Investing in Private Companies

Insights for Business Angel Investors

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HBAN Halo Business Angel Network

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This publication is the result of an agreement signed between EBAN and HBAN with the purpose of serving the organisations' mutual goals of increasing the quantity, quality and success of angel investments in Europe, thus creating a better understanding of angel investment for potential new angel investors and entrepreneurs.

The current document is an adaptation of the original version "Investing in Private Companies, Insights for Business Angel Investors" which was initially targeted to the Irish market.

EBAN – The European Trade Association for Business Angels, Seed Funds, and other Early Stage Market Players

EBAN is the not-for-profit pan-European representative for the early stage investor community, gathering over 100 member organisations in 28 countries. Through direct and indirect membership, EBAN reaches out to 20.000 early stage investors across Europe and beyond. EBAN was established in 1999 by a group of pioneer angel networks in Europe with the collaboration of the European Commission and EURADA.

EBAN's mission is to lead representation of Business Angels Networks and Other Early Stage Investors in start-ups in Europe and to be a platform of exchange and professionalization for them. EBAN powers Entrepreneurship and Innovation by leading, representing and connecting the Business Angels and Early Stage Investment Community to inspire, foster, develop and finance world-class Entrepreneurs in Europe.

Further information is available at www.eban.org

Halo Business Angel Network

HBAN is an all-island umbrella group for business angel networks, dedicated to the promotion of angel investment and supporting the early stage entrepreneurial community in Ireland and Northern Ireland. HBAN works regionally in partnership with the Irish Business Innovation Centres (BICs) in Dublin, Cork, Waterford, and Galway and with Halo Northern Ireland who each run local angel networks. Collectively HBAN actively works to increase the number of angel investors involved in investing in early stage companies and supports the formation of new and existing angel networks, both regionally and internationally.

HBAN, which is a joint initiative of InterTradeIreland and Enterprise Ireland, also acts as a voice to Government, stakeholders, business and the media to promote the interests and needs of the angel investment community.

Further information is available at www.hban.org

This booklet was created by HBAN and was adapted to the European version by EBAN.

Contents

Executive summary

This guide has been prepared to demystify investing in private companies for private investors (known as business angel investors). Investing in private companies is very different to investing in other asset classes.

The following tips are developed further in this guide:

- The most likely outcome of any one angel investment is failure. However studies show, overall, business angel returns are enhanced by using a portfolio approach to investing;
- It is important at the outset for you to decide how you determine success;
- The relationship between investor and entrepreneur is like a marriage but one with a planned divorce;
- Start the process of relationship building well ahead of when the money is needed;
- You should undertake due diligence on the company prior to deciding to invest;
- Entrepreneurs can also undertake due diligence on you, checking your record of support or otherwise, so be prepared for this…;
- You should commit to a non-executive director or advisory role but not an executive role;
- Make sure that every contact with a company addresses the top three investment criteria in some form;
- The best exit is a trade sale for cash…it usually maximises value for all shareholders;
- The revenue potential of the company must demonstrate a scalable business that is capable of producing significant returns for you;
- The best business plans have a great executive summary – the point of an executive summary is to succinctly sell the investment opportunity, not to just describe the business;
- A compelling and fully costed business plan is essential;
- It is important that the company's management team understand and be on top of the numbers;
- Investors rarely want to 100% fund a business and will take comfort from other funders;
- Founders should have ideally had made or intend to make a cash equity investment in the company, i.e. have 'skin in the game';
- Have a realistic valuation expectation – entrepreneurs have to be incentivised;
- An equity deal is not just about the headline valuation;
- An apparently unattractively high valuation can be mitigated by a liquidation preference;

- When considering an investment, you need to take into account any potential future funding rounds and the effect that may have on your ultimate shareholding and returns;
- Whilst there have been many successes by individual investors, participating in an angel syndicate can have significant benefits; and
- Syndicates need to be well managed to take advantage of the benefits and mitigate the pitfalls; the best syndicates use a charter.

Investing in private companies, whilst high risk, can be rewarding and worthwhile with positive financial and non-financial outcomes. If it accelerates the growth of company then entrepreneurs will reap similar rewards.

This is a win-win.

Introduction

This guide has been prepared to demystify the equity investment process. It has a particular focus on what business angel investors should look out for when considering investing in a private company.

Equity capital

Equity capital in this guide refers to equity invested in unquoted private companies[1]. It is not a loan, it is an investment.

You buy shares in a company in exchange for a cash injection. It is unsecured and is permanent capital in a company. You share the risks and rewards with the other shareholders.

Equity capital accelerates growth, adds credibility and inspires confidence amongst customers, suppliers, staff and other funders.

Business angel investors

Business angel investors are high net worth individuals who provide smaller amounts of finance (€25,000 to €250,000) at an earlier stage than many venture capital funds are able to invest. They are increasingly investing alongside other business angels, seed venture capital funds and other investors (eg. crowdfunding platforms, business accelerators, public co-investment funds and family offices).

Angels usually contribute much more than pure cash – they often have industry knowledge and contacts that they pass on to entrepreneurs. Angels will often take non-executive board positions in the companies in which they invest.

The importance of business angels to the equity capital industry has grown significantly in recent years.

With the recent formation and growth of angel syndicates[2], equity from business angels is becoming more and more important to the equity capital industry in Europe.

Rewards

Investing in private companies is very high risk. There is very little data on returns for angel investment.

Recent studies in both the United States and the United Kingdom have indicated that angel investing can generate significant returns through portfolio investing (i.e. investing in more than one company).

A study conducted for ACA[3] showed that overall returns in the US for angel investment were 2.6x[4] in 3.5 years[5].

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[1] Investors usually only invest in limited liability companies so that having a limited company is a pre-requisite to raising investment. Investors do not invest in sole traders or partnerships with unlimited liability.
[2] More than one private investor investing in a company

The study also showed that rate of return improved with the following three core factors:

1. Increased due diligence prior to investment;
2. Experience of the angel investors; and
3. Active involvement in the company once the investment has been made.

A similar UK study[6] by the same researchers showed that the overall return was 2.2x with a holding period of about four years resulting in a 22% internal rate of return ('IRR'). It also showed that 56% of the companies fail[7] and 9% generate a return of more than 10x.

Both studies also showed that investing in follow on rounds often had lower returns. This could be related to the difficulty investors have in determining when to exit investments, particularly ones that do not appear to be successful. It can be a more of a challenge to admit to other syndicate members that an investment has failed and should be written off.

The most likely outcome of any one angel investment is failure. However studies show, overall, business angel returns are enhanced by using a portfolio approach to investing.

Angels do not necessarily measure success purely by return on investment. An individual investor determines success according to personal interests and needs. These could include a mix of:

1. Return,
2. Satisfaction from having helped other entrepreneurs ('giving back' – perhaps reminding them of themselves when younger),
3. Interest in a business model or sector, etc.

Tip: It is important at the outset for you to decide how you determine success.

Key strategic choices are significantly related to better investment outcomes[8]

- Angels with entrepreneurial expertise outperformed those without it, especially in earlier-stage opportunities.
- More than half of the investments were very early-stage, going into pre-revenue ventures.
- Those who invested in opportunities where they have specific industry expertise failed significantly less.
- Those who perform at least some due diligence, even just 20 hours, experienced fewer failed investments.
- After the investment is made, some involvement with the venture was related to improved investment outcomes. However, failure was greater where investors were perhaps too involved, specifically when they held management roles.

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[3] Angel Capital Association
[4] 'x' is times the original investment – anything less than one is a loss
[5] Source: OECD (2011), Financing High-Growth Firms: The Role of Angel Investors, OECD Publishing
[6] Source: OECD (2011), Financing High-Growth Firms: The Role of Angel Investors, OECD Publishing
[7] A definition of 'failure' was not provided but it would be reasonable to assume that it means the investors received less than their money back or, at worst, zero proceeds
[8] Source: NESTA Research Report: Siding with the Angels, 2009

- Exits where the business angel investor had made follow-on investment in the venture were significantly less successful.

Tax incentives for business angels

Several countries in Europe have tax incentives for individuals making investments in private companies. These can assume different forms and a more extensive presentation is provided in EBAN's Compendium of Fiscal Incentives in Europe.

Europe's leading tax incentive for business angels comes from the UK. Enterprise Investment Scheme (EIS) and Seed EIS provide one of the most beneficial angel tax relief schemes in the world. Details should be checked on line, but currently these include significant up front tax relief (30-50%), tax relief on losses at your highest tax rate, no Capital Gains Tax (CGT) on successful investments and CGT relief currently on existing gains transferred into angel investment. To put it another way, most UK tax-paying angels investing in qualifying companies if successful will get to keep all of the gains without tax and if unsuccessful are likely to have over half of such an investment returned by the tax man[9]. Clearly this helps in mitigating the high risk involved in angel investing. While tax relief is never a good reason for making an investment, these benefits are very helpful in mitigating the high risks involved in angel investing. It should be noted however that both EIS schemes apply to capital growth (not dividend income) and also force the use of plain 'vanilla' shares i.e. not preference shares.

[9] Legislation relating to tax incentives changes from time to time and can be found in the following website: www.hmrc.gov.uk.

Equity raising process

Investing equity in a private company is an all-consuming exercise for you as a private investor.

You have to be prepared to put in considerable effort into the process: before, during and after the actual deal is done.

