Angel Investor Survey

2011

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Australian Association of Angel Investors

Bentleys THINKING AHEAD

Contents

1 Executive summary

The Angel investor community in Australia is a growing and vibrant sector that brings together investors and entrepreneurs with a shared passion for innovation.

The 2011 Bentleys Australian Angel Investors Survey is the fourth annual survey undertaken across the Angel investor community.

The 2011 survey data and report highlights the increasing contribution and voice of the Angel community in the innovation space. Increased profile for the community gained through vehicles such as the annual Angel investor survey increases the opportunities to gain further recognition as a formal investor group by policy makers and governments. It provides tools and market insight to assist the entrepreneurial sector to gain the support it needs to achieve growth.

This survey and findings are further supported by a report previously released by the Organisation of Economic Cooperation and Development. That report indicates that the Angel investment market is widely considered to be a significant funding source for entrepreneurial businesses globally.

The 2011 report shows that across the respondent pool, total individual Angel Investments were $5.45m, with gross collective investments from all investors $57.26m. This equates to leverage ratios of 10:1, a significant increase from the 2010 ratio of 5:1. This offers support to the OECD finding that investment by Angels often serves as a signalling effector for other investors, demonstrating that these firms have passed a first screening of due diligence by investors with experience in the field. It provides further support for the anecdotal evidence that Angels are increasingly investing in syndicates.

The growth in the Angel investor sector is also evidenced through increasing interest in group membership and increasing numbers of "sophisticated investors" taking an active interest in Angel investing. For example, there were four new Angel groups established in 2011 and the number of respondents classified as sophisticated investors increased from 50% to 56% of the survey pool.

The number of survey respondents identifying as Angel investors also increased slightly in 2011 (up from 58% to 64%) and a far more significant proportion of the survey respondent pool were Angel group members this year, compared to 2010 (57% vs 28%). In all, 16 of the 17 Angel groups across Australia were represented in the individual survey. Of those respondents not currently members of a group, 60% are considering joining an Angel group.

At a macro level, the inaugural (2008) Angel investors survey estimated that in that calendar year there was in excess of $1.6 billion invested by Angel Investors into approximately 5,000 entrepreneurial companies, employing more than 35,000 Australians. Co-investment data collated in that year indicated that Angel Investment represented a 5:1 leverage ratio, so consequently it was estimated that there was more than $5 billion in investments in innovative Australian businesses.

In FY 2011-12, there was an increase in major investment to science, research and innovation from the Australian Government – as reported in the Australian Innovation Systems Report 2011 issued by the Department of Innovation, Industry Science and Research – to over $9.4 billion (from $6.54 billion in 2008). Although hard data is unavailable as to the total size and reach of the Angel Investor community, it is widely held that this growth in government priority has paralleled a similarly significant growth in the Angel Investment funding pool.

At its core, Angel investing embraces innovation and entrepreneurship. 56% of respondents invested at the Seed or Start-Up stage (Series A) of a business. 2011 saw the ongoing investment into Clean Tech, Life Science and Web based Software.

A key principle of Angel investing is to contribute intellectual capital, as well as financial capital. In addition to investment dollars in 2011, Angel investors committed on average 47 hours per month to Angel investment activities.

This survey report provides an overview of the data collected from the Angel community in Australia and provides continued thought leadership around the contribution Angel investing makes to the sustainability of innovation in Australia. It offers, for the first time, data and insight into the results and exit returns experienced by Angel Investors in the market.

2 Introduction and background

The 2011 Bentleys AAAI Angel Survey is the fourth annual survey of visible Angel Investment activity in Australia. The 2011 survey has been produced by Bentleys Chartered Accountants and Business Advisors (Queensland) in conjunction with the AAAI. The survey promotes capability and performance knowledge for both the Angel Investment community and individual Angel investors by:

- Providing industry performance comparison
- Giving opportunities to compare Individual investment performance
- Leveraging survey results to lobby the Australian government
- Attempting to increase AAAI membership and knowledge base, and therefore greater access to Angel Capital

The survey was conducted via an online survey distributed to a database of approximately 1,000 Angel and other investors. The 2011 survey covers Angel investment activity for the calendar year starting 1 January 2011 and finishing 31 December 2011.

Participants were invited by email to complete the survey. The survey was conducted using the Survey Monkey online tool and involved a series of 37 multiple-choice questions with provision for open-ended answers where appropriate. A further six questions were available for feedback and contact details. Data from the 2009 and 2010 surveys was used to produce comparison. All data was collated by Bentleys and analysed with input from the AAAI.

