**The Angel Market and COVID-19**
**Building Bridges or Piers**

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The stock price of the fast growing semiconductor company dropped from $50 per share to $1.60 per share in less than 12 months, the start-up online toy outlet valuation crashed from a high of $84.50 per share to less than 10 cents and the online grocery store poised to revolutionize food shopping suffered a one month loss of $830 million. If these tales sound familiar then, like many angel investors, you have been through cycles. The companies, Transmeta, EToys and Webvan, were victims of the bursting of the dot com bubble in 2001. Fast forward 20 years to today and in less than one month the short term rental start-up WanderJaunt reduced its staff by 25%, with ridership collapsing Lyft lost close to $100 million in the first quarter, Airbnb has laid off 1,900 employees and ClassPass (a membership program for fitness centers) lost over 95% of its revenue in 10 days. According to the New York Times in just a few weeks in March more than 50 start-ups have reduced their work force by 6,000 employees (NYT, April 2, 2020 "Start-ups Pummeled by Virus Shakeout"). History repeating itself? Maybe, but what do the data say.

First, two important caveats. Monthly angel data is highly variable – it is the inherent nature of angel investing and is sample based, so the potential for statistical anomalies increases. Second, comparing the COVID-19 crisis to the 2001 dot com bust and the 2007 housing bubble is questionable, but the first two crises did build relatively quickly and each resulted in a recession, and recessionary impacts on angel investing do provide a valuable lens to the future of the angel market in the current economic uncertainty.

The Numbers

In a normal first quarter, the number of angel deals completed exhibits a modest year on year decline. This decline can be attributed to a recalibration after year end assessments by angels and the seasonality of deal flow. Since angels invest their own capital and generally require 2-3 months for due diligence, the typical holiday slowdown in deal flow is reflected in the first quarter with January showing the largest decline of close to 11% for 2018 to 2019 and February and March exhibiting more modest declines. In comparing the first quarter of 2019 to 2020 all first quarter months experienced a pronounced decline in deals, ranging from -34% (January) to -13% (February). The total for the 2019 to 2020 quarter decline is 4X that of the decline in first quarter 2018 to 2019 deals (-6.8% to -25.1%). For angel dollars invested, a more sensitive data point than deals, two of the three months of the first quarter showed significant declines for 2019 to 2020 when compared to 2018 to 2019 quarterly figures, as well as total dollars invested for the quarter (22% vs -36%). These data on deals and dollars indicate that the COVID-19 impact was swift in the angel market.

| | angel deals | | | angel dollars | |
|---|---|---|---|---|---|
| | 2018 to 2019 | 2019 to 2020 | | 2018 to 2019 | 2019 to 2020 |
| Jan | -10.7% | -33.9% | | 73.7% | -55.6% |
| Feb | -3.8% | -13.0% | | 49.7% | -47.4% |
| Mar | -4.8% | -26.3% | | -35.0% | 18.8% |
| Total | -6.8% | -25.1% | | 21.9% | -36.2% |

Source: Center for Venture Research, PitchBook

Historically angels invest primarily in software and healthcare and these two sectors dominated angel investments in 2019 with their total market share increasing from 43% in 2018 to 62% in 2019. Sector analysis across years and quarters provides an indication of how angels may be reallocating their investments in response to the COVID-19 pandemic, at least in the short term. Not surprisingly B2B and B2C declined by 3X and 2.5X, respectively. Software also experienced a significant decline of 4X. Healthcare was the sector that benefited the most, experiencing a much smaller decline in absolute terms year on year, with a 15.1% decline in year on year quarter 2018 to 2019 being reduced to -8.2% for 2019 to 2020. These preliminary data indicate that healthcare could be poised to be the dominant sector for angels, but it is worth noting that software investing is fluid and has widespread applications. Also, since angel investing is an individual decision, allocations can change within quarters, especially in the current uncertainties caused by the pandemic.

