

Revenge of the Angel Investor

Increasing Angel sophistication and lack of liquidity among Venture Capitalists has a relatively new source of funding flying high

When Mark Opausky launched an enterprise software company in 2002, he mortgaged his house and raised equity from his inner circle. But when Mr. Opausky started trolling for serious seed capital in 2003, his efforts stalled. Burned by the dot-com bust, venture capitalists weren't biting.

That's when an angel came into his life.

John Phillips, a retired lawyer and entrepreneur living in Toronto, became aware of Mr. Opausky's firm, BPS Corp., and went where no venture capitalist would go. He personally covered the payroll, keeping the company afloat until it could get a second lease on life.



Steve Murray, National Post Photo Illustration, Getty Images File Photo

Mr. Phillips had invested in many companies before, but never to this degree. "The three "Fs" -- family, friends and fools -- had already gone in and [BPS] was in a desperate situation," says Mr. Phillips. "I had lots of refusals," he says, recalling months of door-knocking among venture capitalists. But the angel's faith paid off when Covington Capital Corp. and Brookfield Asset Management Inc. partnered with Mr. Phillips in 2004 to provide an infusion of cash. Now, the company employs 75 people, has offices in New York and has signed deals with several international banks.

Once uncommon, partnerships between angels and venture-capital fund managers in Canada are taking root. During the tech boom, deep-pocketed venture capitalists had little to do with angel investors. But on this occasion, Covington made an exception, says managing director Scott Clark.

The reason: lack of liquidity. With venture-capital investment in Canada plummeting from \$5.9-billion in 2000 to \$1.7-billion in 2006, venture capitalists are reluctant to invest in startups and are swimming downstream toward safer investment pools -- second-and third-round financing deals. "We no longer have the liquidity to go after what we want," says Mr. Clark. Like many other large venture capital funds, he is using his cash to support existing deals, and is only investing in new companies if there's an engaged partner.

Call it the revenge of the angels. A new breed of entrepreneur is bridging the early-stage funding gap and taking a bigger role in the venture-capital sector. No longer content to provide early seed financing for fledgling firms, investors are also pooling capital and fronting millions to co-invest with fund managers in larger financing rounds. Having fled the sector in the booming 1990s, angel investors have returned to fill the growing void in the market. By building networks -- otherwise known as syndicates --across North America, Canadian angels are going where venture capitalists fear to tread.

The patron saint of start-ups in Canada is Terry Matthews, founder of Newbridge Networks Corp. and chairman of Mitel Networks Corp. and March Networks Corp. He specializes in high-tech start-ups from the Ottawa region. His investments, however, are only the tip of the iceberg. Many angel networks are building momentum by trading deal flow and pooling capital. Venture-capital financing is a high-risk business, particularly if entrepreneurs can invest in only five or six companies, says Mike Volker, founder of the Vancouver Angel Technology Network (Vantec). "But if you can do a more organized, broad-based pool type of strategy, you can get very good returns," he says.

By day, Mr. Volker works as director of Simon Fraser University's industry liaison office; by night, he is an angel crusader, holding seminars for new investors and reviewing deal proposals. Over the past seven years, Mr. Volker, has built the investor network from 12 souls to 500 and raised \$250-million for 150 companies by recruiting entrepreneurs such as Don Rix, founder of MDS Metro Laboratory Services.

In 2003, Mr. Volker also launched the \$5-million venture capital fund, WUTIF VCC Inc., to capitalize on demand from smaller investors, as well as leverage the province's tax credit aimed at venture capitalists supporting local start-ups. The baby fund has already seeded 34 firms.

In the past, angels might front a few hundred thousand. Now the stakes are higher. "We do \$5-million deals as part of our regular diet now," says Ed Alfke, who leads the three-year-old Okanogan Angel Network in Kelowna, B.C. Once a lone wolf, Mr. Alfke has become a champion of investor networking, helping individuals raise as much as \$10-million from angels. The director for the National Angel Network travels extensively in the United States drumming up cross-border investments. Of the 15 deals the Okanogan angels have invested in, four have U.S. involvement. He is also brokering deals with fund managers. "In the old days, venture capitalists had a tendency to come in and wipe the angels out," says Mr. Alfke, referring to the funds' ability to leverage better deals and dilute angel investment. "Now we are working together and getting smarter," he says.

