ROCKTHEPOST REPORT

What Angel Investors Know About Startup Investing That You Don't

September 2013

Startup Investing:
Soaring to New Heights

ROCKTHEPOST REPORT

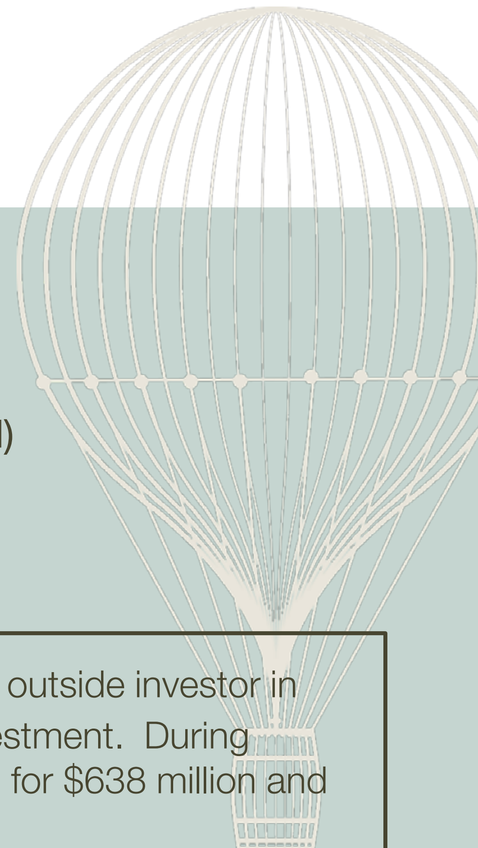
Startup investing is within your reach. And it can be the high ROI asset class your portfolio needs.

With recovery from the financial crisis well underway, it is clear that economic rebound isn't synonymous with a heroic return to the way things were pre-crash. Investors frustrated by flat fixed-income securities and an economic climate wrought with uncertainty are increasingly including alternative investments in their portfolios in an effort to obtain uncorrelated returns. Many have augmented their investment portfolios with angel investments – investing capital in startup companies, in hopes of achieving exponential returns even a fraction of those like early Facebook, Airbnb, and Dropbox investors.

Investing in early-stage companies is not as challenging as venture capital firms make it seem, and with the passing of the Jumpstart Our Business Startups Act (JOBS Act), startup deals will soon be accessible to the general public.

As a leader in the startup investment space – sometimes called "equity crowdfunding" – RockThePost is in a unique position to offer our perspective on the utility of startup investing as the newest type of alternative investment alongside private equity, hedge funds, real estate, and managed futures. While investing in startups can be risky, when utilized as part of a balanced portfolio strategy, the returns on successful investments can more than compensate for the risks

This report provides a comprehensive overview of the transformative shift in investing strategies within the context of the current US investment environment. We pay specific attention to the reasons why startup investing is a new "alternative investment" and startup investing platforms are a veritable and increasingly accessible channel to source startup investment opportunities.



INVESTING EARLY IN STARTUPS HAS THE POTENTIAL TO YIELD HIGH RETURNS*

$1,000 in Facebook in 2005 = $624,500 today (62,450% ROI)

$1,000 in Airbnb in 2009 = $589,667 today (58,967% ROI)

$1,000 in Dropbox in 2008 = $391,500 today (39,150% ROI)

PETER THIEL, former co-founder and CEO of PayPal, was the first outside investor in Facebook in 2004, receiving a 10.2% stake for his $500,000 investment. During Facebook's IPO in May 2012, Thiel sold 16.8 million of his shares for $638 million and another $396 million in August 2012, for a total of over $1 billion.

*Investing in early stage companies is highly risky and illiquid. You should consult an investment advisor to determine if startup investing is right for you. Note that these are estimated values that are intended only for marketing purposes and may not take into consideration pre/post-valuation and/or other financial details. Data available on SecondMarket.

US investment environment: Really a recovery?

Though the Dow Jones Industrial Average has hovered over 14,000 for most of 2013 compared to its March 2009 low of 6,440, the performance of other securities markets has left much to be desired. One of the most referenced fixed-income benchmarks, The Barclays US Aggregate Index, has declined over 3 percent this year following indications from Federal Reserve Chairman Ben S. Bernanke that the Central Bank may begin reducing bond purchases.

