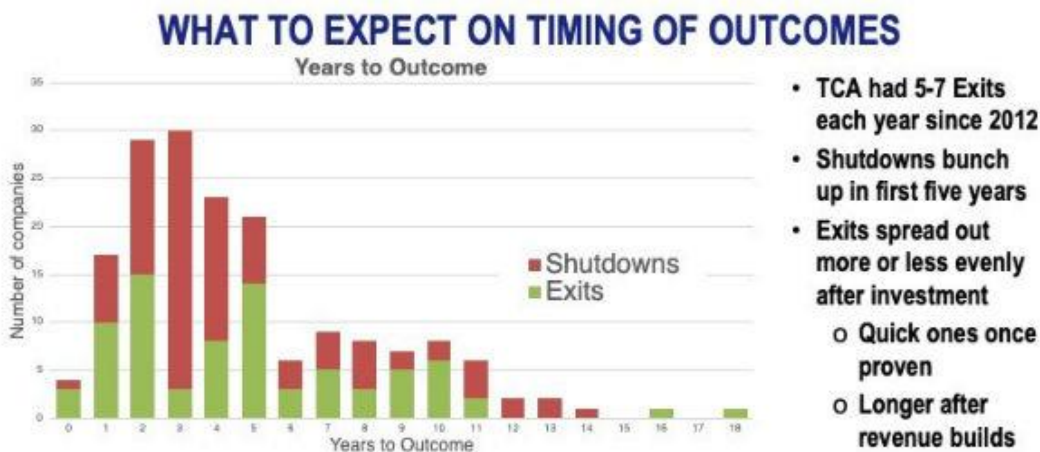
We can conclude for this data that follow-on investing, for the right reasons, can be a successful approach to angel investing, with the capability of producing excellent returns.

Author: Rick Timmins, Central Texas Angel Network
Publication Date: June 2020

ACA Investor Insights Report 2020
Exits

Outcomes Timing Expectations

What should angels expect on timing of outcomes? Based on analysis of 182 outcomes in Tech Coast Angels' portfolio since 1997, shutdowns tend to bunch up in the first five years as they fail to gain sufficient traction and run out of funding. In contrast, exits are spread out more evenly over a longer period.

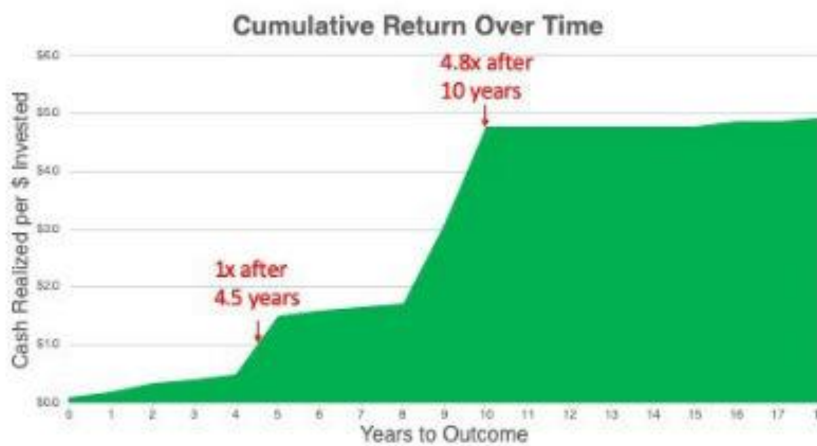


Source: Analysis of 182 Tech Coast Angels Outcomes, Including Exits and Shutdowns

Source: Analysis of 79 Tech Coast Angels Exits that Realized Cash

Insight continued on the next page.

ACA Investor Insights Report 2020
Exits



Source: Analysis of 179 Tech Coast Angels Outcomes, Including Exits and Shutdowns

So, the takeaway is BE PATIENT! Don't be too discouraged if the early outcomes you realize as an angel are disappointing. Failures often come early, but successes take much longer!

Author: John Harbison, Tech Coast Angels
Publication Date: August 2019

ACA Investor Insights Report 2020
Returns

Making Money on Angel Investments

New angels often ask 'can I make money at this?' The answer, if you look at the data, is yes.

Here's a look at one well-diversified portfolio (about 105 companies) put together by a large angel network (about 150 investors working across almost 20 years), with good discipline about doing diligence and crafting reasonable deal terms.

Even when compared to a market benchmark like the S&P500, it is clear that the portfolio has delivered value (and has much more to go - many of the holdings in the portfolio are still less than 5 years old). And this is a fair comparison: while the S&P numbers do not include reinvestment of dividends, the angel values also do not include mark-ups. All un-exited holdings in this portfolio are valued strictly at last transaction value.