'A marriage with a planned divorce'

The equity process can be described as a marriage although a marriage with a difference, one with a planned divorce (the exit). Therefore, the level of commitment to this business relationship is high.

You are likely to want to join the board of directors of the company and take an active part in the development of the business. Entrepreneurs will need to welcome this participation.

Since your investment is unsecured, you need to become very comfortable with the people you are backing.

'Dating' process

The process starts, to borrow the marriage analogy, with the 'dating' process. This is about you building a robust business relationship with the entrepreneur.

Like the real dating process, attractiveness helps build relationships whilst 'neediness' usually does the opposite. Ironically, when an entrepreneur actively asks you for money, it can come across as 'needy'.

When an entrepreneur goes into a meeting with you seeking money, he will often come out with advice instead. It might be that if an entrepreneur goes into a meeting with you seeking advice, he may come out with money. The former approach may be considered 'needy' whilst the latter is more attractive.

This means that the equity raising process is not like raising debt, e.g. a mortgage for a house purchase, which is more mechanistic.

Tip: start the process of relationship building well ahead of when the money is needed

Understanding what you find attractive

Like any relationship, it is essential that you understand what you find attractive.

It is important that you decide what your personal criteria are when assessing an opportunity. There is more about this later in this guide.

A typical angel investment process

Deal sourcing	Deal sourcing can be proactive or reactive. Most deal sourcing comes through members, through their networks and interactions with other players in the ecosystem
Deal screening	Applications are normally centralised and managed with a software package (Gust is often used). Initial screening can be informal (conducted by some members) or formal (conducted by a group or network manager)
Initial feedback/coaching	Companies making the initial screening will be contacted and may receive some coaching regarding the expectations of investors and how to better present the company
Company presentations	Selected companies may then be invited to present to the members at an event, normally held once a month. Typically 2-4 companies present. The investors then discuss aspects of the company and potential deal in a 'closed' session
Due diligence	Due diligence is normally done on a formal basis and includes: a competitive analysis, validation of product and IP[10], an assessment of the company's structure, financials and contracts, a check of compliance issues and reference checks on the team
Investment terms and negotiations	If members remain interested, term sheets[11] need to be prepared and the company valuation negotiated. Increasingly, angel groups and networks use standardised term sheet templates. The company may present to the members a final time
Investment	Interested members can then invest as an individual or form a syndicate to invest in the company. The final documents are drawn up and a lawyer is usually engaged in the process. There is a formal signing of documents and the agreed-upon funding is collected
Post-investment support	After the investment, investors often monitor, mentor and assist the companies with expertise and connections. In addition, the investors often work closely with the company to facilitate an exit at the appropriate time

Source: OECD (2011a), summarised from ACA, EBAN and Tech Coast Angel materials

[10] Intellectual property
[11] A term sheet outlines the main terms of a proposed investment including amount and percentage shareholding for the investor(s)

Investor due diligence

The studies discussed earlier underlined the advantage in undertaking due diligence prior to making an investment.

Tip: Consequently, you should undertake due diligence on the company prior to deciding to invest.

Due diligence is a process that verifies and confirms statements and views about a business and its prospects. Due diligence reduces the risks of an investment.

Every deal has risks attached to it so that you need to understand what risks to accept and which demand more detailed investigation.

A due diligence programme should help to answer the following questions:

- What is critical to the investment decision?
- Which sources of value need to be underpinned?
- Which risks must be mitigated?

Due diligence falls into the following main areas:

Area	Issues
Commercial and operational	• Company's strategy for delivering identified revenue enhancement and/or cost savings • Technical merits of product/service offering • Strengths of customer and supplier relationships • Competitive positioning • Market outlook • Ability to influence the market • Possible synergies
Management	• Assessment of capability – management interviews • Identification of gaps and future plan • Take up references from previous employers, customers, suppliers and funders
Financial including tax and pensions	• Historic financial performance • Current financial position • Financial model and projections • Tax: all taxes (corporation tax, VAT, employment taxes, rates, stamp duty, import duties, etc.) including deferred tax provided in balance sheet • Pensions: adequate provision in balance sheet

	• IT status and future requirements
Environmental	• Environmental risk of a company's site(s) • Highlight any non-compliance with environmental regulations or company's own policy • Assessment of any 'contaminated land'
Risk management and insurance	• Assessment of any present, future and past exposures
Legal	• Legal compliance with statutory obligations • Ownership of company's IP including patents • Shares properly issued • Assessment of any shares 'promised' to current or former promoters and/or employees

Not all of this will be applicable to a start-up or young company but they should be at least considered.

A sample commercial and legal due diligence questionnaire is included in Appendix A.

Entrepreneur due diligence

Tip: Entrepreneurs can also undertake due diligence on you, checking your record of support or otherwise, so be prepared for this…

This may be a challenge for entrepreneurs since angel investors do not generally have a website or publicly available information. However, through professional online networks and word of mouth within the entrepreneurial community, the entrepreneurs may find some information on you. You are also welcome to facilitate this process if you consider that will incrase the transparency in the relation.

Time to investment

It can take a long time from initial discussions to the completion of an equity investment. This can be up to a year or even longer.

Deals can and have been done much quicker than this. A typical time frame is three to six months.

However, allowing a lengthy time period will help you. You get to know the company, its markets and its management better the more time you have.

Investor commitment

As studies have shown, where there is significant investor commitment in terms of time as well as money then the prospect of success with enhanced returns is increased.

This commitment is before, during and after the deal.

Commitment after the deal is also important.

Tip: You should commit to a non-executive director or advisory role but not an executive role.

As discussed earlier, more involvement than an advisory role by you can lead to underperformance for the company as your contribution could turn from positive help to negative interference.

An involvement of around two days a month can be optimal – however, circumstances may dictate (e.g. at another fundraising process, a senior recruitment, an exit, etc.) that more time is required on occasion.

The exit

The relationship ends with the exit. The different types of exit are discussed in the next section.

Any previous exit experience that you may have will enhance the returns for all shareholders.

Vendor warranties on an exit

One issue to consider on exit is vendor warranties.

Warranties are legal statements that confirm certain issues[12] are true as far as the warrantor knows. The vendors are usually expected to give warranties on a sale to a third party.

It primarily falls on management although investors are increasingly expected to join management in giving warranties. This can be a cause for some conflict between investors and entrepreneurs.

The issue is sometimes addressed by putting some of the sale proceeds into an escrow account[13] for a limited time period[14] to cover any claims against the warranties and/or taking out warranty insurance although the latter can be expensive and hard to obtain cover.

[12] For example: the company is not facing any legal action or that debtors will be realised, etc.
[13] This is a bank account usually jointly controlled by the purchasers' and vendors' solicitors
[14] Time periods vary from six months to two years, even longer for tax warranties

1. Top three investment criteria

Amongst the many investment criteria on which a company can be evaluated, the following three are in the top of preferences for many venture capital investors to assess the attractiveness of a proposition. Business angel investors are probably no different.

The top three criteria are[15]:

1. Management team;
2. Exit opportunity; and
3. Revenue potential.

Tip: make sure that every contact with a company addresses the top three investment criteria in some form

From the above, it is worth noting that venture capital investors are not overly focused on what the company does (the product or service is not in the top three criteria). They are interested in how they will make money from their investment.

Whilst business angel investors tend to focus more on what the company does and aim to add their relevant domain experience to the opportunity, the 'sell' to you is not a 'product sell' but a 'commercial opportunity sell'. Entrepreneurs often miss this point as they are passionate about their product.

Management team

This is the number one, most important criterion for investors. People (investors) invest in people.

Question: how well would you need to know someone before you gave them €100,000 of your own money?

Investors spend a great deal of time becoming comfortable with the management team and the business. They will assess management's knowledge of the market, the opportunity and management's ability to execute the business plan. The management team's track record will be assessed.

Using advisors and/or non-executive directors will add further credibility to a proposition.

A management team consists of more than one person – investors do not usually back one-man bands.

[15] Health warning: some investors do take a different view on the top criteria – you should decide what is important to you

They usually also avoid family businesses with family members (husbands, wives, brothers, sisters, etc.) being actively involved in the management of the business. Investors do not want to add the potential for family relationship breakdown to their list of risks.

Investors like to see at least the core of a developed management team. Early stage businesses in particular often do not have a full time team. Therefore the business plan needs to address how the company plans to fill the gaps in the management team as the business grows and develops.

Exit potential

This is another critical criterion, the second most important.

It is important to recognise that investors want to make as much money as possible from their investment. That is the business that you are in.

Typically an investor will seek to invest at €1 per share and sell at €7 or more per share. Whilst that is the usual aim, outcomes can be lower than this (see earlier discussion on rewards[16]).

Most investors invest for a capital gain at the end of the investment. They do not want to be locked into a company 'forever'. Venture capital funds have a typical life of ten years so that they must make and realise their investments in that time frame. Business angels do not have the same constraints but they still wish to realise their investment, typically in a five year time frame.

Consequently investors seek capital plays rather than income plays (e.g. annual dividends).

There are three main investor exits. They are a share buyback, an Initial Public Offering ('IPO') and a trade sale.

