

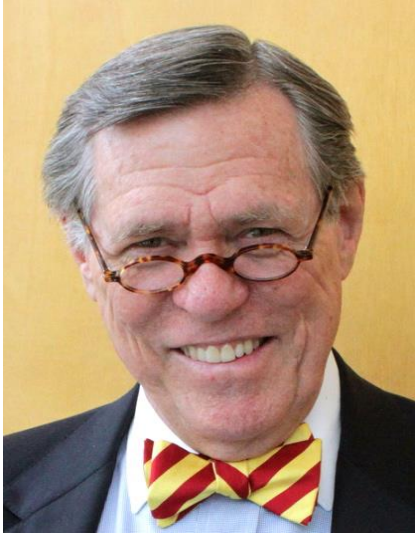


ANGEL CAPITAL ASSOCIATION

After the Check: Seven Tactics to Improve Returns

November 9, 2016

OUR SPEAKERS



John Huston, Chair Emeritus

OHIO Tech Angels



Jim DeCarlo, Shareholder

GT GreenbergTraurig

PREMISES

- Angels love the “Thrill of the Hunt”
- All our returns occur at the exit
- However, angels often spend more time with companies during due diligence than after we’ve invested

QUESTION

Do angels *pick* winners or *nurture* winners?

Definition of winner = a great angel investment (*not* just a great company)

WHICH ONE WILL BECOME “BEST IN SHOW?”



NON-DIRECTOR ANGELS CAN BOOST THEIR RETURNS VIA ENGAGEMENT

We rely mainly on our angel Directors to drive the venture toward a lucrative exit, but.....

- Anyone on the cap table can help
- This morning we will discuss 8 tactics non-Director angels can use to boost their returns

#1: CONTROL CEO'S TOTAL COMPENSATION

Exit Goal Congruence (EGC) with CEO depends upon:

- Below market wage so CEO is not “comfy”
- The higher the CEO's salary today, the larger the exit desired
- CEO's increase in wealth only occurs at the exit (options vest + founders shares)
- At today's low rates, consider CEO's exit proceeds required to replace \$250K of compensation

SO: Who is on the Compensation Committee?

#2: GOAD/HELP THE ANGEL DIRECTORS

Don't be a “high maintenance angel” who:

- Requests special information
- Asks unnecessary questions each time information is provided

