National Angel Organization™

Seven Key Questions to Screen Investment Opportunities for Angel Groups

Question 1: Is this a good deal for our Angel group?

Industry Sector: Angel investment groups generally focus on high-growth industry within the range of expertise offered within their Angel membership. With the exception of sector-specific groups, industry preferences are generally defined by industry exclusions. Sectors typically excluded from consideration include: partnerships, proprietorships, franchisees, investment funds, retail stores, publishing, professional or consulting services, real estate, entertainment (television/film/theatre production, restaurants, athletic & recreational facilities, etc.), natural resources (agriculture & agribusiness, mining & mineral exploration, energy generation & oil/gas production, etc.

Question 2: Is this the right team to execute this business?

Ultimately, the investment decision hinges on the Angel's degree of confidence in the management team. A superior product and large market with the potential for a profitable exit are all required components of any Angel investment, but it is the management team that can make or break any deal. At the initial screening stage, when dealing primarily with documents, it is difficult to gauge the personal attributes of the lead entrepreneur. But the documents should reflect the track record of key team members.

There should be a balance of operational expertise (including financial), domain knowledge, and business acumen (including capital markets), though the team does not necessarily need to have all these capabilities from the outset. Angel investors can often be relied upon to help round out the team's management capabilities through their own efforts, or can help to source the right people through their business networks. Ideally, Angel groups look for experienced and passionate teams with relevant industry expertise, a clean reputation, technical capability, enthusiasm, and a willingness to seek out mentorship.

With respect to teams, it is worth noting that there are two primary categories of companies that are not appropriate for Angel groups:

1) The "one-man-show": Any company that could be completely wiped out in the event the lone business or technology expert becomes ill or injured is simply too high-risk.

2) The Family-based business: Long experience in dealing with family-based businesses has led venture capitalists and Angels alike to avoid these opportunities under many circumstances.

Regarding complete submissions, note the entrepreneur's attention to detail. Are they able to clearly and concisely articulate what it is they are doing and how they intend to make money?

Question 3: Does this business have superior proprietary products?

Typically, Angel groups focus on technology opportunities, but Angels with strong marketing backgrounds (usually well-represented in Angel groups) will often consider the “right” services opportunity. The key question when it comes to screening is the ability of the company to scale.
Competitive Analysis: It is absolutely essential for any company to recognize not only that they have competition but to be able to clearly differentiate themselves from competitors. Angels are looking for incremental change in the order of 10X (better/faster/smaller/cheaper). They will also assess the nature of the competition (is there an 800-pound gorilla?), and the degree to which competition can be expected within the first two years. Note that products that represent a paradigm shift in the market, especially those opportunities that require an entirely new market be created, are better left to the deeper pockets of the formal venture capital industry.
Sustainable Competitive Advantage: Angels are looking for companies whose product or service has a strong intellectual property position or other significant barriers to entry that a competitor would have *difficulty overcoming.*

Freedom to Operate: Although this issue is usually dealt with in detail at the due diligence stage, care should be taken to note if the technology developers have recent employment histories with companies active in the same technology sector.
Product Line: Companies should have the technical ability to develop follow-on products. Applicants who have licensed or acquired technology and consequently do not control their technology pose a higher risk to investors.

Question 4: Do the products address a clear need in a large market?
Value Proposition: The submitted documentation should articulate a clear economic value proposition. It is useful to note whether the product is a painkiller (need to have) or a vitamin (nice to have).
Market Size: Is the market large enough to support the revenue projections? Angel groups do not necessarily require the venture capital industry’s minimum $1 billion annual market. It is often prudent to consider companies that, while unlikely to capture follow-on venture capital financing, can reasonably capture a majority position in a $100 million market, if there exist reasonable exit opportunities.
Market Segment: Has the company identified one or more niche market(s) in which there is a reasonable chance of market acceptance for the product? As well, has the company correctly identified who will be making the purchasing decision on the product/service (as opposed to the end users)? Is this group targetable with a minimal marketing effort?
Sales: Does the company have paying customers or beta users as a reference?

Question 5: Is the requested investment sufficient for the company to achieve key milestones?
The capital being sought by the company should be sufficient to achieve a set of milestones that would either make them attractive for follow-on venture investment or bring them to cash flow break-even. Sometimes, particularly in capital-intensive industry sectors such as life science or alternative power, relatively small capital injections are needed to achieve a specific milestone (usually a regulatory approval step). Once achieved, these companies are within reach of formal venture investing, after

which a larger amount is required to bring the product to market. Angel groups that do not specialize in these sectors tend to prefer opportunities that show a reasonable ability to achieve revenue generation based on a single Angel round.

Question 6: Has this company made a compelling case for the overall attractiveness of the business opportunity?

Has the company clearly identified and analyzed its strengths and weaknesses relative to its likely competitors? Are the products or services to be offered being developed with the human and financial resources the company already has or can reasonably obtain?

Question 7: Is this an attractive investment opportunity?

Valuation Expectations: The company valuation must not be wildly unreasonable. It is unusual for any pre-revenue company to be able to justify a pre-money valuation over $3 million across most sectors, though exceptions do occur where there is substantial intellectual property protection in place. An expectation of twice or even three times higher than that baseline may prove justifiable on further due diligence, and if not, the difference falls within the reasonable range for negotiation. That said, any company with a pre-money valuation expectation over $10 million should be rejected outright. Even in the event that this valuation is justifiable, the equity available to an Angel syndicate is not sufficient to warrant the due diligence effort.

Potential for Lucrative Exit: When investing in a group, Angels typically seek returns of at least ten times their initial investment within three to seven years, so a clearly articulated exit strategy that would reasonably provide investors with those expected returns is essential.

The Deal: It is relatively unusual for investment opportunities to specify a set valuation and deal structure but this does occur on occasion, especially in the event of a deal syndicated across Angel groups. Concerns can, and frequently do, arise when the company has secured monies at unreasonably high valuations along with untenable deal structure terms from lone Angels.