So, next time someone asks you if they can make money, the answer is yes, you can make money as an angel if you are patient and use a thoughtful process.

Author: Christopher Mirabile, Launchpad Venture Group
Publication Date: May 2020

Angels Are Not VCs

Angels are not VC Funds. We represent a different asset class that: 1) often invests earlier in company development; 2) generally isn't constrained on how long we can hold investments; and 3) typically make investment decisions as individuals rather than through an investment committee. So it is always risky to make data comparisons between Angel and VC returns.

That said, there are times when using VC metrics can help answer important angel questions. For example, Launchpad Venture Group recently applied a "Total Value to Paid-in-Capital" (TVPI) lens to portfolio returns over the past twelve years to answer the important question "are we building a systematic process to make good investments, or did we just get lucky once or twice?"

TVPI is a metric commonly used by VCs to report specific fund returns while they are still maturing. It includes two parts:

- "Distributed to Paid-in-Capital" (DPI) that covers realized gains or losses from investments, and
- "Retained Value to Paid-in-Capital" (RVPI), which includes unrealized gains/losses in companies that have repriced but not yet exited.

TVPI is typically expressed as a multiple of the original investment basis. The advantage of reporting this way is that you can include returns-to-date for active investments, which given long angel investment horizons may represent a large portion of the portfolio.

Launchpad grouped the portfolio into "cohorts" of investments made within a single year and tracked the TVPI returns of each cohort over time. They also converted these returns to an annualized growth rate to account for the longer holding time of older cohorts. Finally, they compared the returns of each cohort year to Cambridge Associates' top quartile VC fund returns. (This is probably not the most appropriate benchmark for Angel returns, but it is a readily available one).

Insight continued on the next page.

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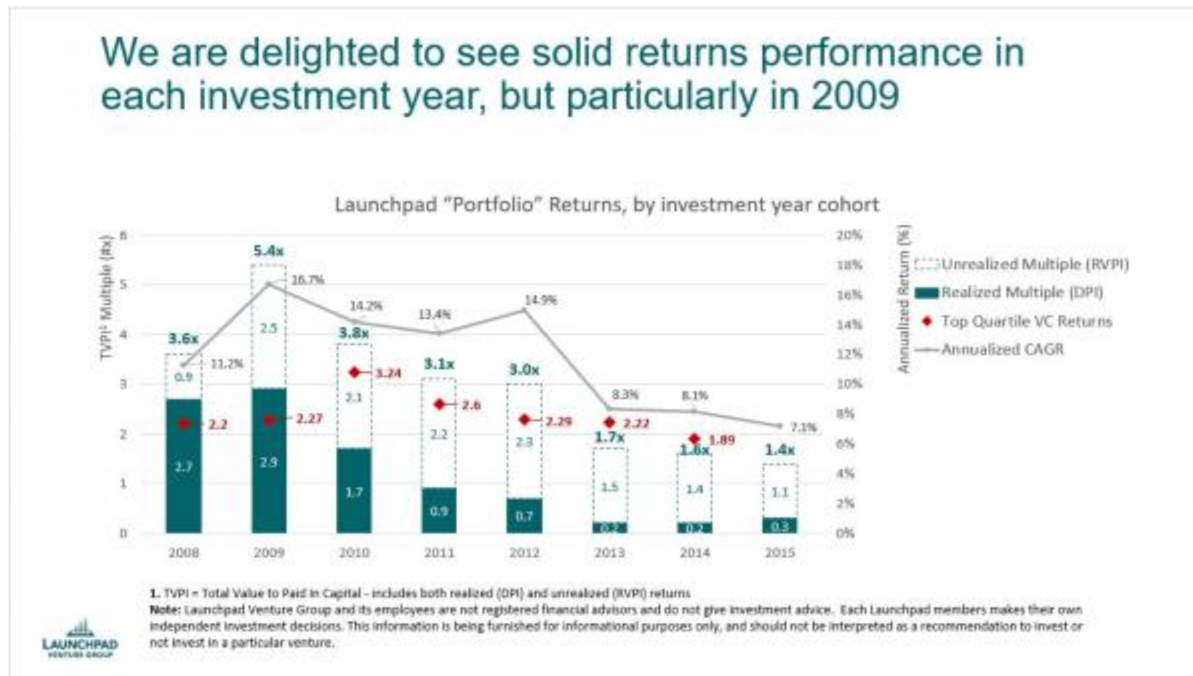
Returns



The analysis yielded three important insights:

1. Launchpad does indeed seem to have built a systematic investment sourcing and diligence process that consistently delivers better than 3x returns (equivalent to top Quartile VC funds) across every year from 2008 to 2012.