- A **share buyback** is where the company or the other shareholders buy the investor's shares. It is the most unattractive option as it will lead to the investor and the other shareholders being in serious conflict at exit: the investor wants the company to be valued as high as possible whilst the other shareholders will want the company valuation to be as low as possible. Share buybacks do happen but are not preferred at the outset by investors;

- An **IPO** is listing the company's shares on a recognised stock exchange and, in theory, the investor is free to sell its shares on the open market. However, selling a significant amount of shares in a relatively young thinly-traded[17] public company is likely to have a hugely negative impact on its share price (it will bomb!) and is, therefore, usually not a cash exit for investors; and

- Usually the best exit option to maximise investment sale proceeds is a **trade sale for cash**, where all shareholders exit at the same time as the entire company is sold to a third party (usually another corporate). This alignment of interest means everyone wins and is in stark contrast to the share buyback mentioned earlier. The business plan should mention any mergers and acquisitions (M&A) activity in your industry that would give some substance to the trade sale aspiration.

[16] Source: OECD (2011), Financing High-Growth Firms: The Role of Angel Investors, OECD Publishing
[17] Thinly traded means that the volumes of shares traded each day is low compared to the number of shares in issue

Other exits exist (such as secondary buy-outs[18], management buy-outs (MBOs) and liquidation (both solvent and insolvent)) but the one that maximises value for all is the trade sale.

Tip: the best exit is a trade sale for cash…it usually maximises value for all shareholders

Revenue potential

This is the third most important criterion.

The revenue potential needs to demonstrate that the business is scalable; scalable enough to yield the significant return sought by you.

Anything that you identify that demonstrates this is important:

1. The scale of existing orders and sales funnel[19];
2. The size of the market – it needs to be big enough (usually involving international sales) to build a significant business; and
3. Evidence of any other business in the industry showing similar growth to the growth that is being planned.

Tip: the revenue potential of the company must demonstrate a scalable business that is capable of producing significant returns for an investor

[18] Secondary buy-out: where another investor buys the existing investor's shares
[19] Also known as the sales pipeline

2. Company executive summary

The executive summary is the most important part of any business plan.

It should be prepared last and should summarise the main points of the investment proposal to potential investors. It is the hook that should attract your attention and get you to want to read further.

> ***Tip: The best business plans have a great executive summary – the point of an executive summary is to succinctly sell the investment opportunity, not to just describe the business***

Ideally the executive summary should be no longer than one to two pages long. The summary should set out clearly and concisely the main aims and purpose of the business. It should answer your basic questions in a clear, concise and punchy manner.

The summary should address the issues clearly upon which the decision to invest will be made. If, after reading the executive summary, you understand what the business is about and are keen to know more, then the summary has done its job.

The critical points of the financial projections should be addressed in the summary – breakeven points, maximum funding requirements, etc.

It should set out the key strengths of the business be it management, product benefits or market sector. It should detail whether any events such as product licensing or regulatory approval are necessary in order for the business to succeed. It should also address the key risk factors of the proposed venture.

Key elements
Here is the advice given to entrepreneurs. The key elements are:

1. **The Opener**: start with the most convincing statement of why they have a great idea. Often this is about the uniqueness of their solution to address a big problem. Keep it specific and not woolly. If they are already working with world class people, companies or founders that have done it before then mention them here;

2. **The Problem**: explain clearly the pain point (could be current or emerging) being experienced by their customers that they are proposing to solve. This gives the context to establishing their value proposition;

3. **The Solution**: state what they are offering to whom. Is it software, hardware/product, service or a combination? Do not use acronyms but explain in plain language what they have that provides a compelling solution to the problem identified. They may need to explain how they fit into the value chain or distribution channels and why the players in their industry will be keen to work with them. If they have customers and revenue then state that clearly. If not then state when they will;

4. **The Market Opportunity**: explain the market (segmentation, size in value, growth, drivers and influences, how many customers and competitors). Targeting a reasonable percentage of a well-defined growing market will be more compelling than a micro percentage of a very large mature market. Make sure that any values stated are about the target addressable market in which they are operating;

5. **Competitive Advantage**: they have competition – if they do not then there is no market for their solution. As a minimum they are competing with the way business is currently being done. Someone, somewhere in the world, is probably doing what they are proposing to do. So, they need to state clearly what their sustainable competitive advantage is. 'First mover advantage' as their sole competitive advantage rarely convinces investors; they need to state clearly their unique benefits and advantages;

6. **The Business Model**: state how they are going to generate revenue and from whom. They need to demonstrate how their model is scalable and how (what metrics? – customers, licences, units, revenues, margins) the business will be assessed. State what levels will be reached in three to five years;

7. **The Management Team**: the number one criterion used by investors. Explain why their team is destined to succeed. Avoid summary CVs – relate individual team member's experience to the factors that will make the business flourish. Name big branded companies that any of team has worked for if they can;

8. **The Reward**: the summary financial projections need to demonstrate that a significant return will be achieved for their investors' capital. If these are not believable then everything that they have done is wasted. They should show, in summary form, three to five years revenue, overheads, losses/profits, cash balances and headcount – in some cases, it may make sense to include a key driver like number of customers or units shipped; and

9. **The Funding Requirement**: state how much they are raising now. This should be enough money to enable you to reach the next significant milestone. If there will be a future funding round then give an indication of the scale of that round.

The executive summary should not be an extended contents page. It should engage the reader and encourage them to read more. It has to convey the message of the business idea concisely and clearly, missing nothing out and adding nothing new in.

It is exactly what it says – it is a concise summary of the business plan.

An executive summary can also be very useful when an entrepreneur wishes to give someone with limited time a flavour of their business.

A brief, punchy executive summary that grabs the attention could lead to an investment or, indeed, any beneficial business relationship.

Entrepreneurs could send you a one page flyer, based on the executive summary, as a useful 'teaser' document. A standard Investment Summary used by HBAN, is included in the Appendix B.

Business plan

Tip: A compelling and fully costed business plan is essential.

Investors recognise that the outcome may be different, particularly so in 'start-up-land'[20]. However, it remains important to write down plans and goals.

There are plenty of standard business plan templates available. Some of these take the form of a series of questions that the promoter answers and, quite honestly, they look exactly like a set of answers. Sometimes the promoters even leave the questions in as well…not impressive…

It is better to use a methodological approach to preparing the business plan, perhaps using a tool like the Business Cube to answer the fundamental questions.

The Business Cube[21] uses a set of related topical questions that, when considered, come together to complete a section of the plan.

Other methodologies and templates are available including a business plan template from the Dublin Business Innovation Centre[22].

A well thought through business plan makes for a credible proposition as it demonstrates careful consideration has been given to the business and its plans for growth.

[20] New young companies in the early stages of development
[21] More information on the Business Cube: http://www.intertradeireland.com/media/intertradeirelandcom/businesssupport/equitynetwork/Business%20Planning%20Tool%20-%20Business%20Cube%20methodology.pdf
[22] Visit www.dbic.ie for further information

3. Funding requirements

Most companies lose money in the early years – this is not unusual.

More recently, the cost of building a business has fallen so that the funding requirements should not be as high as they used to be.

Historical trading information

Standard financial information in the business plan would be summary historical profit and loss accounts and balance sheets for the years of trading to date, if available, with a brief commentary on them.

Detailed accounts should be included in the business plan appendices.

Financial projections

The business plan should include projected profit and loss accounts and projected balance sheets along with cash flow statements. Again, these should be summarised in the main text of the business plan along with a commentary.

Projections need to be realistic and stated monthly for the first year and either quarterly or annually after that (detailed projections should be included in the business plan appendices).

Crucially, the assumptions underlining the projections need to be clearly stated.

Tip: It is important that the company's management team understand and be on top of the numbers.

This does not mean that the CEO needs to become an accountant but it is vital that when questioned on the numbers, the CEO and management team are able to know what is being asked and to satisfy the investor that they are on top of the numbers.

Professional help with projections

It is worthwhile for entrepreneurs getting professional assistance from an accountant to prepare financial reports and the projections but entrepreneurs still need to know what they mean.

How much to raise?

With an early stage company, a rule of thumb would be to raise 18 months' worth of cash. This provides 12 months to achieve whatever milestones are required to support a further funding round and another six months to raise that funding round.

This ideal may be too high and, therefore, is not always possible to raise. However it can be a useful target.

Costs are generally known but future revenue is not guaranteed so that any formula used to calculate monthly cash burn[23] should give some assurance that the amount being raised will last 18 months.

Therefore, the definition of one month's cash is:

Gross costs per month less secured-only revenue[24] per month

Use of funds table
For what the money being sought will be used should be clearly stated. An application of funds table like the following would benefit a proposition:

Use of funds	€000s[25]
Development costs	250
Working capital	100
Business development	200
Capital expenditure	150
Headroom (contingency)	150
Total	**€850**

Source of funds table
Equally a source of funds table like the following would be helpful.

Tip: Investors rarely want to 100% fund a business and will take comfort from other funders.

Source of funds	€000s[26]	Status
Promoters	250	Committed
External equity – private investors	250	Pitching
External equity – other investors	250	Subject to matching
Government agency – grant	50	Subject to others
Bank debt	50	Credit committee
Total	**€850**	

Both of these tables' totals should equal.

You will want promoters to have 'skin in the game' with a cash equity investment in the company.

[23] Cash burn refers to the amount of cash being used by a business
[24] Cash received from customers
[25] The figures are illustrative only and do not represent a recommended use of funds allocation – this will vary with each different business
[26] Again, the figures are illustrative only and do not represent a recommended source of funds allocation – this will vary with each different business and whether the company is in Ireland or Northern Ireland

Founders working for nothing or low salaries are 'givens' for young companies and will be reflected in the company's valuation.