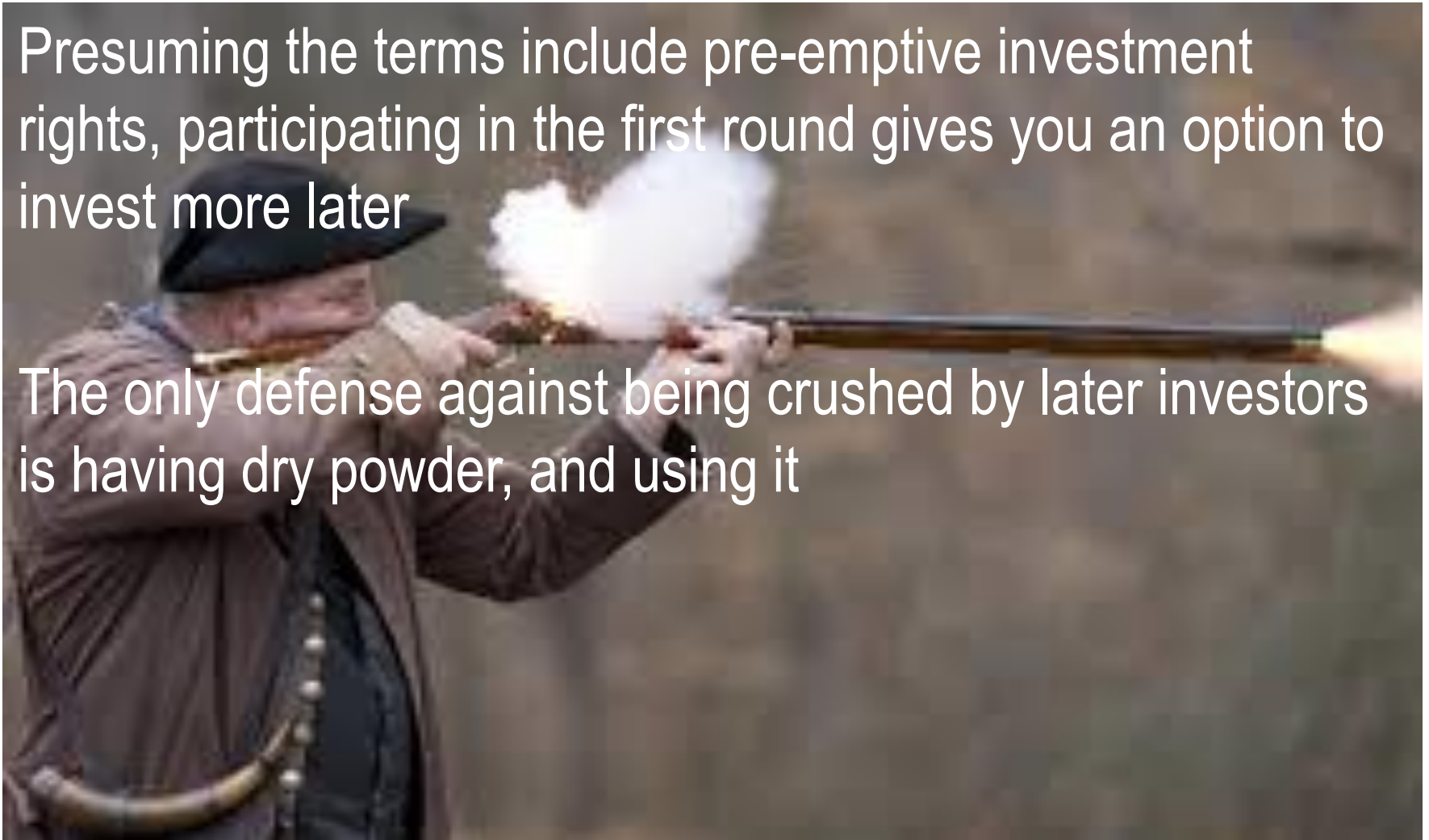
Do:

- Recommend regular reporting of key KPIs that drive bidders' value
- Recommend compensation for angel Directors (1% options)
- Push for a BOD Chair who is not the CEO
- **Offer VC Vetting Questions** + suggest the CEO not lead the VC selection process
- Provide exit expectations reminder: What is the Minimum Acceptable Deal (MAD) the BOD would accept today?

#3: KEEP AMPLE DRY POWDER

Presuming the terms include pre-emptive investment rights, participating in the first round gives you an option to invest more later

The only defense against being crushed by later investors is having dry powder, and using it



THE RULE OF DOPE SLAP INTENSITY

Huston's "Dope Slap Intensity Rule:" Whenever I have lost money, the pain of my Dope Slap was increased exponentially by the number of checks I had written (i.e. Writing two checks quadrupled my pain).

#4: USE YOUR FOLLOW-ON CHECK TEMPLATE

At the minimum, decide what factors will cause you to automatically reinvest or decline, such as:

- 1) Write a second check when
 - You are a Director;
 - Company is performing to plan
 - Round is grossly over-subscribed
- 2) Decline when
 - Lost confidence in the team;
 - Pivot with a divot;
 - More investment won't fix lack of revenues
 - VCs are now essential for an exit (**See EGC**)



#4: USE YOUR FOLLOW-ON CHECK TEMPLATE

Critical IP Issues to consider before check #2:

- Is IP counsel managing the life cycle of the process?
 - Provisional Patents: What's the plan for converting to non-provisional?
 - IP Improvements: How are these being tracked?
- Issues regarding trademarks

#5: MINIMIZE YOUR LOSSES

When the BOD has lost all hope of a lucrative exit:

- If the company becomes a Zombie, what can you do?
http://www.angelcapitalassociation.org/data/Webinars/2016%20Slide%20Presentations/UnexitablesFINAL.pdf?utm_source=website+list&utm_medium=email&utm_term=email-link&utm_content=html&utm_campaign=April+23+Webinar+Flash
- Push your Director contact regarding a Lights Out Reserve (LOR)
- If the venture is a C Corp, ask your tax advisor whether IRC 1244 might apply to any of your loss
- What about selling off the IP from dead companies?
- Does failing as a business mean the idea/IP has no value?