This survey invited Australian Angel Groups to extract reporting from 'Gust' (formerly Angelsoft). Gust is an online portal specifically designed for Angel groups to maintain Angel membership databases and manage deal activity of the group. In analysing Angel group investments, this survey considered data on investments made by Angel groups in calendar year 2011 only. Between the 2010 and 2011 surveys, the number of groups increased by four (bringing the total number of groups to 17). All data collection processes were in accordance with the AAAI Privacy Policy, and the Bentleys (QLD) Pty Ltd Privacy Policy.

This report draws on the analysis of the raw data from survey respondents. Survey respondents provided their responses anonymously. Bentleys and AAAI make no representation as to the suitability of these results as being fit for any particular purpose. The results are an accurate presentation of the data from respondents adjusted for eligibility, relevance and terminology.

3 Driving sustainable growth in the innovation sector

The Australian Angel community has a core objective to drive economic growth through developing stronger innovative and entrepreneurial businesses. By definition, Angel Investors are committed to the advancement and development of innovation in Australia and they seek to apply their experience to contribute to the development of future generations of entrepreneurial enterprises.

The 2011 survey data indicates that Angel Investment continues to build businesses and sectors that in turn grow the economic strength of Australia.

At a financial level, 43% of Angel investors surveyed invested up to $25,000 in 2011, with 31% of respondents investing between $25,000 and $100,000. Average Angel investment per deal for the year was $55,630 as a part of an investment round that, on average, totalled $584,297. The 2011 figures show significant growth on the 2010 figures when the average investment per deal was $15,850, (as part of an investment round that, on average, totalled $443,750).

The 2011 results deliver improved outcomes on the anticipated levels of investment, as indicated by investors at the end of 2010. Survey respondents had indicated that they would invest on average $52,941 in the 2011 calendar year. The actual average investment of $59,909 is an uplift of 13% on that forecast.

Looking ahead, and assuming similar alignment to forecasts in 2012, investment activity looks strong with 78% of respondents anticipating investing up to $50,000 per deal.

Further analysis of the 2011 data identifies growth in active portfolio building in 2011. Of all survey respondents, 61% had made an investment prior to completing the survey, and 46% had undertaken investment in 2011. Of those investing in 2011, 70.5% had invested once or twice throughout the year, and almost 20% had invested three to five times in 2011. Comparatively, of those who indicated in the 2010 survey that they had invested in that year, 64% had invested once or twice and only 5.5% had invested three to five times.

The number of investors who were inactive throughout 2011 went down on 2010 measures – in 2011 24% of investors indicated that they did not invest. In 2010, 30% of investors reported no activity for the year.

Almost one in every five investors in 2011 indicated that this was their first year for Angel investing. This group recorded investments ranging from $5,000 to over $100,000 and collectively invested over $250,000 in 2011 – 5% of the total individual investment pool of $5.45M recorded through the survey.

52% of respondents invested up to $25,000 in their last investment in 2011. A further 10% invested up to $50,000. In 2010, these numbers were 32% and 29% respectively. In both surveys, about half of the respondents made at least two follow-on investments during the survey year.

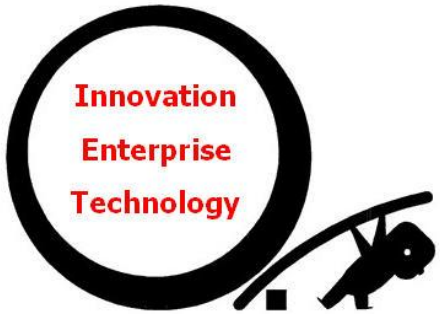
On a geographical level, 38% of investors are seeking investments within 150km of their homes. A further 10% of investors prefer a company in the same state while 33% of Angel investors recognise Australia as a single market and will consider an investment anywhere in the nation.

As in 2010, when 2011 survey respondents were asked about their preferences, the individual Angels were indifferent as to leading the co-investment but, 80% prefer co-investing with other Angels. Angels who are AAAI members are still the most preferred.

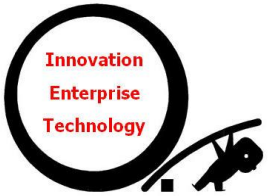
Least preferred as co-investors are university and government with the uncertainty only a little lower for venture capital funds. Venture capital funds and Corporate investors that are members of the AAAI rank higher than their unaffiliated colleagues.