Tip: Founders should have ideally had made or intend to make a cash equity investment in the company, i.e. have 'skin in the game'

4. Valuation and terms of investment

Valuing young companies is very challenging and is very much an art rather than a science.

The valuation needs to be low enough to ensure you can achieve an attractive return. It needs to high enough to keep existing shareholders incentivised.

Valuing a company is how an equity deal is 'priced'. Valuation is not the only issue – the terms of an investment are also important.

Degree of influence

You will want to have influence, supported by your percentage equity stake, in a company. Therefore, very low percentages of the equity on offer are unlikely to be attractive to you.

Many equity deals are for between 20% and 40% of the equity with 25% to 30% being common.

Tip: Have a realistic valuation expectation – entrepreneurs have to be incentivised

Valuation multiples/metrics

Where there is revenue and/or profits, various multiples or metrics can be applied to establish a valuation.

These metrics can also be applied to future revenue and/or profits and discounted back to today's value.

Examples include:

- A multiple of recurring revenue;
- A multiple of EBITDA[27];
- A multiple of profit after tax; and
- A value for every active user/customer.

Investors are very interested in the potential future value as discussed earlier in the Exit section. Therefore, any multiples and metrics arising from companies being sold in the industry are important to highlight if available.

Studying companies sold in the company's industry may reveal what multiples are relevant. Public companies have to disclose transaction details but private companies do not. As a result, gaining close examples to the company may be a challenge.

However, an entrepreneur knowing something about this is likely to impress on you that he understand your needs.

[27] EBITDA – earnings before interest, tax, depreciation and amortisation

A simplistic example of a valuation based on future profitability is set out in the table below.

Valuation based on future value – illustration only	€000s[28]
Future EBITDA	3,000
Multiple[29] – say	4
Future enterprise value[30]	12,000
Future debt – say	2,000
Future equity value[31]	10,000
Return required – say	10 times
Therefore, value today	1,000
Equity amount sought – say	300
Therefore, equity stake required (300/1000)	30%

In this example, the valuation of €1 million is the post-money valuation, i.e. the value after your cash investment is made.

The pre-money valuation (i.e. the value of the company's equity prior to your investment) is, therefore, €700,000.

Terms of investment
The principal terms and conditions of an equity investment are usually stated in a term sheet (see Appendix C for a sample HBAN term sheet).

Tip: An equity deal is not just about the headline valuation

Valuation is important but the other terms of an investment are important too.

Investment terms and conditions include the following:

- Amount and use of investment;
- Percentage ownership;
- Equity and debt structure;
- Dividend and interest (if applicable) rights;
- Voting rights;
- Management incentive schemes;

[28] The figures are illustrative only and do not represent any preferred outcome – this will vary with each different business
[29] The potential multiple is specific to a particular industry and a company's stage of development – multiples can be lower or higher than the four in this example
[30] Enterprise value is the value of company (i.e. before the deduction of debt)
[31] Equity value is the value of the entire issued share capital of the company and is the value attributable to shareholders

- Exit arrangements;
- Management changes;
- Investor board representation;
- Investor veto rights;
- Reporting requirements and consequence of failure;
- Costs and confidentiality; and
- Steps to closing.

Legal agreements

It is essential that the terms of your investment is outlined in appropriate legal agreements.

The principal legal agreements are:

- Investment agreement (sometimes called a shareholders agreement);
- Articles of association (as amended); and
- Directors' service agreements

Liquidation preference

A term that is common in venture capital deals is a liquidation preference. Some angel deals now include it.

Despite its name, this is not exclusively about when the company goes into liquidation.

In this case 'liquidation' refers to any liquidity event (e.g. when any of the exit mechanisms discussed earlier occurs or when the company goes into liquidation).

There are two types of liquidation preference:

- 'Soft' liquidation preference[32]: on a liquidity event, the holder of shares having a soft liquidation preference will have the right to receive the higher of their money back *or* the percentage shareholding that they hold in the company;

- 'Hard' liquidation preference[33]: on a liquidity event, the holder of shares having a hard liquidation preference will have the right to receive their money back *plus* the percentage shareholding that they hold in the company.

As an investor, if a liquidation preference is being sought then a hard liquidation preference is better for you. However, a hard liquidation preference is harder to defend than a soft liquidation preference.

[32] 'Soft' liquidation preference is not a term in general use but is used here for convenience
[33] 'Hard' liquidation preference is not a term in general use but is used here for convenience. This type of liquidation preference is commonly called a 'double dip'

The following table illustrates how each works. As the exit proceeds increase, the effective percentage of total proceeds attributable to you will fall. Therefore, whilst a liquidation preference can increase your share of the proceeds, it generally considered to be a downside mechanism by investors as it attempts to return at least the original amount invested.

€2,000 investment	**No liquidation preference €000s**[34]	**'Soft' liquidation preference €000s**[35]	**'Hard' Liquidation preference €000s**[36]
Equity exit – total proceeds	3,000	3,000	3,000
Liquidation preference (1X)	Nil	2,000	2,000
Proceeds after preference	3,000	1,000	1,000
Investor's share – say 50%[37]	1,500	Nil	500
Total investor proceeds	1,500	2,000	2,500
Investor proceeds as a % of total proceeds	**50%**	**66.7%**	**83.3%**

As the table implies, the liquidation preference may be higher than 1X (one times investment). Deals have been completed at 2X, 3X, 4X and higher.

Tip: An apparently unattractively high valuation can be mitigated by a liquidation preference

Instruments – types of shares

Cash is invested in a company through one or more financial instruments. A financial instrument is the form that an investment takes.

If you are investing under a government tax incentive scheme then the instrument type you can use may be restricted so that seeking professional tax advice before completing a deal would be essential if you are investing in this way.

The principal instruments are:

Ordinary shares
This is the most basic form of shareholding in a company. Ordinary shares receive any dividends and exit proceeds after all creditors, debt and other share classes are paid. The amount received per share is pro-rata to the total number of ordinary shares in issue. The total number of ordinary shares that you hold divided by the total ordinary shares in issue gives your percentage ownership of the company.

Preference shares

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[34] The figures are illustrative only
[35] Again, the figures are illustrative only
[36] Once again, the figures are illustrative only
[37] This assumes that the investor has a 50% equity stake

Preference shares provide the holder with a preference to dividends and exit proceeds over ordinary shareholders. This preference is usually fixed although a variable element can be used.

Preferred ordinary shares
Venture capitalists use this type of share to provide the benefits of ordinary shares and preference shares in one instrument.

Liquidation preference rights (see above) are usually provided for in preferred ordinary shares.

Convertible loans
Cash can be invested as a loan that can be converted, usually at the holder's option, into shares (usually ordinary shares) at some point in the future. The loan can also carry an interest rate although any payment of interest is usually rolled up to a future date. The basis of conversion (i.e. valuation of the company) can be set at a later date. For example, the valuation used by a future equity funding round (sometimes at a discount to compensate for the 'early risk' taken by the investor) could form the basis for the conversion.

Anti-dilution protection

Particularly in the case of an agreed high valuation, you can seek anti-dilution protection if there is a future 'down round'.

A 'down round' is where a subsequent valuation per share is lower than the previous valuation. In case this, anti-dilution protection re-prices the previous round to the new round's valuation and you will receive extra shares (at a nil or nominal price) as compensation.

(UK: Angels investing under EIS/SEIS cannot use preference shares of any type. Similarly anti-dilution protection will disqualify EIS/SEIS relief.)

Drag and tag provisions

These provisions apply where shares are being sold post investment. Usually drag and tag provisions go hand-in-hand.

A **drag provision** compels other shareholders to sell their shares at the same price as the selling shareholders.

For example, 51% of shareholders wish to sell their shares to a third party and as long as 51% is at or higher than the trigger level[38] then the remaining shareholders can be compelled to sell on the same terms and conditions.

A **tag provision** provides other shareholders with the ability to sell their shares at the same price as the selling shareholders.

For example, 40% of shareholders wish to sell their shares to a third party and as long as 40% is at or higher than the trigger level[39] then the remaining shareholders can join the selling shareholders and can sell their shares on the same terms and conditions.

[38] The trigger can be any agreed percentage
[39] As previous footnote

Multiple funding rounds

When funding young companies, further funding rounds are almost a certainty. As discussed earlier, studies have shown that participating in further funding rounds can reduce investment performance.

Having a reasonable shareholding at the outset based on a reasonable valuation can help to mitigate this problem and leave you freer not to participate in a future round.

Tip: When considering an investment, you need to take into account any potential future funding rounds and the effect that may have on your ultimate shareholding and returns.

If the valuation of the company is increasing at each funding round then this is not as great a concern as if the valuation was static or falling.

Further funding example – increased valuation

In the following example, an angel investor has invested €100,000 for 25% of the equity and a new investor later invests €200,000 for 25% of the equity.

The original angel investor does not participate in this round (although it is important to note that new investors will expect existing angel investors to invest again unless the circumstances for them not doing so are compelling). In this case, whilst dilution is suffered from 25% to 18.8%, the value of the angel's shares has increased by 50% from €100,000 to €150,000.

