Angel Investing

Deal and Negotiation

FUND·HOUSE

Deal and Negotiation

Structuring the deal is a key aspect of completing an angel round of financing, as such, negotiating and structuring the deal is one of the most complex and important aspects of Angel investing.

> The very first time I ever negotiated a term sheet (and then legal docs for closing the round) I found the experience very frustrating. I was desperate to get my funding finalized to derisk my business as well as to get capital in the bank to meet our growing cash needs.
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> But my VC didn't seem to be in such a rush. Nor did their lawyer.

Deal and Negotiation

Angels normally aim to take 20-25% ownership of early-stage companies.

Valuation = Price Tag

Pre-money Valuation **= value of business before investor funds.**

Post-money Valuation **= value of business after funding.**

Valuation

For the most part: High-end tech, medical/pharma, and clean-tech require large capital input and almost never make sense for an Angel. Best bets for Angels are software and service-related ventures.

Angels are very often at odds with the entrepreneur regarding valuation. Most frequently used valuation method is backing into it from the EXIT VALUE.

Factors At Play In Valuation

- Management Experience
- Size of Opportunity/Addressable Market
- Size of Round
- Intellectual Property
- Barriers to Entry
- Need for Future Rounds
- Industry Comparables
- Exit Opportunities

Structuring the Deal

Equity ownership structures:

- Common Stockholders
- Preferred Stockholders
- Convertible Preferred Shareholders
- Participating Preferred Shareholders
- Convertible Notes

Preferred Stockholders have priority in getting their invested capital back, along with any unpaid dividends BEFORE the common stockholders receive any distribution

Structuring the Deal

Participating Preferred Shareholders will be repaid their original investment plus any unpaid dividends upon liquidation and their share in the remaining assets as if they hold common stock.

Convertible Preferred Shareholders are able to convert their shares to common shares at a predefined conversion rate. CPS are provided downside protection because they have preferred status, and the option to convert to common stock provides upside potential.

Convertible Notes are DEBT that converts to equity including interest. No need to determine valuation in initial pre-money round. **Valuation Cap**: price at which the notes will convert. **Discount Rate**: discount investor receives relative to investors in subsequent funding rounds. Normally, Angels require both valuation cap and discount rate.

Example: Convertible Note

CN has $4 million valuation cap. Pre-money valuation in Series A round is $12 million @ $10 per share.

$4NC/$12PMV = ⅓

Share price $10 x ⅓ = $3.33 share price for CN holder

$10,000 investment / 3.33 = approx. 3,000 shares

In comparison: Investor in Series A at $10,000 would receive 1,000 shares.