| | angel deals | |
|---|---|---|
| | Jan to Feb | |
| | 2018 to 2019 | 2019 to 2020 |
| B2B | -8.6% | -26.6% |
| B2C | -12.5% | -31.30% |
| Healthcare | -15.1% | -8.2% |
| Software | -7.1% | -29.0% |

Source: Center for Venture Research, PitchBook

2019 Market Indicators

A few key metrics for the angel market in 2019 indicated that the market fundamentals may not be as secure as to withstand shocks to the market, especially one as fast and as pronounced as the COVID-19 crisis. The angel yield rate is defined as the percentage of investment opportunities that are brought to the attention of investors that result in an investment. In 2019 the yield rate was 30.7%, continuing a steady rise in yield rates from 17.2% in the first half of 2018. While a high yield rate is encouraging for entrepreneurs, historically yield rates above 25% have not been sustainable over the longer term.

In 2019 angels invested in deals with an average valuation of $4.0 million, a 38% increase from 2018. This substantial increase in deal valuation was indicated in the mid-year 2019 angel report (valuation $3.95 million) and the mid-year 2018 report (valuation $3.7 million). These valuation trends are likely an indication of upward pressure on valuations resulting in overvaluations in some sectors and/or regions of the angel market.

In combination these angel market metrics bear watching. As national yield rates increase so does competition for deals. In turn, some of this competition is reflected in rising valuations. Since over 1/3 of angel investments are in the seed/start-up stage, high valuation in these early stages are often cause for concern.

Past Market Impacts on Angel Investing

During the great recession of 2008/2009, the angel market experienced a two year contraction in total dollars invested. The decline from 2007 to 2008 was the steepest (-26.2%) with a modest (-8.3%) contraction in 2009, followed by a slow rise in subsequent years. The number of angel deals experienced a less precipitous decline than those in dollars invested, resulting in smaller deal sizes and lower valuations. The market altering impact was in the decline in seed and start-up stage investing that occurred in 2009 and 2010. In addition, yield rates declined to 10% in 2008 and 14.5% in 2009. Certainly the causes of the post 2000 decline and the 2008/2009 recession were different than today's pandemic induced downturn, but the impacts could be similar.

The Potential COVID-19 Impacts

Combining angel investing data from the first quarter of 2020, data on previous external shocks to the angel market and key metrics in the 2019 angel market points to the potential for significant impacts for angel investors, and the entrepreneurs they invest in, as 2020 unfolds. First the good news. Angel investing is, and will continue to be, a long term investing strategy. Liquidity events typically occur 7 to 10 years after the initial angel investment and during that time frame the savvy angel will expect both internal challenges and external market challenges that will affect the growth and exit of their investments. Also, additional rounds of growth capital are anticipated, either from individual angels, angel syndicates or the institutional venture capital, or some combination of these sources.

Since angel investors are high net worth individuals, given the correction in the public equity markets the angels' net worth will likely have declined and so will the pool of capital they deploy for angel investments. Thus, it is expected that total dollars invested in 2020 will decline. However, if past events offer any guide, the total number of investments will hold steady. Market yield rates will be depressed as angels adopt a more cautious approach to investing and angels factor in the added risks of the pandemic. The most pressing issue, from a market perspective, will be decisions on where to allocate the angels' diminished investment capital. Angels will prioritize and bridge their existing portfolio companies, and if this reallocation of risk capital is

substantial it will be at the expense of the seed and start-up stage market. Angels are the predominant source of seed and start-up capital for our nation's entrepreneurs. Any potential decline of the foundational, and critical, seed and start-up financing provided by angel investors could lead to significant, and lasting, repercussions throughout the risk capital ecosystem.

The risk/return calculus for angel investors will undoubtedly be altered in terms of stage, exits and valuations. All signs indicate that 2020 may likely be a challenging time for angel investing. But how lasting these impacts are will likely be determined by a myriad of factors, many of which are beyond the control of the angel investor.