Capitalisation table	Existing %	First angel invests %	New angel invests %
Management	90.0	67.5	50.6
Staff	10.0	7.5	5.6
First angel investor – €100,000	-	25.0	18.8
New angel investor – €200,000	-	-	25.0
Total	**100.0**	**100.0**	**100.0**
Company valuation – post money		€400,000	€800,000
Value of original angel's shares	-	€100,000	€150,000

Further funding example – decreased valuation[40]

In the following example, an angel investor has invested €100,000 for 25% of the equity and a new investor later invests €200,000 for 35% of the equity.

[40] Also called a 'down round'

Again, the angel investor does not participate in this round. In this case, dilution is suffered from 25% to 16.2% and the angel's share value has fallen below cost.

Capitalisation table	Existing %	First angel invests %	New angel invests %
Management	90.0	67.5	43.9
Staff	10.0	7.5	4.9
First angel investor – €100,000	-	25.0	16.3
New angel investor – €200,000	-	-	35.0
Total	**100.0**	**100.0**	**100.0**
Company valuation – post money		€400,000	€571,429
Value of original angel's shares	-	€100,000	€92,857

5. Angel syndicates

When investing on your own, angel investment is high risk.

> ***Tip: whilst there have been many successes by individual investors, participating in an angel syndicate can have significant benefits***

Business angel syndicates

Syndicates are two or more private investors working together to share the risks and rewards of investing together in private companies. Syndicates can be formal and informal.

Benefits of syndicates

The principal benefits of participating in an angel syndicate are:

1. **Diversified portfolio**: portfolio investing (i.e. investing in more than one company) is a lower risk approach to investment compared to the higher risk 'all eggs in one basket' approach of investing in just one or two companies;
2. **Pooling of economic resources**: pooling of funds provides the opportunity to invest in several companies and/or in larger deals;
3. **Pooling of skills, contacts and experience**: syndicate members will benefit from each other's skills, networks of contacts and experience. This all enhances the possible success and returns of investing; and
4. **Due diligence**: ability to undertake a greater level of due diligence.

Challenges of syndicates

The principal challenges of participating in an angel syndicate are:

1. **Challenges in agreeing goals and actions**: members may have differing goals for investment (e.g. exit time frame) and/or actions when things are going wrong with an investee company. Therefore, it is important that a syndicate agrees at the outset issues like the exit time frame and the approach to taking action when challenges arise;
2. **Time and costs**: there remains a significant time commitment. There can be some costs like membership fees that are payable – these costs are generally not significant; and
3. If you do not invest for a prolonged period of time then **you may be asked to leave the syndicate**.

Syndicate charter

> ***Tip: Syndicates need to be well managed to take advantage of the benefits and mitigate the challenges; the best syndicates use a charter***

The best syndicate groups do this by establishing and agreeing a charter amongst the members.

A Charter will address the following principal issues:

- Standard of conduct of members;
- Confidentiality and conflicts of interest;
- Participation and on-going responsibilities of members including actively participating in pre-investment due diligence and post-investment monitoring and support; and
- Modus operandi including minimum amount that individual investors are expected to invest in any given deal.

A sample charter is included in Appendix D.

6. Conclusion

Investing in private companies is very different to investing in other asset classes.

Here is a reminder of the tips:

- The most likely outcome of any one angel investment is failure. However studies show, overall, business angel returns are enhanced by using portfolio approach to investing;
- It is important at the outset for you to decide how you determine success;
- The relationship between investor and entrepreneur is like a marriage but one with a planned divorce;
- Start the process of relationship building well ahead of when the money is needed;
- You should undertake due diligence on the company prior to deciding to invest;
- Entrepreneurs can also undertake due diligence on you, checking your record of support or otherwise, so be prepared for this…;
- You should commit to a non-executive director or advisory role but not an executive role;
- Make sure that every contact with a company addresses the top three investment criteria in some form;
- The best exit is a trade sale for cash…it usually maximises value for all shareholders;
- The revenue potential of the company must demonstrate a scalable business that is capable of producing significant returns for you;
- The best business plans have a great executive summary – the point of an executive summary is to succinctly sell the investment opportunity, not to just describe the business;
- A compelling and fully costed business plan is essential;
- It is important that the company's management team understand and be on top of the numbers;
- Investors rarely want to 100% fund a business and will take comfort from other funders;
- Founders should have ideally had made or intend to make a cash equity investment in the company, i.e. have 'skin in the game';
- Have a realistic valuation expectation – entrepreneurs have to be incentivised;
- An equity deal is not just about the headline valuation;
- An apparently unattractively high valuation can be mitigated by a liquidation preference;
- When considering an investment, you need to take into account any potential future funding rounds and the effect that may have on your ultimate shareholding and returns;
- Whilst there have been many successes by individual investors, participating in an angel syndicate can have significant benefits; and

- Syndicates need to be well managed to take advantage of the benefits and mitigate the pitfalls; the best use a charter.

Investing in private companies, whilst high risk, can be rewarding and worthwhile with positive financial and non-financial outcomes.

If it accelerates the growth of the company then entrepreneurs will reap similar rewards.

This is a win-win.

Appendix A

Sample commercial and legal due diligence questionnaire

This sample due diligence questionnaire is aimed at larger venture capital deals and, therefore, may be considered a superset of what an angel investor would seek.

STANDARD LEGAL AND COMMERCIAL DUE DILIGENCE QUESTIONNAIRE

PROPOSED INVESTMENT IN SOFTCO LIMITED

Please supply the following information in respect of Softco Limited and each of its subsidiaries (each such company being referred to in this questionnaire as "the Company"). We suggest that you retain photocopies of the documents you send us, so that the two sets of copy documents can in due course be incorporated (where appropriate) in the Disclosure Letter.

Company Details

1. Please supply details of:-

   1.1 the Company's registered number;

   1.2 its registered office;

   1.3 the full names and addresses of its directors; and

   1.4 its accounting reference date;

2. Please supply details of any shareholdings which the Company has in any other companies.

Shareholders

3. Please confirm that none of the Shareholders or directors has an interest in any company or business which competes with the Company's business.

4. Please supply details of:-

   4.1 any loan by or to the Company,

   4.2 any guarantee given by the Company, and

   4.3 any other contract involving the Company, in which any of the Shareholders or Directors or managers of the Company or any persons connected to them has a personal interest.

5. Are all of the issued shares fully paid up? If not, please provide details.

6. Are there any agreements, arrangements or informal understandings between the Company, the Directors its shareholders or any person connected with them relating to the management of the Company or its affairs? If so, please give details.

Plant and Equipment

7. Is the Company's plant and equipment register up to date? Please supply a copy or confirm that it is available for inspection.

Property

8. Please supply details of all freehold and leasehold property in which the Company has an interest (including any licences to occupy), together with copies of all relevant title deeds and documents and (where relevant) authority to inspect the register.

9. Please supply copies of any valuations of such property.

10. Please confirm whether all necessary planning and other consents have been obtained in respect of such property and its current use and supply copies of all consents.

11. Please supply details of any leases, tenancies or licences granted by the Company in respect of such property and copies of the relevant agreements.

12. Please supply details of any leasehold property in which the Company has had an interest in the past.

Intellectual Property

13. Please identify details of all trademarks, trade names, service marks, patents, registered designs, design rights, copyright, know-how and other intellectual property owned or used by the Company in connection with its business.

14. Please supply copies of all Registration Certificates, specifications and all other documents evidencing such intellectual property. Please also supply copies of all agreements relating to the licensing or use of such intellectual property (both to and by the Company).

15. Please provide any patent infringement analysis carried out by the company or any third parties, including search reports from the relevant Patent Offices.

16. Please provide details of any intellectual property infringement claims made either by the Company or against the Company.

Employees

17. Please supply full details of the Company's employees, and of all terms and conditions relating to their employment, including:-

    a list of all employees, giving their names, job titles, ages, dates of commencement of employment, notice periods, salaries and other benefits (including any commission or bonus arrangements, fringe benefits, share incentive and similar arrangements).

18. Please identify employees who are spouses or co-habitees, parents, grandparents, children or grandchildren (including step and adopted) or otherwise related to the directors of the Company.

19. Are there any outstanding claims against the Company from any past or present employee or officer?

Insurance

20. Please supply details of the Company's insurance arrangements (including a schedule stating the insurers, the risks covered, the sums insured and the premiums).

Financing

21. Please supply details of the Company's financing arrangements, including copies of any loan agreements or facility letters (with details of agreed overdraft limits).

22. Please supply copies of any mortgages, charges or other security documentation affecting

the Company, and a copy of its register of charges.

23. Please supply details of any government or other grants to the Company, including any terms under which they may be repayable.

24. Please supply details of any factoring or similar arrangements relating to the debts of the Company.

25. Has the Company exceeded its agreed banking facilities within the last 12 months?

26. Has the Company borrowed or raised any money or taken any financial facility beyond its overdraft facility as at its last financial year end or has it agreed to do so?

Contracts and General Business Matters

27. Please supply details, including copy documents, relating to any of the following:-

    27.1 long-term arrangements (i.e. which may last for more than six months) relating to supplies by the Company;

    27.2 long-term arrangements relating to purchases by the Company;

    27.3 agency, distributorship, franchising or similar arrangements relating to the Company;

28. Please supply details (including copies) of any other contracts relating to the Company which are of particular significance or of an unusual nature.

29. Please supply details of any quotations or tenders by the Company for any major contracts which are currently outstanding.

30. Please supply a list of the Company's major customers (i.e. more than 5% of turnover) and their related turnover and major suppliers (i.e. more than 5% of goods or services supplied).