June was the worst month for investor withdrawals from bond funds since 1961. Over $60 billion was pulled out of bond funds in the 30-day period

Likewise, 10-year yields on US Treasury notes averaged 2.16 percent thus far in 2013, having only reached a year-to-date high of 2.98 percent on September 6, up from 1.66 percent earlier in the year. Similarly, June was the worst month for investor withdrawals from bond funds since 1961. Over $60 billion was pulled out of bond funds in the 30-day period, led by $9.6 billion in redemptions suffered by Pimco Total Return Fund (PTTRX), the largest mutual fund in the world. With 12-month inflation rates reaching 2 percent in July, fixed income is hardly the preferred investment vehicle in which to tie up long-term capital.

The recovery of the US economy is more like a mutation, driven in large part by the efforts of those at the forefront of innovation – entrepreneurs, thought leaders, and those seeking alternatives in the wake of financial or professional ruin. Long-term investments in private equity, hedge funds, and real estate are driving wealth creation where long-term fixed-income falls short.

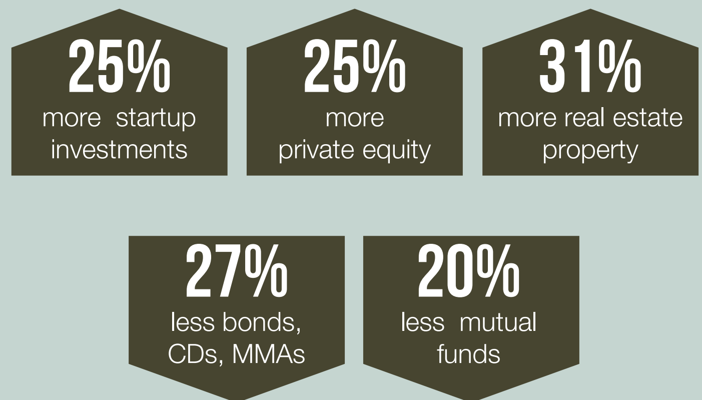
Typically considered "alternative investments," these vehicles are becoming more mainstream as they become increasingly accessible and satisfy several characteristics today's investors are seeking – they are long-term investments with the potential for uncorrelated high returns, there is a more stringent due diligence process on the investment, and investors are closer to the management process, therefore having a high visibility of the potential outcome.

PORTFOLIOS: THEN & NOW

Investors are looking for higher returns, uncorrelated to lackluster traditional markets, as part of a diversified portfolio strategy that includes looking for additional sources of alpha through alternative investments.

Preliminary results from RockThePost's investor survey indicate that investors' portfolios contain a lower percentage of fixed income and mutual funds than 10 years ago. Likewise, alternative investments make up a larger percentage of portfolios today.

Investor portfolios today vs. 10 years ago



Margin of error for preliminary results of 12.6%. Complete survey results will be published in Q4 2013.

Angel investing on the rise

Like investments in private equity, hedge fund, and real estate investments, non-institutional investments in startups – known as "angel investments" – are gaining momentum among the alternative investor crowd. Angel investing is growing in the US, led by a group of successful entrepreneurs, venture capitalists and savvy early investors reaping the benefits of big ticket acquisitions and IPOs over the past decade, and who, in turn, want to contribute both capital and experience to the startup ecosystem.

Reaching nearly $23 billion in 2012, angel investors are not only responsible for funding over 67,000 startup ventures annually, but their capital also contributed to job growth by helping to finance 274,800 new jobs in 2012 according to the Angel Market Analysis by the Center for Venture Research at the University of New Hampshire. On the contrary, venture capital firms only invest in 1,000 new companies per year.

While angel investors contribute about five times less capital to startups than VCs, individual investments in startups grew by 36 percent from 2008-2012, while venture capital investments dropped by 8 percent, according to Dow Jones VentureSource. The average angel investment grew more than 20% from 2011 to 2012, from $70,690 to $85,435, according the Center for Venture Research.