4 Fuelling sustainable industries for Australia's future

2011:
10:1 Leverage Ratio



2010:
5:1 Leverage Ratio



Across the respondent pool, total individual Angel Investments were $5.45m, with gross collective investments from all investors totalling $57.26m. This equates to a leverage ratio of 10:1, a significant increase from the 2010 ratio of 5:1. In the start-up sector, this demonstrated ability to attract co-investment funds to a new enterprise is of significant benefit – representing positive outcomes for both the Angel investor and the investee company.

Dissection of the data shows that core activity and investment within the Angel community was closely aligned with growth areas in various industry sectors. The top three sectors (ranked by number of Angel investments received) (based on figures provided in individual survey) in 2011 were:

1. **Biotechnology/Life Sciences** - 21% of the number of Angel investments made in 2011 went to Life Sciences enterprises, making it the sector that attracted the highest number of investors. These investments totalled $340,030 – representing approximately 5% of total investment funds for enterprises in this industry sector.

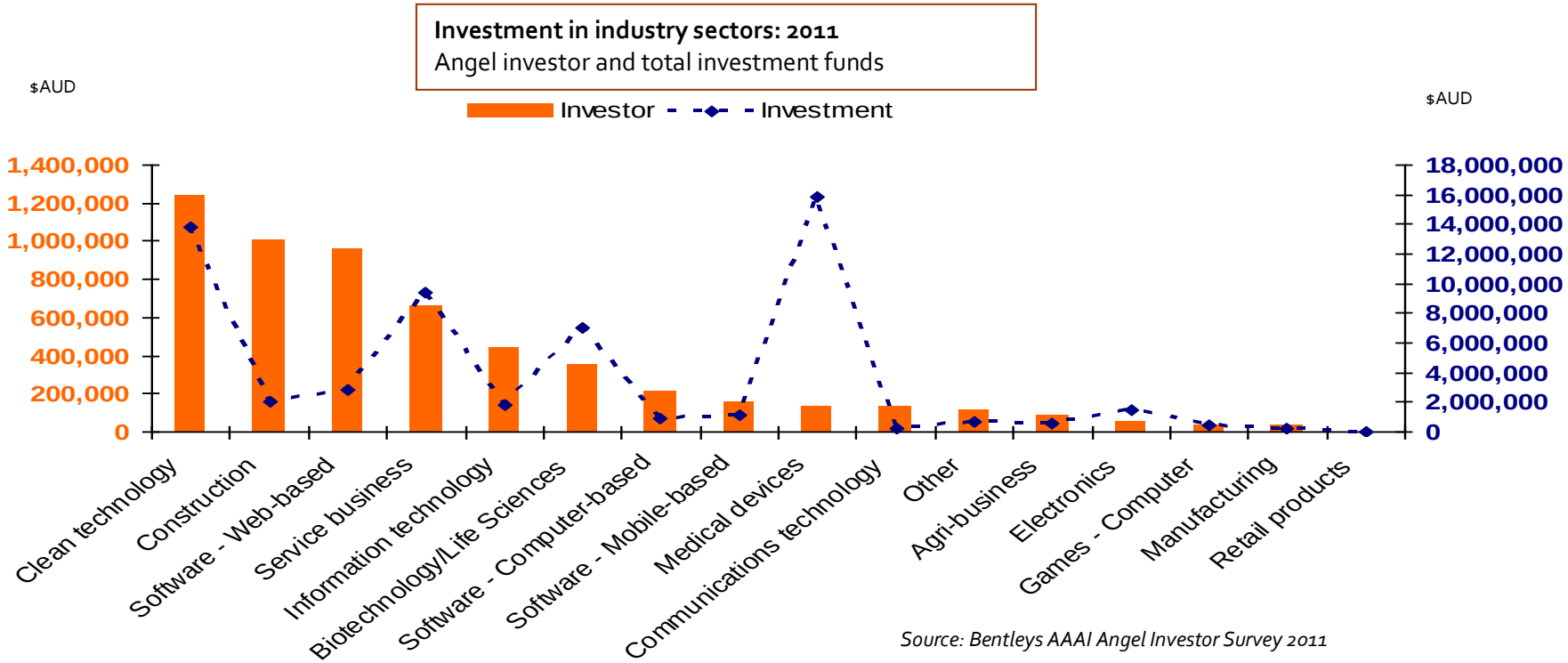
2. **Clean Technology** – Although only 13% of the investments made by Angels in 2011 were in Clean Technology, this industry sector saw the highest injection of Angel funds across all sectors – with $1,239,375 of Angel funding going to the sector. These funds represented 9% of the total investment pool for these Clean Technology enterprises in 2011.