31. Please supply copies of all licences or consents necessary to carry on the business of the Company (e.g. Consumer Credit Act licences).

32. Please supply details of:-

    32.1 any arrangements for the exclusive supply of goods or services to or by the Company; and

    32.2 any contracts or practices of the Company which are or may be within the ambit of the Restrictive Trade Practices Act or any other legislation relating to competition.

33. Are there any outstanding judgements or court orders outstanding against the Company?

34. Please provide details of any arrangements that involve (or may involve) obligations or long term liabilities which may impose an undue burden on the Company or which by reason of its nature duration or magnitude may impose an undue burden on the Company.

35. Please provide details of any agreement which is liable to be terminated by another party or under which the rights of any person are liable to arise or be affected as a result of any change of control management or shareholders of the Company.

36. Has any event occurred or are you aware of any event which may occur which would constitute a default under any agreement or arrangement and which would have a material adverse effect on the business or prospects of the Company?

Environmental

37. Please supply details of any licences or authorisations which the Company has in respect of environmental matters.

Disputes

38. Please supply details in relation to the Company of any of the following which are current, or which are known to be possible:-

    38.1 litigation or arbitration proceedings (whether as plaintiff or defendant);

    38.2 prosecution; and

    38.3 investigation by a governmental body.

39. Please supply details of any complaints by, or disputes with, the Company's customers, suppliers, employees or otherwise which have occurred since the last accounts date or (if longer) during the last six months.

40. Please supply details of any known failure by the Company to comply with any relevant statutory requirements.

41. To the best of your knowledge has any event occurred which would be likely to give rise to any industrial or trade dispute?

Recent Events

42. Please supply details of any of the following which have occurred in relation to the Company since the date of the last accounts:-

    42.1 any acquisition or disposal of fixed assets;

    42.2 any proposal relating to capital expenditure;

    42.3 the declaration or payment of any dividend or other distribution; and

    42.4 the loss, or anticipated loss, of any major customer or major supplier or any significant change in the terms on which a major customer or major supplier does business with the Company.

Accounts

43. Have the Audited Accounts for the last financial year been prepared on a basis consistent with the accounts for each of the preceding years including the valuation of stock and work in progress?

44. Have the Audited Accounts for the last financial year been affected by any extraordinary exceptional or non-recurring items or by any other circumstance which make the profit or losses for the period of the accounts unusually high or low?

45. Is the trading position of the company fully and fairly represented by the latest management accounts?

46. Have such management accounts (a copy to be attached to your reply) been prepared on the basis of the accounting policies disclosed in the last Audited Accounts?

47. Has the Company carried on its business profitability, in the ordinary and usual course and without interruption or alteration in the nature scope or manner of its business?

48. If the Company’s stock and work in progress good, has any obsolete or redundant stock been written off and is the stock and work in progress valued at the lower of cost and net realisable value?

49.	Has the Company paid all amounts to its creditors as and when they fall due?
50.	Are there currently any outstanding amounts owed by the Company to its creditors which are overdue for payment?

Appendix B

One page investment summary example

Company Profile: Attractive Company Limited

Company: Attractive Company Ltd

Stage of Development: Start-Up

Investment Required: €750,000

Sector: Technology-Software

Skills Sought: Finance; Marketing

Revenues:
2012: €213,000
2013: €2,475,000
2014: €6,511,000

One Line Pitch:
Attractive Company Limited (ACL) is seeking equity funding of €750,000 for sales & marketing expansion and for the hiring of key staff to build an affiliate network for international sales.

Business Summary:
ACL provides cost effective solutions to customers with a well understood need. Using the cloud, customers experience benefits faster and more efficiently than other solutions on the market.

Present Position: The product has been developed and has undergone pilots in Ireland. The system is fully functional in Ireland and the UK and a new property can be switched on within a week.

IPR Position/Strategy:
ACL has developed its own software and owns the IP. The intention is to establish and grow the ACL brand rapidly in its key markets.

Sales & Marketing:
ACL will focus on its target customers with Ireland, UK and USA being targeted initially. For larger customers there will be a direct sales approach with a list of prospects identified and engagement already progressing. Two experienced senior industry experts will be hired. For smaller customers ACL will conduct an extensive marketing campaign.

P&L Summary

'000s	2014	2015	2016
Total Sales	xxx	xxx	xxx
COS & Overheads	xxx	xxx	xxx
EBITDA	**xxx**	**xxx**	**xxx**
Margin	-	xx%	xx%
Employees	10	17	24

Financial Information (EUR): Customer pays €50 per month for entry-level system. The target number of customers will rise from 340 in 2014 to 4,088 in 2016.

Target Market: The Opportunity
There are 12,000 customers in the UK, 55,000 in the US and 900 in Ireland. In Europe, there are over 132,000 customers. Additional opportunities exist in other international markets.

Management & Shareholding:
John Experienced, Founder & CEO: 25 years' experience in global sales & service management with BigCo. Founder of innovation consultancy, working internationally on customer-experience projects in multiple sectors.
Joe Brains, CTO: Over 20 years' experience on CRM and mobile projects working with private and public organisations.
Mary Smith, COO: Over 25 years' experience in ramping and running technology businesses.

Appendix C

Sample term sheet[41] (no values)

This document is for guidance only and neither HBAN nor Venture Legal Services (who have prepared this sample term sheet for HBAN) shall have any responsibility or liability for actions taken based on the information contained in this document or any loss or damage arising out of use of this document.

Venture Legal Services is a modern law firm advising corporate and private clients with a particular focus on the angel, start-up and venture capital sectors.

Term Sheet in Respect an Investment of up to €[•] in [Company]

1.	Company	[*Company*]
2.	Founders	[*Name1*], [*Name2*] & [*Name3*]
3.	Investors	*[Investor1*] [The lead investor(s)], [*Investor2*] & [*Investor3*]. [*The lead investor(s) shall be authorised to represent the interest of the investors collectively in relation to the company.*]
4.	Investment Security	[*Ordinary shares of [€0.01] each]/[Preference Shares of [€0.01] each]/[6%] Convertible Loan Notes*]
5.	Closing Conditions	• Completion of due diligence satisfactory to the Investors • Satisfactory assignment of IP rights to the company • [Incorporation of reincorporation in Ireland] • [Other (if applicable)]
6.	Pre-money valuation	€[•] on a fully diluted basis including an unallocated employee share option plan ("ESOP") of up to [•]% and on the basis that the Investors would hold no less than [•]% of the company on a fully diluted basis after Closing.
7.	Capital Table	The Company's capital structure before and after Closing is set out in Schedule 1
8.	[BES	The company will on prior to Closing deliver to the investors a RICT Outline Approval and will use its best endeavours to secure full RICT Approval as soon as possible after Completion.]
9.	Liquidation Preference	In the event of a (i) liquidation (ii) sale or (iii) exclusive license or other disposal of substantially all of the equity or assets of the company (an "Exit"), The Investors shall be entitled to receive the higher of: (a) The amount of €[•] being the amount invested by the investors plus any declared but unpaid dividends; or (b) The investors' pro rata share (based on their ownership of shares) of such assets or proceeds.

[41] This sample term sheet was prepared In compliance with Irish law. Northern Ireland law is similar but there are some differences, particularly around tax relief for individuals making investments in private companies.

10.	Protective provisions	The consent of the holders of a majority of the securities held by the Investors (an "**Investor Majority**") shall be required for any of the matters listed in Schedule 2, Part A. The consent of the Board shall be required for any of the matters listed in Schedule 2, Part B.
11.	Conversion	The Investor Shares shall convert 1:1 to ordinary shares at any time at the option of the holder, subject to adjustments for stock dividends, splits, combinations and similar events and as described below under "Down Round Protections".
12.	Down Round	[Alt1: If the Company issues additional securities at a price per share less than the Conversion Protection Price then the Conversion Price shall be adjusted on a weighted average basis in line with the following formula: CP2= CP1 X (A+B) / (A+C) where: CP2 = Conversion Price in effect immediately after the new issue CP1 = Conversion Price in effect immediately before the new issue A = total number of shares on a converted basis B = aggregate consideration received by the Company under the new issue divided by CP1 C = number of shares issued in the share issuance.] [Alt2: No price based on the down round protection]
13.	Pre-emption	All shareholders will have a pro-rata, without obligation, to participate in subsequent financings of the company (subject to customary exceptions). Any shares not subscribed for may be reallocated among the other shareholders. Each Investor may assign this right to any affiliate or family member.
14.	First Refusal & Tag Along	The Investors shall have a pro rata right, without obligation, to participate on identical terms in transfers of any shares of the Company, and a right of first refusal on such transfers (subject to customary permitted transfers, including transfers by Investors to affiliates or family members). Any shares not taken up by the Investors will be offered to the other shareholders.
15.	Drag Along	In the event that the holders of a majority of the Ordinary Shares wish to accept an offer to sell all of their shares (or otherwise transfer effective control of the Company) to a third party then subject to the approval of the Investor Majority and the Board, all other shareholders shall be required to sell their shares or to consent to the transaction on the same terms and conditions subject to the Investors' liquidation preference.
16.	Non-Competes	Each Founder will enter into an employee agreement (containing customary non-compete and non-solicitation obligations) in a form reasonably acceptable to the Investors and shall agree to devote their entire business time and attention to the Company and not to undertake additional activities without the consent of the Investor Majority. A material breach of any of those undertakings will result in dismissal for the cause of such founder.
17.	Vesting	Shares held by the founders will be subject to reverse vesting