There are two primary reasons for the growth in angel investing. First, the cost of starting a business has plummeted in the past ten years from an average of $2 million to around $5,000. It is easier for investors to fund businesses during the earlier stages as the amount of required investment capital is much lower and the number of early stage companies is greater. Second, venture capital firms are investing later in the lifecycle of a company after its founders have demonstrated credible metrics of feasibility and scale, leaving an opening for earlier investors.

Angel investing is not without its ups and downs, however. A study by Cambridge Associates found that over 60 percent of high-tech startups did not provide any returns, while 7 percent generated returns in excess of 5 times invested capital. Many angel investors maintain a portfolio of startups in order to balance the risk, typically no more than 10% of their overall investment portfolios. For individuals and family offices, a startup investment portfolio that is diligently managed can produce returns in line with the risk assumed.

JOBS ACT OVERVIEW

Jumpstart Our Business Startups

- 1933 Securities Act bans general solicitation (public advertising of an offering) for private companies
- April 4, 2012 – JOBS Act signed into law, including Titles II & III regulating investment crowdfunding
- September 23, 2013 – Title II takes effect, lifting the ban on general solicitation for private companies
  - Private companies can generally solicit & receive investments from accredited investors
- Coming soon - Title III will allow non-accredited investors to invest in startups, subject to limitations

With regulatory changes to 80-year-old securities rules originating from the implementation of the JOBS Act, startup investing is now accessible to nearly 8.7 million American households qualified as accredited investors, significantly more than the 268,160 angel investors active in 2012 as members of angel investment groups or who are otherwise well-connected within the community, according to the UNH Center for Venture Research. When Title III of the JOBS Act takes effect – likely in early 2014 – *any* individual will be able to invest in startups, subject to limitations based on income and net worth levels set forth by the SEC.

STARTUPS AT A GLANCE

The 2010 Kauffman Index of Entrepreneurial Activity indicates entrepreneurial activity is at its highest level in the past 15 years.

565,000 NEW BUSINESSES founded each month = **6.7 MILLION** per year

11.9 MILLION SELF-EMPLOYED business owners = **6.5%** of adult population

340 OUT OF 100,000 ADULTS start a business each month, **UP FROM 270** in 2001

Startup investing: The new alternative investment

Top priority for investors is "seeking new ways to position their portfolios for success in a low-yield environment marked by uncertainty and volatility," according to BlackRock's "Alternative Realities" issue of *Currents*. It further affirms that "alternative investments are moving from the periphery to the core as investors seek uncorrelated returns and more risk-efficient portfolios." Effectively, investors are losing faith in traditional markets susceptible to exaggerated or irrational group-think behavior.

Part of a transformational new investment strategy is to consider private equity investments as "equity" rather than "alternative investments," shifting them into a different category within a balanced portfolio. UBS's August 2013 issue of *House Review*, recommends a portfolio that includes 7-11% alternative investments – private equity, hedge funds, real estate and managed futures.

However, re-categorizing private equity investments leaves room in the portfolio for new alternatives with similar alpha. For those aligning their investment portfolios for the new reality of the US economy, BlackRock notes, "alternatives are no longer an 'alternative,' they are often an imperative for portfolios." So where can investors look for the new alternatives?

To begin, the now-mainstream alternative investments generally have four characteristics in common: a long-term horizon (sometimes up to or exceeding 10 years), illiquidity, high risk, and the potential for higher expected returns as a result. Investors in these types of securities are typically accredited in accordance with regulatory requirements, or by virtue of possessing the capital required to carry out the investment.

Accredited investors are those deemed by the Securities and Exchange Commission to be sufficiently sophisticated, according to Rule 501 of Regulation D that sets the thresholds for annual income and net worth. As investments not available on a public exchange, alternative investments are typically intermediated by an institution, fund manager or broker, who in turn receives a management fee as a percentage of the total investment. By their nature as private

STARTUP INVESTOR PRIORITIES

Startup investing is motivated by the same reasons as investing in other alternative investments such as private equity, hedge funds & real estate, preliminary results from the our Investor Survey indicate.

1. "I am looking for investments with potentially high returns"
2. "I want to have an impact on the success of early-stage companies"
3. "I would like to diversify my investment portfolio"

Margin of error for preliminary results of 12.6%. Complete survey results will be published in Q4 2013.

investments, private equity or hedge fund investments are often elusive for investors who may not readily know about them or how to access them. Often times, investors in these securities play an important role in the management of the companies in which they invest, with the goal of improving the company's performance, and ultimately, their own returns.