3. **Web-based Software** - 11% of the investments made by Angels in the survey were made into the Web-based Software industry category – totalling $472,000. This investment represented approximately 26% of the total investment funds for enterprises in this industry sector.

Electronics was the least attractive industry sector for investment, securing only one investment throughout the year.

These results support the thinking that Angel investors gravitate towards highly scale-able and leverage-able investment opportunities.

In comparison, in 2010 the top three sectors based on number of investors, were Biotechnology / Life Sciences, Clean Technology and Web-based Software. In 2009, the sectors were Communications Technology, Manufacturing and Web-based Software.

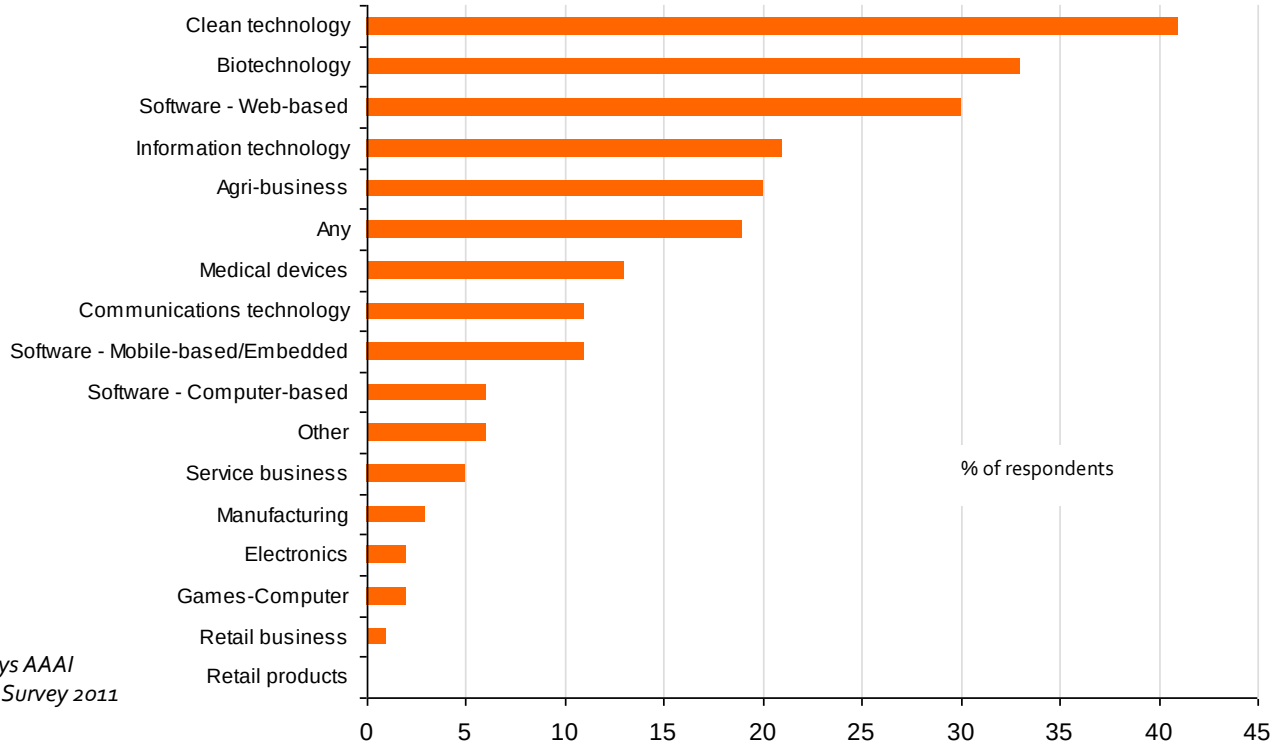


Source: Bentleys AAAI Angel Investor Survey 2011

Across all sectors, 88% of investments made in 2011 were made between the seed and "product development" stage – indicating that the Australian innovation sector continues to show strong signs of recovery and resilience to global economic issues.

