DILIGENCE PHILOSOPHY

ANGEL SYNDICATES CENTRAL℠

It is far more important to successfully invest in a company that goes on to become a winner, than it is to avoid investing in a few losers.

We are constantly bombarded with contacts and applications for funding from a broad variety of companies and capital-seekers. The vast majority of these will turn out not to be of interest to us. The tendency is, then, to process these applications by looking for reasons to <u>exclude</u> the applicant: too much money, not enough money, too early stage, too late stage, too small a market, an incomplete team, a fierce established competitor, … on and on.

The facts of our investment landscape, though, are harsh, and dictate that we be very careful not to get lost in this exclusionary behavior. The facts are:

1) It is very difficult to tell the winners from the losers at this stage of the game, because there are so many factors that are <u>outside the control of the company</u>, and it will likely be one of those uncontrollables that kills them.

2) It is the 1 in 10 of our investments that returns 10X-20X-30X that pays for the dollars we lose in the other 9. Remember that 70% of the dollars that come back to angels come from 7% of the deals invested in[1]. Because it is not obvious which of the 10 will be a big winner, it is essential that we individually be invested in all 10.

3) Angels that spend more than 40 hours in diligence on each deal enjoy a 7.1X larger return than those that spend less[1].

It is thus VERY important for us to maintain our high level perspective, and <u>work to confirm the reasons to invest that led us to choose this opportunity to begin with.</u> Yes, we also must work to identify weaknesses that we can help the company with, in line with angels' practice to bring our experience and expertise as well as our money. Yes, every company will have plenty of warts to be concerned about, but our task is to size up the warts and evaluate the ability of the team (including us) to successfully manage them, not to dismiss the company because the warts exist. The challenge thus becomes: **It is far more important to avoid excluding a company that goes on to become a winner, than it is to avoid investing in a few losers.**

We want them to take risks in the expectation of unusual rewards for all if they are successful. We want the portfolio diversity that will come from including this company's team, plan, market niche, and set of partners. The ASC diligence process is designed with these goals in mind.

[1] *Returns to Angel Investors in Groups, Wiltbank & Boeker, 2007, Angel Capital Association*