Angel investments typically have similar characteristics to other alternative investments – they are long-term, illiquid, high risk, and have the potential for exponential returns – but they also differ along several dimensions. Investors in startups are also accredited, but they carry out investment activities under a different model than other alternative investments. Among them are: the lack of intermediaries, lower investment thresholds, and the ability to have a direct impact on the management of the company – or none at all. Startup investments are typically less sensitive to market conditions because investors' incentives are aligned with long-term success of the company,

Angel investments are typically early-stage – or "seed" – investments in new companies still in the beginning stages of development. The median size of a round of angel investment in one startup at seed stage is $680,000 at a median pre-money valuation of $2.5M, according to the Q1 2013 Halo Report. Therefore, angel investors typically receive a 27.2% collective ownership stake in the startup. This startup capital can be provided by one investor or dozens, meaning that individual investment amounts can generally range anywhere from $10,000 (or less) to $500,000, as in the case of Peter Thiel's original 2005 investment in Facebook.

While a return on a startup investment is generally binary, a portfolio of investments in multiple startups can help to diversify the risk. Furthermore, many startups are so innovative and global by design that they are immune from traditional market forces such as mortgage rates, market hysteria, and local economic trends. For those able to invest in multiple startups, the risk of loss may be worth the potential returns under current economic conditions.

"ACCREDITED INVESTOR" DEFINED

The federal securities laws define an individual accredited investor in Rule 501 of Regulation D as:

1. A natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds $1 million at the time of the purchase, excluding the value of the primary residence of such person

2. A natural person with income exceeding $200,000 in each of the two most recent years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year

3. A trust with assets in excess of $5 million, not formed to acquire the securities offered, whose purchases a sophisticated person makes

More information is available on the SEC's website: www.sec.gov

RockThePost's startup investing platform brings the deals to you

Today, fewer than 300,000 of the 8.7 million accredited households are actively making angel investments. Most of these investors are members of angel investing groups such as Golden Seeds and New York Angels, though over 4,300 unaffiliated individuals have made angel investments according to data from CrunchBase. This number is likely higher when taking into consideration less formal "friends and family" investments. Still, for individuals unaffiliated with angel investing groups or unfamiliar with the startup landscape, the greatest challenge in startup investing is finding the startup investment opportunities.

Now, because of the JOBS Act, online startup investing platforms such as RockThePost are able to showcase startups to the general public. With Title II of the JOBS Act removing the ban on general solicitation this month, startups are able to publicly advertise that they are seeking investments. Accredited investors are currently able to invest in startups via online platforms, eliminating the need to be a member of an angel investing group or personally meet the entrepreneurs at networking events.

RockThePost's startup investing platform allows potential investors who have self-accredited to view startup company information, including founding team backgrounds, financial projections and the terms of the investment in one place. It is safe and easy to carry out an investment online through RockThePost's proprietary investment process in which a level of due diligence is conducted to verify the legitimacy of the entrepreneur, the startup, and the investment transaction itself. Investments are held in Escrow until the minimum level of investment for the round is met. And investors have many opportunities to get to know the founding team via Digital Demo Day and personal interactions on the platform.

Non-accredited individuals will be able to participate in startup investing when Title III of the JOBS Act takes effect. Today, they may follow startups' progress and participate in their growth as users, customers, and advocates. With the potential for significant infusion of startup capital into the market, RockThePost provides the marketplace for investors to find startups, carry out an easy-to-understand due diligence process, and complete an investment transaction. The global reach of technology will allow any investor to have an impact on jumpstarting our business startups.

As startups receive more of the investments they need, their chances of success will increase, providing a viable investment alternative during this transformative investment environment.

STARTUP INVESTING ON ROCKTHEPOST

Investing in startups on RockThePost is secure and easy. Invest as little as $1000 to diversify your risk.

