Positioning an Angel Investment for Follow-on Funding

Some deals have the potential for follow-on venture capital funding. Structuring the angel investment round to appeal to follow-on venture capital rounds is an important consideration. The following table lists a number of helpful hints for angels to consider when investing in early-stage deals:

Structuring the Deal	Keep it simple	Limit the number and complexity of clauses. Use participation rights rather than anti-dilution clauses. Use a voting trust for multiple small angels. – This will expedite shareholder approval in later rounds.
	Consider the terms	Offer a "bridge loan" that is convertible into the Series A Preferred Stock that VCs will invest (perhaps enhanced by some warrant coverage on common). i. Be sure the loan is a "bridge and not a "pier." ii. Use convertible notes to avoid near term valuation issues at the seed stage, put angels on the same relative footing as later VCs, and align interests among all financing parties. iii. Expect to convert notes at the next round. Avoid more than two types of stock. – Use preferred stock for angels, common for entrepreneurs. Expect that VCs will not want multiple angels on the board unless they bring unusual value or experience.

Valuation	Understand how VCs value the deal	Review the database of venture-backed companies and investors offered in Dow Jones' proprietary VentureOne service. Call other angel groups or VCs to evaluate "comparable" deals and to ensure the comparable used is a good fit. Do not understate a competitor's technology or competitive position when determining valuation drivers. Establish reasonable valuations that stay close to the "accepted" valuation metrics. Typical early-stage valuations will be $1 to $3 million.
	Establish a standard due diligence process	Verify sales figures/financials. Build a capitalization table. Anticipate the follow-on financing rounds. What is the expected: i. Financing needed. ii. Equity issued/dilution. iii. Participation rights.
Communication with VCs	Get feedback on the deal, especially prior to closing angel round	Is there a market for the deal with VCs? What milestones must be met for a VC to invest? What do VCs see as possible obstacles to obtaining future financing or achieving long-term success? Talk to VCs that invest in the industry or "space" that you are investing in. Build up a rapport with VC groups.
	Anticipate the typical timeline for VC decision making	Have the entrepreneur start looking for money prior to needing it. Have a reasonable cash reserve – 3 to 6 months – to close a VC deal. Anticipate the need to have "co-lead" investors in a VC syndicate.

Financing	Maintain a reserve	Keep 50 - 300% of amount invested available for follow-on investment. The actual reserve amount will vary depending on the magnitude of total financing required. Larger reserves allow you to participate in more follow-on financing rounds. A reserve allows you to help your winners cover the potential funding gap between seed and initial VC funding. In a down round, a larger reserve allows the investor to protect the initial investment by taking a pro rata share.
	Understand typical early-stage financing deals	Typical angel financing: Between $50,000 - $2,000,000. Typical VC financing: i. Early-stage funds: Between $100,000 - $3,000,000. ii. Later-stage funds: Between $5,000,000 - $20,000,000. Stay on top of the "market" for early stage angel and VC deals. Check out: i. Aggregated angel deals reported on the Wisconsin Angel Network web site. ii. Early-stage deals reported in the NorthStar Economics Guide to Growth and Venture Capital. iii. The MONEYTREE Survey sponsored by PricewaterhouseCoopers, Thompson Venture Economics, and the National Venture Capital Association. (http://www.pwcmoneytree.com/)
	Lessons learned when closing a VC round	To accelerate closing a VC round, entrepreneurs should maintain a due diligence binder describing market research, existing customers, etc. The need for a large syndication will delay closing a VC round. Complex or unusual board or capital structures will delay closing a VC round.

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Have an addition to this list? Please e-mail WAN at info@wisconsinangelnetwork.com.