#6: MAINTAIN “EXIT TENSION”

Push your Director contact to:

- Meet with Investment Bankers (*Provide vetting Questions*)
- Put “progress toward the exit” on the agenda for each BOD meeting



#7: UTILIZE FEDERAL TAX BREAKS

Do investors in C Corps or LLCs have access to more federal tax benefits?

Central Texas Angel Network (CTAN) has provided an excellent analysis:

<http://centraltexasangelnetwork.com/entrepreneurs/llc-c-corp-or-s-corp/>

Angel Directors who receive options or profit unit interests should ask their tax advisor about 83b elections + early exercise programs

For lucrative exits from C Corps ask your tax advisor if the either/both of these Internal Revenue Code sections apply to your gains:

- IRC 1202 (tax exclusion)
(<http://www.angelcapitalassociation.org/data/Documents/Resources/Section1202benefitsandpitfalls2.pdf>)
- IRC 1045 (tax deferral for rollovers into another venture)

#7: UTILIZE FEDERAL TAX BREAKS

R & D Tax Credit: The Protecting Americans from Tax Hikes (“PATH”) Act became law December 18, 2015 and allows qualifying R & D expenditures to be credited against:

- Payroll taxes (up to \$250K pre annum)
- Income taxes + AMT
- 20 year carry forward!

Qualifying companies can be in any industry so long as they had employees (W-2), revenues <\$5 MM in 2016, and no revenue before 2012.

Apply for this credit for all 2016 technology innovation in 1Q17

Contact Adam Winter to learn more: awinter@clarussolutions.org

#8: HELP THE BUSINESS GROW

- Assist company with practical business introductions:
 - Provide angel directors (*Angel Director Vetting Questions*)
 - Potential customers
 - Talent for critical hires
 - Other investors for future rounds
 - Potential partners
- Can you be proactive?
 - *Angel Assistance Poll*



SAMPLE EMAIL TO SEND YOUR PORTCO CEO

Greetings, Helen/Henry: *As one of your angel investors I am offering to provide assistance as you grow your team, customer and supplier base, and seek to optimize your own personal financial reward for all your hard work. My attached resume gives my background, but your answers to the 4 questions below will help me think about how I might assist your team over the next 3 months. Thanks in advance for your response (which I will not share with others).*

Staffing: *What are the open positions you are most anxious to fill?*

Suppliers: *What is your largest problem in this area?*

Customers: *What are your top 3 – 5 prospects you most want to convert to customers?*

Other Challenges: *In light of my background, do you see any specific ways I might assist?*

I know your scarcest resource is your time, so please feel no pressure to respond. Besides, I plan to send you this e-mail quarterly. Ideally at some point prior to your exit I can add my experiential and relationship capital to the financial capital I have already provided.

*Best wishes for your continued success,
Angelica/Andrew Angel*

SUMMARY: 8 “AFTER THE CHECK” TACTICS

- 1) Control CEO's total compensation
- 2) Goad/help the angel directors
- 3) Keep ample dry powder
- 4) Use your follow-on check template
- 5) Minimize your losses
- 6) Maintain “Exit Tension”
- 7) Utilize federal tax breaks
- 8) Help the business grow

RESOURCES ON FLASH DRIVE

- VC Vetting Questions
- Exit Goal Congruence (EGC) between angels and VCs
- Investment Banker Vetting Questions
- Angel Director Vetting Questions
- Angel Assistance Poll
- Jim DeCarlo's GreenbergTraurig articles

QUESTIONS AND COMMENTS

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