Angel investment is a key source of capital for companies in the early stage of company and product development. In comparison, data released by the ABS on Venture Capital and Later Stage Private Equity (VC&LSPE) investment in Australia showed total investments in the late expansion stage attracted the largest share of Venture Capital investment with $3,750m or 43% of total value as at 30 June 2011. Further, 28% of investments from Venture Capital were in established businesses to support a leveraged or management buy-out. VC&LSPE managers only selected 2% of the potential investments they reviewed.

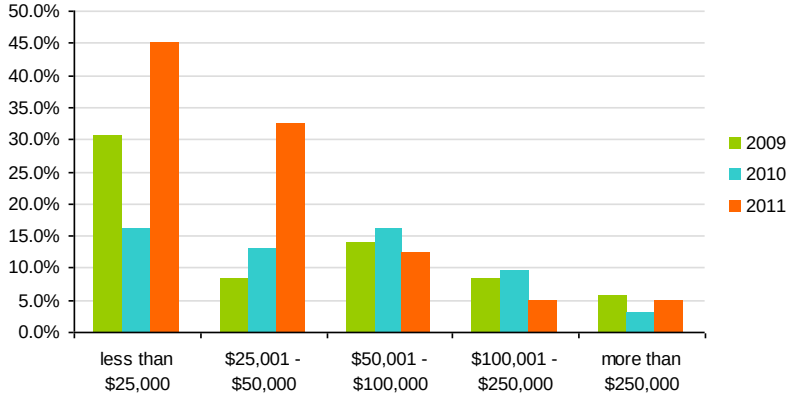
Preferences for industry sectors: 2012



Source: Bentleys AAAI Angel Investor Survey 2011

Moving into 2012, and consistent with the 2011 Angel investments made, survey respondents indicated that they would be looking to industry sectors such as Clean Technology, Biotechnology and Web-based Software for investment opportunities.

According to IBISWorld, Web-based Software (including 'Cloud computing') is expected to report total national revenue of $1.08 billion, down 0.7% on the previous year. Two principal factors are expected to limit growth over the coming five years. The first being concerns over security and the second being limited business capital expenditure.



Further growth of the Australian Biotechnology sector is forecast by IBISWorld, with industry revenue forecasted to grow at an average rate of 5.3% in the next five years, to reach $3.1 billion. Key drivers of this industry sector surround the very long period of time and large amounts of capital required to bring a product to market. Innovation in the sector is being driven by Australian universities and related spin offs, and large pharmaceutical companies.

Amounts invested per deal: 2011

Case Study
Investing in Australia's sustainable communities
'Average' Angel Investment Enterprise Profile (2011 year)

Industry: Clean Technology

Stage of development:
Product development - revenue less than $500,000 per annum

Angel funding received during the year of:
$190,000, from 9 Angel investors

Time taken to invest:
100 days

Total funding received to date of:
$957,823 / leverage ratio of 5:1

Number of staff employed:
5 FTE

Commercialisation Australia funding received:
$272,261 (Experienced Executives + Proof of Concept)

Angels ongoing involvement:
One Angel has been appointed to the board as a non-executive director

Co-investment under the spotlight:
24 companies that received grant funding from Commercialisation Australia also received Angel Investment funding.

Clean technology is a means to create electricity and fuels with a smaller environmental footprint and to minimise pollution.

The sector is expected to post an increase of 5.7% in revenue in the 2011-12 financial year according to IBISWorld.

The industry has benefited from significant assistance in the forms of grants and concessions, but remains at the mercy of its infancy and expensive cost structure.

Key drivers for growth are climate change government policy and the price of fossil fuels.

Innovation in the industry will be delivered through companies willing to capitalise on this growth sector through innovative products and efficient business models.

5 Creating sustainable jobs

When considered in relation to enterprise size, the 2011 data collected indicates that the average company receiving Angel capital is employing more full time equivalent employees than ever before – growing from 4.1 FTE employees in 2010 to 6.0 FTE employees in 2011. The contribution of this growing number and their impact on a sustainable Australian economy is aligned to the growing industry sectors in which Angels are investing.

2011: 6.0 employees

2010: 4.1 employees

2009: 4.8 employees

Most Angel funded businesses are small business enterprises – often with big business aspirations! The small business sector is the backbone to Australian economic growth. It represents almost three quarters of all operating businesses in Australia, is responsible for almost half of the jobs available in the private sector and contributes approximately one third of industry contribution to gross domestic product. (Department of Innovation, Industry, Science and Research, 2011). Therefore, Angel funded enterprises not only represent growth in specific industry sectors but, also growth in the small business sector.