Access to deals

Dozens of startup investment opportunities simultaneously

- Browseable/searchable startups
- Monthly Digital Demo Day webinar

Personalized experience

We help you find exactly the startups you are looking for

- Targeted matching to startups
- Curated deals by industry, stage and geography

Secure transactions

Your capital and personal information is safe

- Managed Escrow account with minimum threshold
- E-sign documents and contracts

Compliance

Meets SEC regulations, in a way that maintains your privacy

- Private verification of investor accreditation status
- Bank-level security

Transparency

Feel confident in your investment choice

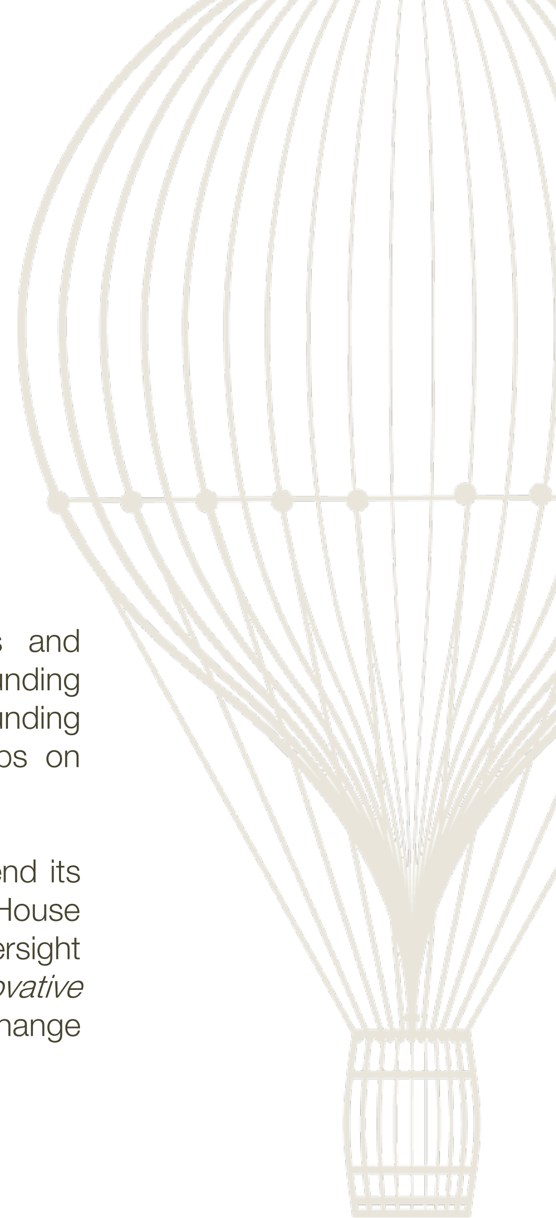
- Crowdsourced due diligence
- Entrepreneur ID check
- Business ID verification

Customer Service

Reach a live RockThePost team member on the other end of the line when you have a question, 24/7

- Phone, email or chat

ROCK THE POST



RockThePost is a startup investing platform for entrepreneurs and investors. Launched in 2011 originally as a donations-based crowdfunding platform, RockThePost has operated as an investment crowdfunding platform since April 2013. As of September 23, 2013, 58 startups on RockThePost collectively raised over $11 million.

RockThePost is frequently called upon by federal organizations to lend its industry expertise. CEO Alejandro Cremades testified at the US House Committee on Small Business Subcommittee on Investigations, Oversight and Regulations hearing, *Financing America's Small Businesses: Innovative Ideas for Raising Capital* and was present at the Champions of Change Ceremony hosted by the White House earlier this year.

If you have any questions regarding the contents of this report, or would like to contact us, you may do so at:

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Investing in startups and early stage businesses involves risks, including illiquidity, lack of dividends, loss of investment and dilution, and it should be done only as part of a diversified portfolio. RockThePost is targeted at investors who are sufficiently sophisticated to understand these risks and make their own investment decisions. You will only be able to invest via RockThePost once you are verified as an accredited investor pursuant to the federal securities laws defining an individual accredited investor in Rule 501 of Regulation D.

The information in this report is intended to serve as informational and promotional in nature, and is in no way an investment recommendation. Investments via RockThePost can only be made on the basis of information provided in the individual company profiles by the companies concerned. RockThePost takes no responsibility for this information or for any recommendations or opinions made by the companies or their representatives.

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