2. The highest return year was 2009, in the depths of the last recession, reinforcing that it is important for Angels to continue investing across business cycles.

3. There appears to be an “inflection point” in returns about seven years after the initial investment where TVPI starts to increase dramatically. This suggests it takes about seven years for Launchpad investments to mature, which helps set expectations on how patient Angels must be. That maturation time appears to be two years longer than the equivalent VC benchmark, which makes sense given the earlier stage of most Angel investment.

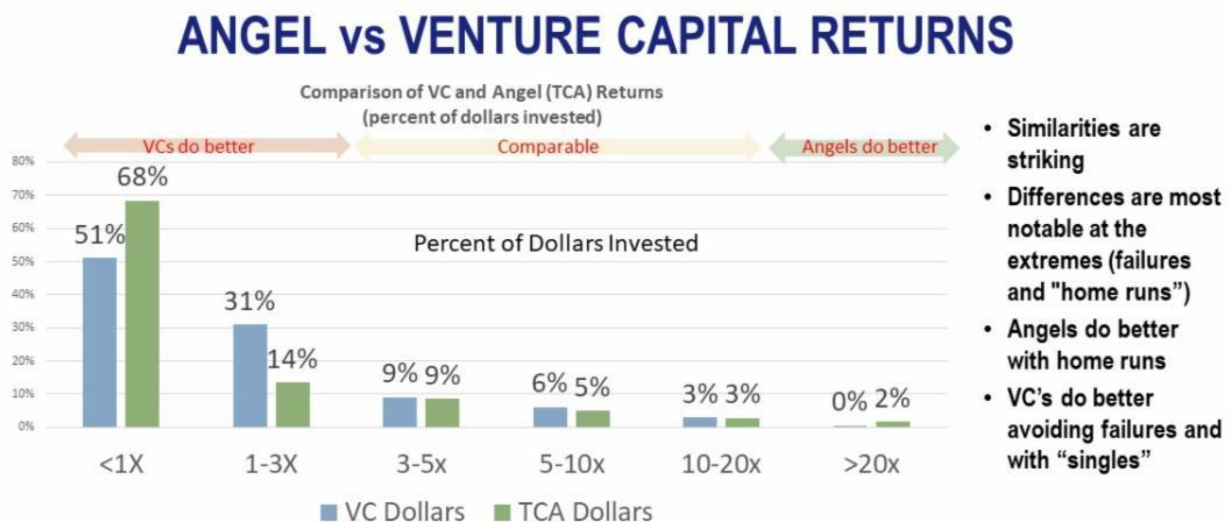
We plan to update this analysis annually to track the evolution of each investment year cohort, inform ways to further improve our processes, and confirm the seven-year inflection point theory.

Author: Ham Lord and Alexander Brown, Launchpad Venture Group
Publication Date: July 2020

ACA Investor Insights Report 2020
Returns

Angel vs. VC Returns

The distribution of financial outcomes for Venture Capital firms and Angels is surprisingly similar, as this comparison shows of 27,878 VC financings to the experience of Tech Coast Angels' in their first 179 outcomes (both exits and shutdowns):



Source: Tech Coast Angels (1997-2019) and Correlation Ventures ($20.5B invested in 27,878 financings (2009-2018) – includes Exits and Shutdowns

But a closer look reveals more nuanced observations:

- The differences are most notable at the extremes (failures and "home runs"). This reflects the higher risk/higher return nature of Angel investing.

- The probability of a "strikeout" <1x return is higher for Angels than for VCs — 68% of dollars in angel deals vs 51% of VC dollars. This makes sense because VCs tend to invest at a later stage when much risk has been taken off the table.

Insight continued on the next page.

- However, probably of a "home run" (>20x) is higher for angels by a considerable margin — 2% of dollars in angel deals vs <1% of VC dollars. This makes sense because angels tend to invest at lower valuations, and because many angel deals don't require significant follow-on dilutive while most VC investments require larger amounts of follow-on capital. So there is less upside for VCs.

- The probability of a "single" (1-3x) is considerably higher for VCs — 14% of dollars in angel deals vs 31% of VC dollars. This makes sense since there is less financing risk in VC deals (since the VCs have more dry powder than angels) and hence the companies benefit from the staying power the VC to hang on long enough until an exit can be found.

- The probability of "doubles" (3-10x) and "triples" (10-20x) is almost identical.