British Columbia is on the cutting edge of angel investment, but its initiatives are having a domino effect outside the province. Randy Thompson, angel investor and partner in the four-month-old Calgary-based company Argon Venture Partners, has recruited 50 angels in the province, who have made \$11-million worth of investments in 24 companies over the past three years. Four deals top \$1-million, "a significant leap of faith for individual investors," he says. The Saskatchewan Angels Investment Network (SAINT) was incorporated in February and made its first \$400,000 investment in Net Security. The Newfoundland and Labrador Angel Investment Network (NLAN) was formed last year.

Ron Thompson of CAIL, a software company in Markham, Ont., runs one of the province's seed investor networks. Since 2001, Corporate Angels has grown to 400 members and raised \$40-million. That doesn't count solo investments by individuals in the group. Now that the network is liaising with U.S. angels, he expects deal flow to improve. "The more people I have at the table with different expertise, the easier it is to determine whether a deal is good or not," he says.

The resurrection of angel investors can be attributed in part to the decline of large venture capital funds. "Five years ago, there were about 60 companies doing deals," says Andrew Waitman, managing partner of Ottawa-based venture-capital firm Celtic House. Now there are only a handful, he says. Ontario and Manitoba labour-sponsored funds (LSFs), which offer federal and provincial tax credits to investors, have been the hardest hit. Fundraising in Ontario slid from \$446-million in 2000 to \$69.9-million 2006. While the large LSFs, VenGrowth Asset Management Inc. and Growth-Works in Ontario, have accrued enough capital to sustain themselves through the "funding nuclear winter," a number of smaller funds -- particularly those engaged in early-stage financing such as XDL Capital Corp. -- either folded or were absorbed by other companies, leaving the space underserved.

So what happened?

The venture capital community was hit with the perfect storm post-2000, says Mr. Waitman. Institutional managers have put more of their eggs into private-equity buyout opportunities, almost abandoning the venture capital space. In addition, the energy and commodities markets have outpaced the high-tech and bio-tech markets -- the traditional domain of venture-capital investors. As a result, hedge fund and wealth fund managers continue to bet big on minerals and oil, not technology.

But Mr. Waitman also blames poor returns. While there were some profitable exits, he says, "there have been no Googles in Canada." If you look at the U.S. market, a lot of venture-capital companies have also disappeared, but the top-tier players are still raising quite a flow of money, he says. "The hills are alive with the sound of money in Silicon Valley."

Brian O'Neill, senior fund analyst at Morningstar Canada, agrees. He has looked at the performance of LSFs within the energy sector. Front Street Energy Funds posted returns of 17.9% over five years compared with the CIBC Energy Mutual Fund, which had a

five-year annualized return of 28.7%. The difference, he argues, is due in part to the high fees charged by LSFs.

Les Lyall, senior vice-president of GrowthWorks, argues that there are LSFs that "have done a good job managing through the [tech] turmoil," and even outperformed many private funds. The venture-capital fundraising woes, he says, are due to government indifference. "When the Ontario government made the decision in 2005 to wind down the tax credit, it cast a pall on the asset class and curtailed fundraising," he says. As these funds in Ontario shrink, it has become harder for LSFs to leverage syndication deals with U.S. VC funds, he adds.

Despite their new clout, angel investors will never replace VC funds. For every successful angel start-up, there are still tales of companies, unable to find late-stage financing in Canada, moving to the United States (See tomorrow's Post). While many entrepreneurs are not enamoured with LSFs, they still believe in government support. "There's a huge amount of government money spent on research at universities and very little on commercializing it," says Mr. Alfke of the Okanogan Angels. "As a result, foreign companies are buying up our intellectual property at our universities."

Mr. Phillips, meantime, is busy building his next company -- Virtual Marine Technology Inc., a simulator for harsh ocean conditions used for rescue and small-craft training. This time, he has teamed with Growth-Works. He is so passionate about the company, he and his wife have bought a house in Newfoundland to be closer to his new investment. "I'm more intensely involved in companies than other venture capitalists," he says. "The angel environment is getting more sophisticated now," he says. "I'm proud to be part of that."

kmazurkewich@nationalpost.com - Tomorrow How Quebec attracted U.S. venture capitalists and avoided the exodus of startups to the south.

FIVE ANGELS AND THEIR INVESTMENTS :

JOHN PHILLIPS

Toronto-based Angel investor has invested millions of dollars in a dozen start-ups.

