band OF ANGELS

Newsletter

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Introduction

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Ed Bierdeman
David Burwen
Brian Frenzel
Bill Hilliard
Larry Kelly
Don Lee
Art Reidel
Stephen Taylor

Dinner Details

Date: Wed., Aug. 18th, 2010

Place: Los Altos Golf and Country Club

Time: 6:15 - 9:00 pm

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It was Finley Dunne, the Chicago-based early 20th century writer and humorist who is credited as coming up with the aphorism "politics ain't beanbag". As our recent experience with portfolio company Pluggd demonstrates, he could have just as well been writing about angel investing.

Pluggd raised its seed financing from the Band and several VCs in July of 2007. As with all such financings, it was structured with a liquidation preference that guaranteed that investors got their money back before common shareholders received anything. This is part of the reason a share of Preferred stock costs 5-10 times more than a share of common stock!

Things didn't go so well at Pluggd and there was a "pay to play" financing that required Series A investors to pony up 55% of their initial investment or be effectively wiped out; and months later another small bridge financing with a 2.25x liquidation preference.

The company was bought last month! Big headlines! Sunny quotes from the founder! Success! But ironically the angel investors who fared the best were those who <u>declined</u> to participate in the "pay to play". They lost just their entire initial investment. But those who participated in the "pay to play" lost their entire A investment plus a large portion of their subsequent investment. The VCs, who gave themselves access to an outsized porttion of the bridge financing, also lost money, but because of the 2.25x liquidation preference on the bridge, did better than any of the angels.

One thing that really stuck in the angels' craws was that, while investors lost millions of dollars, the founders of Pluggd got a 6-7 figure bonus and earn out from the acquirer. What about those liquidation preferences you ask? Well, when there is only one offer on the table, its the Golden Rule that really matters: "he that has the gold, makes the rules".

So, what are some of the lessons to learn? One perhaps is to be careful about "pay to plays"; in the litany of old adages reprinted in this Newsletter the one about "throwing good money after bad" comes to mind. Another is that when negotiating the deal up front, don't be too caught by all the legal terms. They are really a starting point for a future negotiation, not an ending point of all negotiation. Another point is that when you give up control, to a founder or to a group of VCs, you give up control! As our member Dan Seligson said, "this is the opportunity to observe that the investors were screwed and the team walked away golden." But in Pluggd we were minority shareholders whose consent was not required for any corporate action. Maybe we should look for deals where we can remain substantial, if not majority, shareholders and develop a deep partnership with the entrepreneur in a spirit of reciprocity. This means partnering only with genuine partners.

Two examples of such deals with recent news are Vapore and Materna. Materna just closed $1M from the Band; Band members occupy 2 of the 3 board seats, we have equal ownership with the founder, and are hence locked at the hip for better or for worse. Whatever happens with Materna, unlike Pluggd, we will be well informed and part of the team. Similarly, Vapore has a majority of angels on its board; and thru ups and downs, CEO replacements, and new financings, angels have provided superb input and direction. The company just unveiled their aerosolized hydrating product, My PurMist (shown left).

- Ian

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