Because angel investing is even more reliant on "grand slam" home runs compared to VC's, diversification is also more important for Angels – especially since most Angels invest in far fewer deals that the typical VC Fund's portfolio.

Author: John Harbison, Tech Coast Angels

Publication Date: October 2020

The Value of Diversification

What is the value of diversification? Based on analysis of the first 159 outcomes (exits and shutdowns) in Tech Coast Angels' portfolio since 1997, if you'd invested equal amounts in all these companies, you'd have realized a 4.8x return. However, based on a Montecarlo simulation of 20,000 possible portfolios of just 5 of those investments, only 26% of TCA investors would have realized a combined return of 4.8x or greater.

SIMULATING DIVERSIFICATION

5 Investments

- **159 Outcomes (Exits and Shutdowns)**
- ***Montecarlo Simulation (20,000 outcomes)***

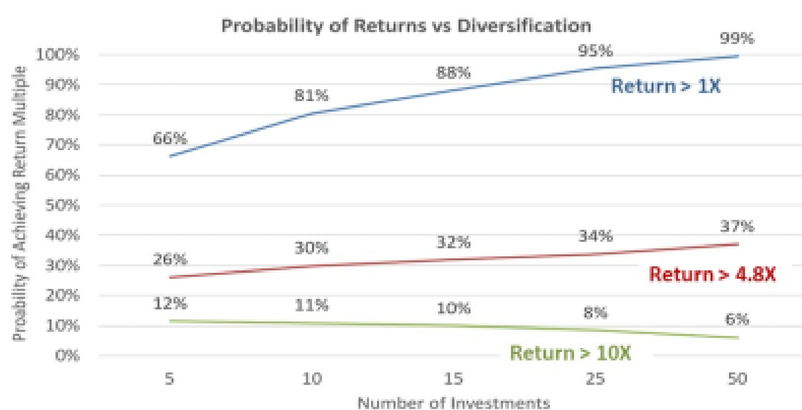
Source: Based of first 159 Outcomes of TCA and Random Selection of Investments & Montecarlo Stimulation of 20,000 Outcomes

This is because any angel portfolio is driven by a very few home runs, and the likelihood of "catching" one of those home runs goes up with more investments. In TCA's case, 3 of the 159 produced 74% of the return (139x, 235x and 263x), so even with a portfolio of 50 investments, it is quite possible to miss all of those home runs. With 50 investments, the chance of reaching the 4.8x is only 37%.

Insight continued on the next page.

ACA Investor Insights Report 2020
Diversification

DIVERSIFICATION IS CRITICAL



- 5 Companies
  - 66% chance of earning at least 1x
  - 26% chance of earning at least 4.8x
- 25 Companies
  - 95% chance of earning at least 1x
  - 34% chance of earning at least 4.8x

Source: Based of first 159 Outcomes of TCA and Random Selection of Investments & Montecarlo Stimulation of 20,000 Outcomes

This explains the recent emergence of many “sidecar” Angel Funds because it would take a lot of capital for an angel to invest in 159 individual investments of $25,000 or more each. Expect to see more Funds in the coming years.

Author: John Harbison, Tech Coast Angels
Publication Date: October 2020

Individual Investor Returns

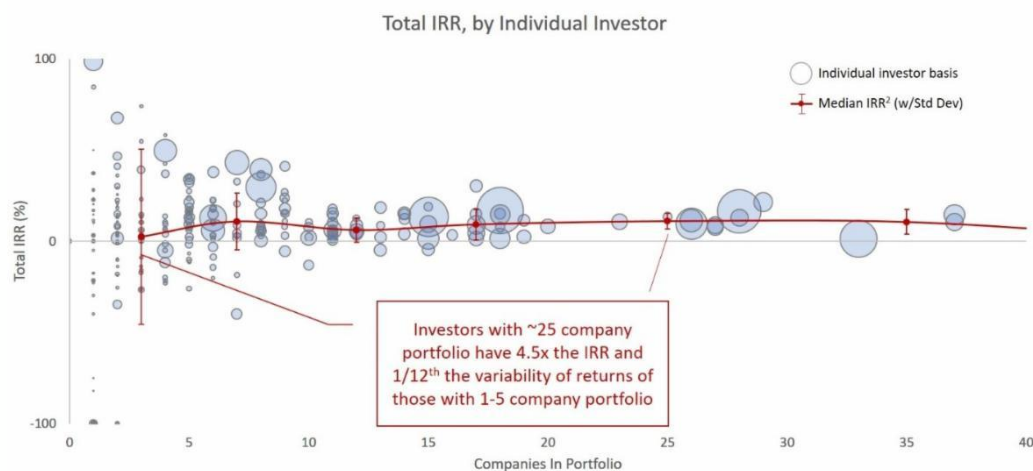
We join angel groups to help streamline deal flow, diligence, and term-sheet negotiation, but at the end of the day we typically invest as individuals, so it is individual returns that matter.