Who A former lawyer with Blakes, Cassels & Graydon, Mr. Phillips worked with numerous entrepreneurs in his previous life before reincarnating as an angel investor. In 1994, he started Clearnet Communications Inc., which was sold to Telus Corp. in 2000. Rick Tuttle of Iron Lion Management Inc., a company that specializes in private-equity investment and management services, approached him with a new proposition: BPS [Business Propulsion Systems] Corp., a GRC (government, risk and compliance) enterprise software company. "It was a great product and [had] some interest in the market-place." Since his involvement in 2003, the company has grown to 75 employees and has made major sales to international banks.

Angel deals Director of SMART Technologies Inc., SuiteWorks Inc. and Digit Wireless Inc. His heart is invested in St. John's-based Virtual Marine Technology, a company that grew out of a research and development project founded by Memorial University of Newfoundland. VMT combines expertise in marine testing, research and simulation-based training to provide realistic, effective and safe training tools for small-craft operators.

RONALD THOMPSON

Founder of software company CAIL and founder of the network Corporate Angels.

Who Eight years as an angel. "My idea is to support entrepreneurship with expertise and money to improve the probability of venture success." He continues: "I took some big hits early on. I was too aggressive and caught up." Now, he says, he never invests by himself, and is working with small-venture capital companies such as Brightspark. "Some [venture capitalists] are engaging with sophisticated angels because they understand the high risk of seed investing."

Angel deals He has personally invested millions in Toronto-based Eloqua Corp., and Ottawa-based Sidense, a company that licenses nonvolatile memory to electronic devices. More recently, he teamed up with Ed Alfke to fund Signalink Technologies in B.C.

MIKE VOLKER

Founder of Vancouver Angel Technology Network (Vantec) and Wutif VCC Inc. angel fund. Considered the granddad of angel investors in Canada.

Who Co-ordinated the original angel investors for Research In Motion Inc. In 1987, he negotiated to have 15% of the company for \$30,000 but agreed to rip up the contract after RIM principals generated more cash. "No regrets," he says, about having inadvertently given up the opportunity of becoming a multi-millionaire. "It just proves you never know what companies are going to make it big." When he started the Vancouver Angels seven years ago, only 12 angels attended the meetings. Today, the membership has grown to 500. Collectively, they have invested more than \$250-million in more than 150 companies.

Angel Deals His pet project is Cold Fusion Inc., an alternative energy source company that proposes using cold fusion rather than nuclear fission to heat homes. So eager is he to give it wings that he's approached Mike Lazaridis of RIM to become an angel investor.

ED ALFKE

Okanogan Angel Network and chief executive of Signalink Technologies.

Who Founder of Rent-a-Wreck, a company he co-founded with his brother at the age of 19. Has been involved in more than 30 companies, including restaurants, property

development and software firms. He chaired Entrust Financial Services in Denver, Colo., which has banking licenses in 40 states, and became involved with the Angels Investment Network there. He is founding member and director of the National Angel Organization, and founder of the Okanogan Angel Network.

Angel deals Recently raised \$5.5-million for Signalink Technologies Inc. Also a champion of Inviro Medical, a safety syringe company that raised \$25-million from angels, and the private-asset company Wellington West. The company, which got its start in Vancouver, has since moved its headquarters to Atlanta, Ga.

TERRY MATTHEWS

Chairman of Wesley Clover, a private investment group, and chairman of Mitel and March Networks, two firms active in developing Internet Protocol (IP) systems for enterprise applications.

Who Co-founded Ottawa-based Mitel Corp., an enterprise voice systems company that sold a controlling interest to British Telecom in 1985. Former CEO and chairman of Newbridge Networks Corp., a worldwide data networking company founded by Mr. Matthews in 1986 and sold to the French multinational, Alcatel SA, in 2000. Helped make Ottawa a hub for high-tech ventures in Canada. In the 2001 Queen's Birthday Honours, he was awarded a knighthood. Formed investment group Wesley Clover.

Angel Deals Has invested in more than 15 firms, including Wesley Clover Solutions and Inuk Networks. The latter is an IPTV technology company that has capitalized on the rapid growth of broadband technologies by developing a platform for the distribution of broadcast quality TV and audio over IP-based networks using multicast delivery.

**Karen Mazurkewich, Financial Post
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