Keeping Australians working: According to IBISWorld, the popular Angel Investor industry of Web-based Software contributed $303.3m in salaries and wages to the Australian economy in 2010.

6 Developing a sustainable Angel community

The number and scope of Angel Groups across Australia has grown significantly over recent years, particularly through the introduction of more specialist and focused groups that attract niche areas of the entrepreneurial market.

At the end of 2011, the active Angel groups within the Australian Association of Angel Investors were:

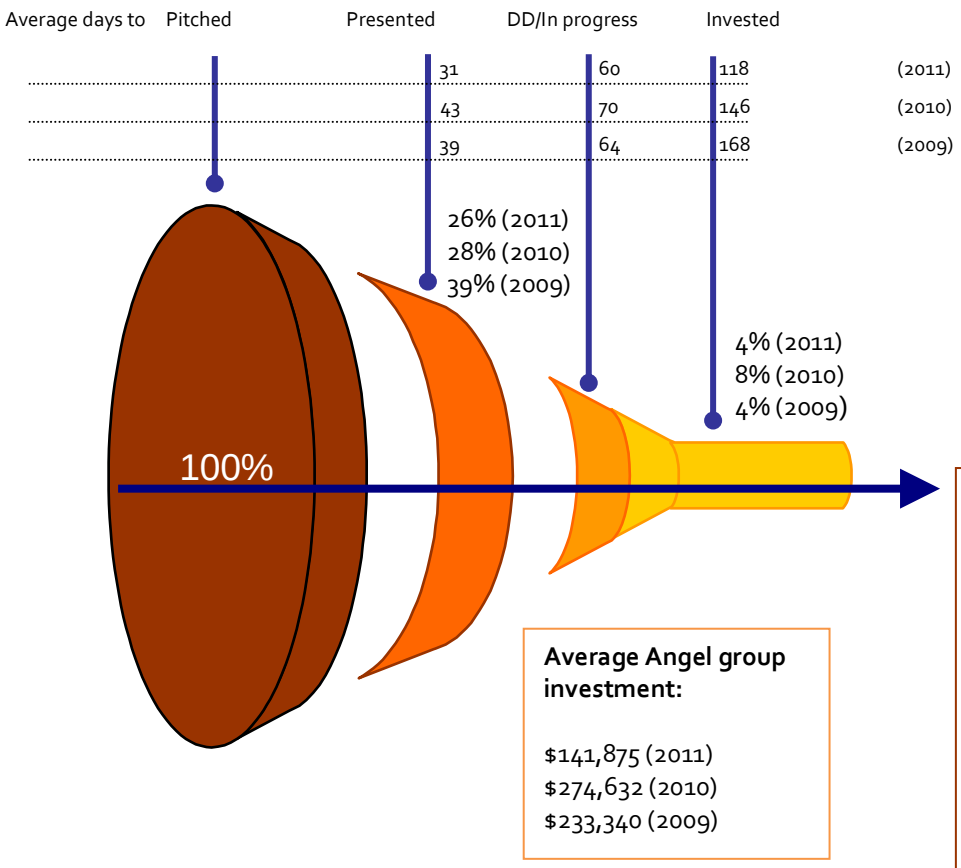
- Angels Tas (Tasmania)
- Hunter Angel Trust (Newcastle)
- WA Angel Investors
- Sydney Angels
- Darling Downs Angels
- Gold Coast Angels
- Rights House (Newcastle)
- SA Angels (Adelaide)
- Brisbane Angels
- Capital Angels (Canberra)
- Hunter Founders Forum (Newcastle)
- Melbourne Angels

Data was collected from a small sample of Angel groups for the 2011 survey to provide some insight into group outcomes and processes.

Key findings from the group data were:

- In 2011, Angel groups participating in this survey invested $1,060,000 in 6 new deals. This equates to a conversion rate of 4%, down from 8% last year.
- The pre-investment valuation of companies seeking Angel investment was, on average, $2,684,935. Those companies had an aggregate market valuation post money of $365,151,206. The average valuation is 8.6% lower than 2010. This decrease is evidence that there has been impact from the focus that the Angel groups have been actively placing on their investment pre-screening activity in an effort to ensure more realistic pre-investment valuations.
- The average amount of capital being sought was $590,087 – down significantly on the 2010 average of $1,164,621. There was a 9.3% rise in previous capital invested.
- On average, the companies had a monthly burn of $30,279 per month for approximately 6 employees. Both the average cash burn and the average number of employees has increased since 2010.
- The Angels use a rating system in Gust that aggregates assessments of the Team, Investment Terms, the Product and the Market. Companies, on average, get a passing grade (60.55%). There was a 16% increase in average rating over 2010.
- The proportion of deals submitted directly online was the same as in 2010 (82.5%). Of the deals that were invested, 1 in 2 were introduced by members of the Angel group and another 1 in 6 were introduced as a syndication by another Angel group in Australia.
- Groups take 31 days to process the good deals through to a pitch to the group and, for the lucky few, an average of 118 days to reach investment. Not surprisingly a 'no" is much faster and takes, on average, 60 days.
- The majority of Group deals in 2011 took less than three months to close after first contact with the opportunity.

7 Deal flow



The average dollar amount invested by groups in deals has reduced from $274,632 in the 2010 year to $141,875 in the 2011 year, along with the percentage of deals being invested in reducing from 8% in 2010 to 4% in 2011. This may be attributed to the increasing diversification requirements of Angel investors and the targeted due diligence of deals presented.

The number of days Angel groups are taking to invest in deals is materially reducing – from 168 days in 2009 down to 118 in 2011. Improved internal due diligence processes and collaboration of Angel investors through the groups appears to be driving this improvement.

A new approach?

In early 2011, Sydney Angels established The Sydney Angels Sidecar Fund. A $10 million investment fund (Early Stage Venture Capital Limited Partnership - ESVCLP) that invests solely in early stage business ventures. The Fund invests alongside Sydney Angels' members.

A venture capital fund registered as an ESVCLP receives flow-through tax treatment - that is, it is not a taxing point. Investors (limited partners) in an Early Stage Venture Capital Limited Partnership are exempt from tax. The manager is entitled to claim carried interest in the fund on capital account rather than revenue.

Case Study
Where it went wrong….
Pitch feedback

Case Study 1
Industry: Internet/web services

Stage of development:
Product in development
Pitched for Angel funding of:
$500,000
Reason for decline:
Declined after presentation due to Angel concerns over assumptions behind revenue and expenditures. Further, some expectations of the entrepreneur may be unrealistic, including pre-money valuation. Barriers to entry to competitors once the model is proven are also low.

Case Study
Where it went wrong….
Pitch feedback

Case Study 2
Industry: Lifestyle/web based software

Stage of development:
Product in development
Pitched for Angel funding of:
$500,000
Reason for decline:
"It was felt that you were too early (in your product development) to consider and there were concerns around what looked to be the creation of another social network. The imminent launch of the service would provide proof of the market and that all going well would then increase the chances of raising capital. At this point it would be more appropriate to pitch. Please keep your application up to date and let us know how you are going early next year. At that point we will reconsider the application based on the new information."

What do the winners look like?

Typically, Angel Investors prefer companies with:

- Industries with low capital needs to turn revenue
- Ability to scale the product globally
- Company life stage between seed and product development
- Entrepreneurs receptive to Angel mentoring
- Defined exit strategy to realise investment return