These returns are driven by individual decisions about what companies to support, how much to invest, when to invest in follow-on rounds, and how many companies to include in our portfolio. On this last point, conventional wisdom suggests one needs at least 10 companies in a portfolio to achieve diversification, but more is better.

Analysis

To test that theory with actual data, Launchpad Venture Group dug deeper into median and variability of member-level returns for past and current investments. The chart below shows anonymized individual returns for 278 individual Launchpad members over the past 20 years.

The x-axis shows the number of companies in an individual's Launchpad portfolio, and the y-axis shows their current Total IRR (including both realized and unrealized returns). The size of each bubble is the total amount of money the individual has invested. We also clustered members by number of companies in their portfolio, and have overlaid median IRR and standard deviation of returns for each cluster, in red. Summary statistics are shown on their own in the second graphic to improve clarity.



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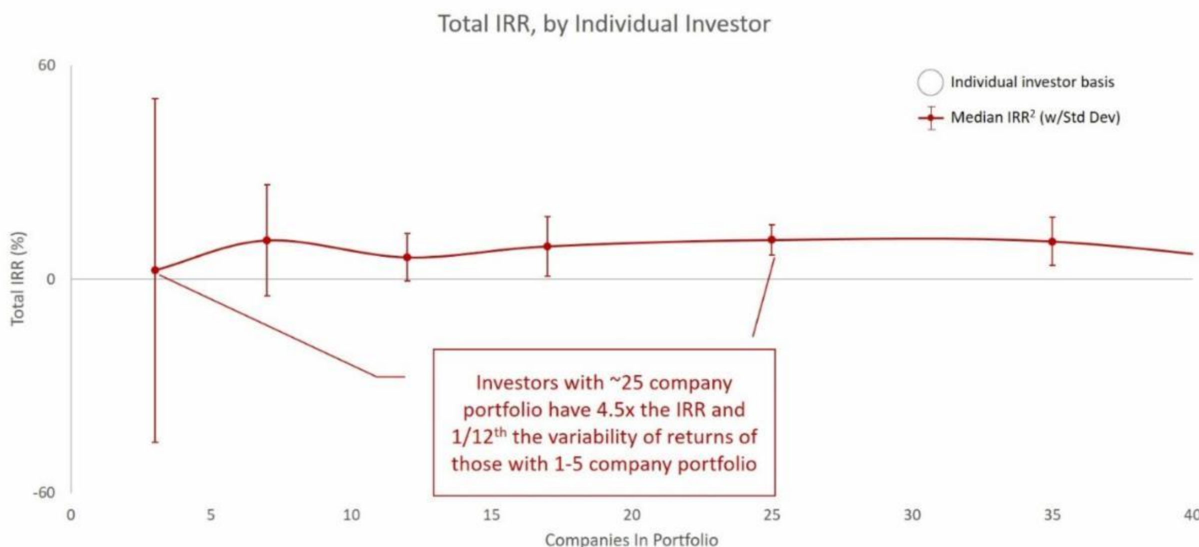
ACA Investor Insights Report 2020
Diversification

Diversification drives higher and more consistent returns



1. Includes 278 investors with at least one investment with measurable returns (either positive or negative) **2.** Median IRR calculated on groupings based on # of companies in portfolio
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We take two key insights from this analysis:

1. As you might expect, diversification is important. Individual returns from investing in only one or two companies range from +100% to -100%. Median returns for the whole group are relatively low, and the standard deviation of returns dwarfs the median return, meaning you are about as likely to lose money as make money this way. Increasing the number of companies in your portfolio to 5-10 bumps median IRR up by a factor of 3-4x and only a few individuals suffered aggregate portfolio losses with this level of diversification.

2. Real diversification takes more than the 10 companies of conventional wisdom. Although median IRR and variability improve dramatically by increasing portfolio size from a handful to a dozen companies, it is only once you get beyond 15-25 companies in the portfolio that median IRR stabilizes at around 4.5x what it was with 1-4 companies, and variance shrinks dramatically to 1/12th of what it was with a 1-4 company portfolio.

We plan to continue to update this view over time to see how total returns shift as the portfolio matures and ensure that new members continue to see the same high-quality opportunities that have driven past performance.

Author: Alexander Brown, Launchpad Venture Group
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ACA Investor Insights Report 2020
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