		provisions over three years as follows: [25% to invest one year after Closing and the remaining 75% to vest in equal monthly instalments over the next two years]. If a Founder leaves the Company voluntarily or is dismissed for cause, they shall offer for sale to the Company (with a secondary purchase option for the Investor) any unvested shares at the subscription price therefor.
18.	Board	The board shall consist of a maximum of [three] directors. The shareholders other than the Investors shall have the right to appoint two members to the board and the Investor Majority shall have the right to appoint one member or one observer to the board. The Company shall pay the Investor Majority representative so appointed a monitoring fee of €[•] per annum.
19.	Information Rights	Each Investor will be entitled to receive from the Company monthly management accounts (within 5 days of each month end), annual financial statements (within 90 days of each year end) and such other information as each Investor may reasonably require.
20.	Documentation	The Investors' counsel will draft the documentation necessary to implement the investment, which shall include customary convents, representations and warranties of the Company (limited to a maximum of the investment amount) and the Founders (limited to a maximum of 25% of the investment amount).
21.	Key man insurance	The Company will [at/as soon as practicable after] closing put in place key man insurance in favour of the Company of no less than €[•] over the lives of [Founder1, Founder2, & Founder3].
22.	Expenses	The Company shall bear the reasonable expenses of one counsel to represent the interest of all Investors, not to exceed €[•]. [*The Company shall on the date of execution of this Term Sheet make a prepayment in the amount of €[•] in respect on the Investors' expenses as aforesaid.*]
23.	Exclusivity	In consideration of the Investors committing time and expense in progressing the fundraising contemplated under this Term Sheet, the Company and the Founders agree not to discuss, negotiate, or accept any proposed sale, investment or other transaction which might conflict with the terms of the investment contemplated herby for 60 days from the date of execution of this Term Sheet.
24.	Confidentiality	The Company and Founders agree to treat this Term Sheet confidentially and will not distribute or disclose its existence or contents outside the Company without the consent of the Lead Investor, except as required to its shareholders and professional advisors.
25.	Legal effect	This Term Sheet is not intended to be legally binding, with the exception of paragraphs 22, 23, 24 & 25, which are binding upon the parties hereto and shall be governed and constructed in accordance with the law of Ireland.

Schedule 1: Capital Structure before and After Closing

Part A: Capital Structure before Closing

Shareholder	Class of share	No. of shares	Issue Price	Shareholding
Founder 1			€•	•%
Founder 2			€•	•%
Founder 2			€•	•%

Part B: Capital Structure After Closing

Shareholder	Class of share	No. of shares	Issue Price	Shareholding
Founder 1			€•	•%
Founder 2			€•	•%
Founder 3			€•	•%
Investor 1			€•	•%
Investor 2			€•	•%
Investor 3			€•	•%
ESOP			€•	•%

Schedule 2: Protective Provisions

Part A: Matters requiring the approval of an Investor Majority

The Company shall not without prior written approval of the Investor Majority consent:

1. vary in any respect its articles of association or the rights attaching to any shares of the Company; or

2. increase the amount of its issued share capital, grant any option or other interest (in the form of convertible securities or in any other form) over or in its share capital, redeem or purchase any of its own shares or effect any other reorganisation of its share capital; or

3. issue any loan capital or enter into any commitment with any person with respect to the issue of any loan capital; or

4. apply for the listing or trading of any shares or debt securities on any stock exchange or market; or

5. pass any resolution for its winding up or present any petition for the appointment of an examiner (unless it has become insolvent); or

6. incorporate any subsidiary or acquire shares in any other Company or participate in any partnership or joint venture (incorporate or not); or

7. close down any business operation or dispose of or dilute its interest in any of its subsidiaries from time to time; or

8. amalgamate or merge with any other company or business undertaking; or

9. enter into any transaction or arrangement of any nature whatsoever (other than service contracts approved by the Board) with any of the Company's members or directors or any person who is connected to any of its members or directors whether or not any other person

shall be party to such transaction or arrangement; or

10. enter into any arrangement, contact or transaction outside the normal course of business or otherwise than on arms' length in terms; or
11. enter into, as lessor or as lessee, any operating lease (as defined in Statement of Standard Accounting Practise 21) for a duration exceeding five years or involving aggregate premium and annual rental payments in excess of [€50,000]; or
12. grant any rights (by license or otherwise) in or over any intellectual property owned or used by the Company in the ordinary course of business; or
13. create or permit to be created any mortgage, charge, encumbrance or other security interested whatsoever on any material asset or the business of the Company in whole or in part or any of its shares, other that (a) liens arising in the ordinary course of business, and (b) any charge arising by the operation or purported operation of title retention clauses and in the ordinary course of business; or
14. establish or amend any profit-sharing, share option, pension scheme, bonus or other incentive scheme of any nature for the directors, officers or employees; or
15. agree to remunerate (by payment of fees, the provision of benefits-in-kind, or otherwise) any officer of or consultant to the Company at a rate in excess of €[•] per annum or increase the remuneration of any such person to a rate in excess of €[•] per annum; or
16. enter into or vary any contact of employment providing for the payment or remuneration (including pension and other benefits) in excess of a rate of €[•] per annum or increase the remuneration of any staff (including pension and other benefits) to a rate in excess of €[•] per annum.

Part B: Matters requiring the approval of the Board

The Company shall not without prior written approval of the Board consent:

1. adopt or amend its annual Business Plan, or enter into any contact or commitment not provided for in the Business Plan under which it may incur costs in excess of €[30,000], or which may not be influenced or completed within the period of one year; or
2. make agreement with any revenue or tax authorities or make claim, disclaimer, election or consent exceeding €[30,000] for tax purposes in relation to the Company or its business; or
3. change either (a) the Company's auditors, or (b) its financial year end; or
4. make or permit to be made any material change in the accounting policies and principles adopted by the Company in the preparation of its audited and management accounts except as may be required to ensure compliance with the relevant accounting standards under the Companies Acts 1963 to 2009; or
5. declare of pay any dividend that exceeds in any year [20]% of its post-tax deductible profits as shown by the audited accounts for that year, or make any other distribution (by way of capitalisation, repayment or in any other manner) out of its distributable profits or any of it reserves; or
6. make any loan (otherwise that by way of deposit with a bank or other institution the normal

business of which includes the acceptance of deposits) or grant any credit (other than in the normal course of trading) or give any guarantee (other than in the normal course of trading) or indemnity; or

7. give any guarantee, suretyship or indemnity to secure the liability of any person or assume the obligation of any person; or
8. open or close any bank account or alter any mandate given to the Company bankers in relation to any matter concerning the operation of the Company's bank accounts; or
9. Dismiss any director, officer or employee in circumstance in which it incurs or agrees to bear redundancy or other costs in excess of €[30,000] in total; or
10. institute, settle or compromise any legal proceedings (other than debt recovery proceedings in the ordinary course of business) instituted or threatened against the Company or submit to arbitration or alternative dispute resolution any dispute involving the Company.