8 Delivering sustainable returns – what were the results?

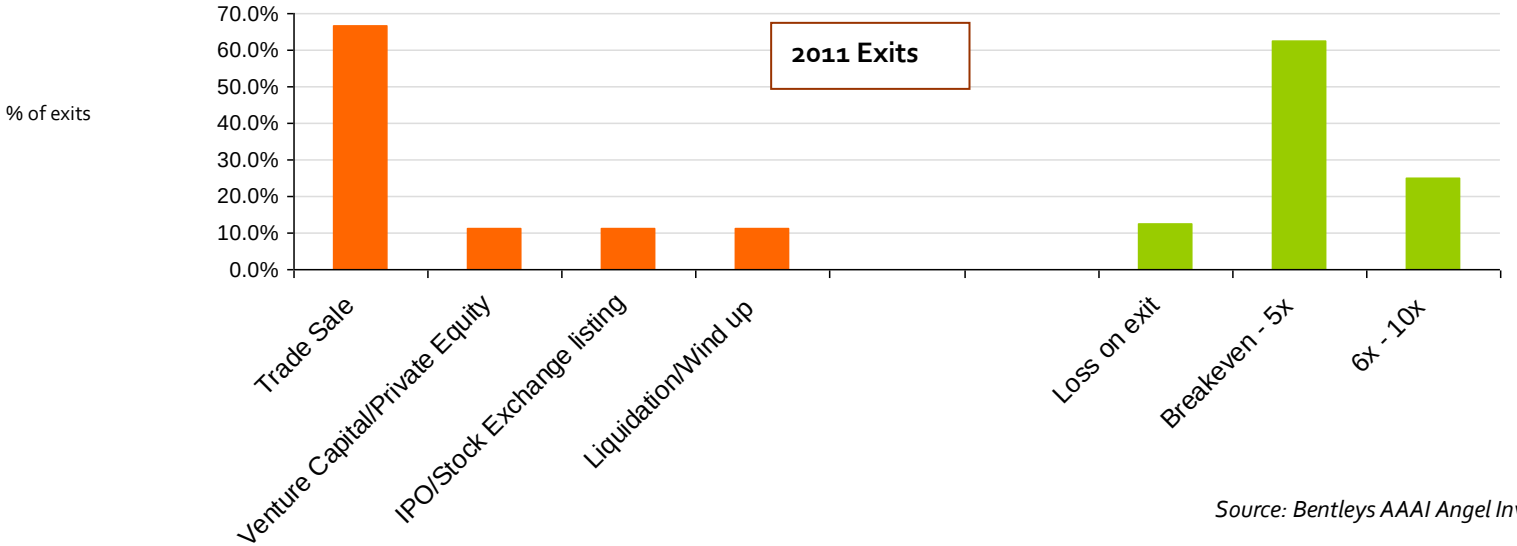
This is the first year that exit data on Angel investments has been collected. There were a total of nine exits reported by survey respondents during the 2011 year.

Returns on investment in Angel terms are measured with reference to the exit cash/scrip amount received as a representation of the cash outlay of the initial investment. This method reflects the Angels requirement to secure a tangible cash/scrip return on their own private capital invested.

89% of exits were trade sales or private/public takeover and 88% of those exits had a positive return on investment.

Further to this, 25% of exits reported a return of between six times initial investment and 10 times initial investment. These levels of returns are consistent with the perceived risk associated with Angel investments and Angels expectation of significant returns on their private capital invested.

Most return on investment to investees is through exits from investments. The value of exits through trade sales, IPOs and buybacks was $1,433m in 2010-11, compared with exits of $686m in 2009-10.



Source: Bentleys AAAI Angel Investor Survey 2011

9 Nurturing a sustainable Angel community – who are we and what keeps us engaged

In 2011, Angel investors spent an average of 47 hours per month on Angel investment activities. This is broken up by:

- 14 hours/week on post-investment management (including any executive roles; 2010 - 12hrs, 2009 - 13hrs)
- 9 hours/week on mentoring and shaping entrepreneurs' investment pitches (2010 - 11hrs, 2009 - 10hrs)
- 7 hours/week on due diligence and term sheets (2010 - 8hrs, 2009 - 8hrs)
- 6 hours/week on professional development as an Angel Investor (2010 - 5hrs, 2009 - 5hrs)
- 6 hours/week on other Angel Investment related meetings and forums (2010 - 7hrs, 2009 - 6hrs)
- 5 hours/week on attending pitching sessions (2010 - 5hrs, 2009 - 7hrs)
  (Note that not all survey participants spend time in all the areas described.)

Survey respondents

- 86% male (79% - 2010, 86% - 2009)
- Average age of 49 (53 - 2010, 47 - 2009)
- 76% based in eastern states of Qld, NSW & Vic (75% - 2010, 77% - 2009)
- 57% sophisticated investors (2010 - 51%, 2009 - 49%)
- 90% are affiliated with an Angel group (51% - 2010, 52% - 2009)
- 83% made ≥1 Angel investment in 2011 (73% - 2010, 66% - 2009)
- 75% plan ≥1 Angel investment in 2012 (71% - 2010, 68% - 2009)
- 75% plan to invest up to $100,000 in 2012 Angel Investments (74% - 2010, 70% - 2009)
- 80% are willing to co-invest (79% - 2010)

The increasing proportions of Angel investors in the 36-45 year age bracket (2011 – 23%; 2010 –15%) has reduced the average age of survey respondents to 49 years (compared to 53 years in 2010). This suggests the possible emergence of a younger generation of investors having the investment nous and financial means to be active Angel investors.

Representation of women in the Australian Angel Investor market appears to be in line with the USA, where 13% of Angel Investors are female (OECD report).

10 Glossary and references

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