Investment Options

Summary

Our angels are not required to invest. Investments should be made only after you become comfortable with the overall angel process, and you feel comfortable with a specific company.

The conventional wisdom for angel investing is that angels need to make 10 to 20 investments to achieve a positive return. Making 20 investments at $25k per investment requires $500,000. Because that investment amount is prohibitive for many, the network provides two investment options.

***Option one* - Traditional investment approach**

In the traditional angel model, the minimal investment size is $25,000. This approach benefits companies by limiting the number of investors needed to raise a certain amount of funds.

The Southwest Angel Network's expectation for this option has been and remains the following, "Consider making two $25,000 investments per year. Investments are an expectation and not a contractual obligation".

***Option Two* - 5x10 investment approach**

In this approach, investors decide to make 10 investments of $5,000 each, spread over 3 years. Note that three years consists of 12 funding cycles. Angel can opt out from investing in several funding cycles.

5x10 allows investors to build a large portfolio with a smaller financial commitment.

In the 5x10 approach angels are not limited to investing $5,000 and may invest a larger amount.

In practice, several investors may come together and collectively make a total investment of possibly $25,000 or more in a company.

Some companies may insist on a minimum investment of $25,000 per investee. In this case, if sufficient 5x10 investors are interested, the angel network will establish an LLC to pool the 5x10 funds and to make a single investment of $25,000 or more.

Notes:

1. There is no specific due-diligence performed by the angel network on companies offered using the 5x10 approach. The angels making $25,000 investments may or may not have performed due diligence.

2. Investments made under the 5x10 approach are at risk, just like all early-stage, angel investments.

3. To be clear, the 5x10 Approach is not a Fund. Angels hold their money until they personally decide to invest in a specific company. There is no fund manager, no carry and no draw.

4. If required, a Texas LLC company can be created by filing a certificate of formation with the Texas Secretary of State

   The owners of an LLC are called members. Generally, the liability of the members is limited to their investment and they normally have pass-through tax treatment

   If an LLC is created, the 5x10 angels will receive an annual K-1 tax report.

   > K-1 reports that show zero income and zero loss typically do not get reported to the IRS by the K-1 recipient.
   >
   > In the case of equity investments, the K-1 typically will have zero income and loss until a liquidity event.
   >
   > In the case of convertible debt, there may be a non-zero K-1 at the time of conversion, after which time the investment typically becomes an equity investment.
   >
   > In the case of royalty-based financing or loans with periodic payments, the K-1s will likely be non-zero every year.

   The LLC may elect a manager to manage the affairs of the LLC. The manager of an LLC may or may not also be a member. The Executive Director will handle the paperwork of creating the LLC, and will serve as the manager.

   The overhead costs for the 5x10 approach are the following one-time fees:

   - the cost of filing the LLC with the state of $300
   - administrative fee paid to the Executive Director of $100.

   These costs would be shared equally by all the 5x10 investors, and would be paid in addition to the investment dollars.

   Sources of information on Texas LLCs are:

   - https://www.sos.state.tx.us/corp/businessstructure.shtml
   - http://www.nolo.com/legal-encyclopedia/texas-form-llc-31745.html