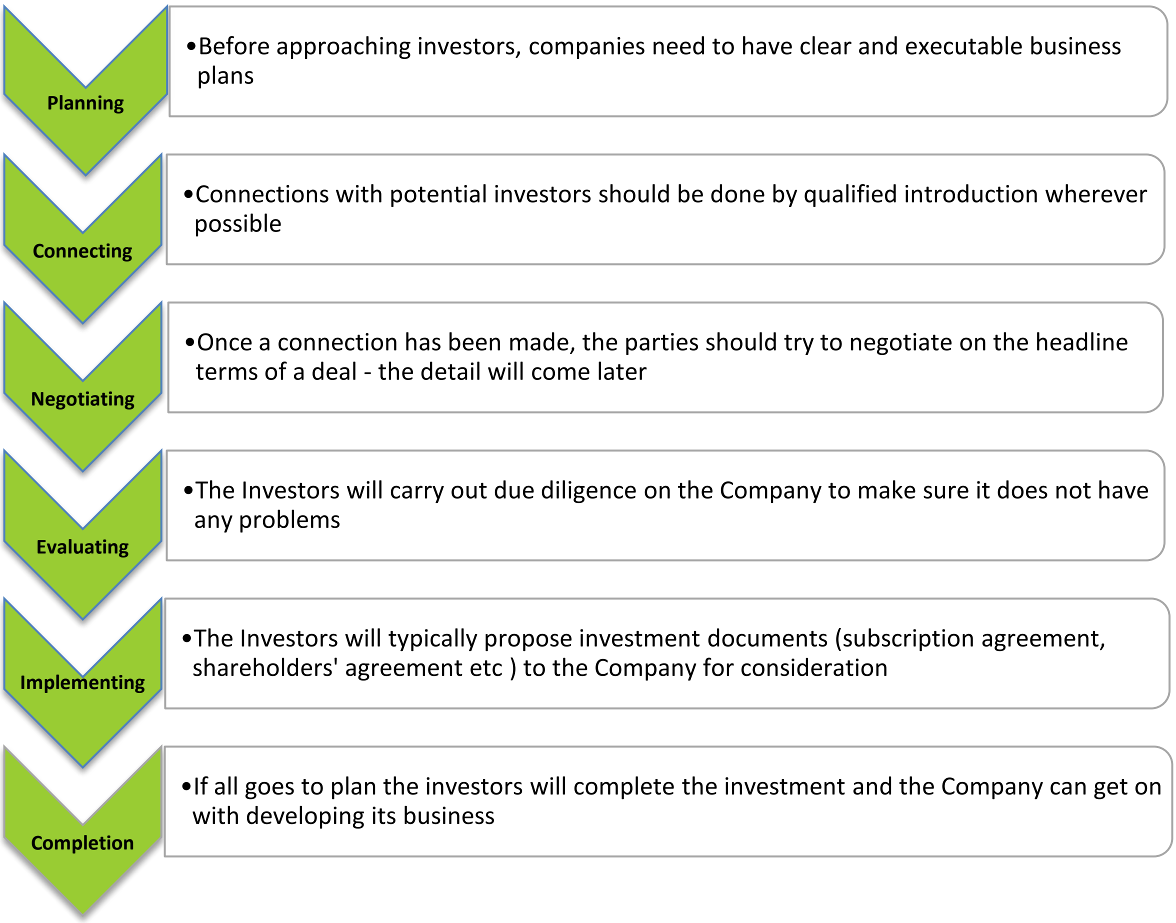
TERM SHEET GUIDANCE NOTE

1.	Company	This section should set out the full corporate name (incl. any registered business name(s)) of the company that will issue shares to the investors.
2.	Founders	These are the people that are leading the growth of the Company. They will typically be asked to give various commitments in relation to the status of the Company at closing ('warranties'), in relation to how the Company carries on its business and to protect the Investors' interests.
3.	Investors	Self-explanatory. It is important for angels to agree a mechanism to allow the Company to deal with only one (or at least a small number) of the angels to avoid 'swamping' the executive team.
4.	Investment Security	Typically investors will invest in either ordinary shares (ranking alongside the Founders), preference shares (ranking ahead of the Founders in certain respects (but unable to avail of certain tax incentives in Ireland and UK)) or convertible loan notes (transferable loans that are convertible into shares in certain circumstances). Founders will typically prefer to issue ordinary shares – the Investors and the Founders will sit side by side and rank equally. Investors may require various preferential rights, in which case they will wish to receive preference shares. In some cases (eg where valuation cannot be agreed or where a further fundraising is contemplated shortly at a higher valuation) a convertible loan note may be an appropriate investment security. Convertible notes are generally least common in an Irish context.
5.	Closing Conditions	The investment agreement will set out the matters that must be done before closing can occur.
6.	Pre-money Valuation	Both sides must fully understand the valuation and its implications. A convertible loan note can be used effectively to postpone a difficult valuation discussion. Basic explanations of pre-money and post-money valuation are available online and US and UK articles will generally be

		relevant in an Irish context without change.
7.	Capital Table	This provides a useful snapshot of the Company's capital structure before and after completion. It should always be verified against the original statutory registers at the time of closing.
8.	BES	Business Expansion Scheme (BES) and Enterprise and Investment Incentive Scheme (EIIS) in Ireland and Enterprise Investment Scheme (EIS) in the UK all offer tax advantages (subject to certain conditions) for investors in certain companies.
9.	Liquidation Preference	The Liquidation Preference describes the preferential rights of investors in the event of a sale, stock market listing or other liquidity event in relation to the Company. They do not apply only in cases of liquidation/winding up. After price, they are typically thought to be the second most important commercial term since they determine how the proceeds of a transaction are divided among the shareholders.
10.	Protective Provisions	These are typically structured as a series of positive (ie the Company will do A, B and C) and negative (ie the Company will not do X, Y and Z without consent) commitments. The Founders will typically be asked to support these commitments personally. This should be fine provided some safeguards are adopted. Where there are multiple investors, the protective provisions should be structured so that no single investor (or small but vocal minority) should be able to exercise the protective provisions to the detriment of the interests of the Company or the majority of the investors.
11.	Conversion	This is only applicable to preference shares. Conversion rights are the mechanism whereby investors convert their preference shares to ordinary shares in the event of a sale or other similar transaction.
12.	Down Round	Sometimes also called anti-dilution protection (even though it is something of a misnomer), this clause - if adopted - seeks to protect the investors from the diminution in the value of their initial investment where the Company subsequently raises money at a lower price per share.
13.	Pre-emption	This refers to the shareholders' rights to participate in future funding rounds so as to maintain their initial ownership percentage. This is one of the most fundamental rights for early stage investors and they should plan to follow their money throughout the life-cycle of the Company.
14.	First Refusal & Tag along	First refusal rights give investors and others the right to buy shares which other company insiders wish to offer for sale. Tag along rights protect the interests of minority shareholders from an exploitative sale of a majority stake by the other shareholders from which certain shareholders' are excluded.
15.	Drag along	This is an important provision which should ensure that a small minority of shareholders cannot veto a transaction and thereby seek to secure better terms for themselves. It can also be used to deal with absent/missing shareholders in the context of a sale.
16.	Non-competes	These are important to ensure that Founders cannot simply leave a

		business which has raised angel or other investment and reverse engineer around any applicable intellectual property rights.
17.	Vesting	Usually adopted as reverse vesting in Ireland (for tax reasons primarily), this allows all or part of the shares held by early Founders to be gathered back into the Company (eg in order to be used to incentivise replacement staff) in the event a Founder departs the Company prematurely.
18.	Board	Board composition is an important aspect of any company and the Founders will typically expect to maintain control at board level beyond the initial two stages of fundraising.
19.	Information Rights	Minority investors will need express information rights to reflect the fact that the rights of shareholders to information under Irish law are weak.
20.	Documentation	It is important to establish clearly who will do what and when to keep the process under control.
21.	Keyman Insurance	Key man insurance is insurance taken out (and paid for) by a company against the lives of senior executives. It can facilitate a buyout of a deceased executive's shares or make it easier to recruit a replacement on an interim and a long term basis.
22.	Expenses	It is customary for the Company to bear the costs of one legal (and sometimes also a financial advisor) to the Investors. It should be possible to agree fixed or capped fees in most cases.
23.	Exclusivity	Given the time, energy and expense that goes into an investment it can be important to ensure that the prospective investors are not 'gazumped' and an exclusivity clause allows this to be done.
24.	Confidentiality	It is typical to provide for confidentiality once negotiations are underway in earnest. In early discussions investors will be concerned not to be bound by confidentiality in respect of ideas that are unproven and unknown.
25.	Legal effect	It should be clear what portions of the Term Sheet are intended to be legally effective and what parts are just a (usually non-binding) declaration of commercial intent.

The Typical Investment Process – A Flowchart



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Venture Legal Services is a modern law firm advising corporate and private clients with a particular focus on the angel, start-up and venture capital sectors.

Appendix D

Sample syndicate charter

This note summarises the basic rules that will govern how the syndicate will conduct its business. Please note running a successful angel group requires a commitment to significant work by the members. It is critical to the success of the group that ALL members share this workload.

Best Practice

- In the event, following a presentation by a company to the syndicate, that the syndicate wishes to further explore the possibility of an investment then a sub-group will be setup for this purpose and a representative nominated as the liaison person with the SME. The liaison person will communicate in a reasonable timeframe with the company ensuring the actions and thus the reputation of the syndicate is highly professional at all times.
- Members shall conduct their business in a professional manner and will not engage in practices, which would be damaging to the image of the business angel market.
- Members shall promote and maintain ethical standards of conduct and at all times deal fairly and honestly with all parties.

Confidentiality & Conflicts of Interest

- Members will take all reasonable precautions to keep investee information private and confidential. Members will use investee information solely for the purpose of evaluating investment and not exploit it or otherwise apply it in any way.
- Members must return to the investee on demand any written information or other materials.
- The above undertakings do not apply to any information which is in the public domain or is already in the possession of the members or which subsequently becomes known to Members independently.

Participation & On-going Responsibilities of Members

- Syndicate meetings will be held monthly with the exception of July/Aug
- Members are expected to **commit to attend** a minimum of **70% of the meetings,** e.g. members must attend a minimum of six meetings in a calendar year.
- Members agree to actively participate in the vetting process of prospective companies.
- The syndicate will have three sub-committees: Steering, Membership & Due Diligence; Members of the steering & membership sub-groups will be identified and will change from time. Due diligence sub-groups will be formed to investigate companies of interest to the group. Members will partake in due diligence at least once per year.

Modus Operandi

- The decision to invest in a proposal and the structure of the deal will be the responsibility of the specific group members investing in that deal

- *Once members have indicated that they wish to invest in a deal, the group leader is given executive power, allowing him/her the power to commit the group following a deal within permitted ranges +/- 10%. Same to be collectively agreed!*
- Each individual investor acknowledges that a decision to invest is a personal decision and that no responsibility for the consequences of that decision is accepted by the syndicate or any other member of the core group
- Minimum investment level for each investor is likely to be €XXk and the average investment level is expected to be €XXk-€XXk per investor per deal and €XXk-€XXk per deal
- A due diligence sub-group will be setup for any particular investment under consideration by the group
- Most investments will qualify for Enterprise Investment Initiative Scheme (EIIS) tax relief (supporting evidence of this should be sought from the company).
- Members will decide on whether the identify of syndicate members will be made publicly available on the syndicate website in due course
- The syndicate is interested in opportunities across a broad range of sectors with a primary focus on early revenue opportunities and some high growth opportunities
- The group may decide to charge an annual membership fee in the future