Emergence of Canadian unicorns sparks angel investors

Higher-net-worth investors are joining groups instead of flying solo in financing young companies

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Jason Nagy began investing in Enthusiast Gaming Inc. in 2016 after hearing its pitch to an angel-investor group. But he didn't expect an opportunity for a return so soon. The Toronto-based digital media company, which is devoted to video-gaming and runs Canada's largest gaming expo, plans to go public this year.

"That's the golden egg – I got lucky on my first investment," says the 49-year-old president of Wise Crescent Inc., a Guelph, Ont.-based builder of websites for small businesses. "I invested $10,000 … and have since put more money in it. My other three angel investments are coming along slowly."

A growing number of higher-net-worth investors are financing startups, often in exchange for ownership equity or convertible debt, but many are now becoming angel investors as part of group instead of flying solo.

Mr. Nagy is among members of the Oshawa, Ont.-based Spark Angel Network who invested in Enthusiast Gaming after doing their due diligence. He also became more involved by joining its board of directors.

"It's been a really interesting ride," he says. "For me, the major focus is seeing some really interesting companies flourish. … If I make some money along the way, that would be great."

Angel investing, which typically functions as a bridge between financing from family and friends and venture capital, has gained momentum over the past five years, says Yuri Navarro, chief executive officer of the National Angel Capital Organization (NACO), an association of angel investors in Canada.

A NACO survey in 2017 found that 43 Canadian angel groups made 505 investments totalling $162.6-million. Their investments were made mostly in information and communication technologies followed by life sciences.

Startups that have disrupted traditional businesses are gaining notoriety, and that's generating a lot of excitement, Mr. Navarro says. "We are starting to see unicorns, which are startups valued at more than $1-billion, emerging in Canada. … We have Shopify, an e-commerce company, and Kik Interactive, a messaging platform."

Those with cash to invest are looking for new options as stocks and bonds have failed to generate sufficient returns. ISTOCKPHOTO

Investors are looking for new places to park their money as traditional asset classes such as bonds, Treasury bills and stocks have failed to generate sufficient returns, Mr. Navarro says. Studies from the United States indicate that the average annual return from angel investments is about 27 per cent for startups that are eventually sold or go public, he adds.

Angel investors are usually required to meet certain financial criteria. To qualify as an accredited investor, an individual must either have earned more than $200,000 annually (or $300,000 with a spouse) over the past two years, or have $1-million in investable assets, or have net assets of more than $5-million.

Because investing in emerging companies is risky, it's better to make multiple smaller investments rather than one big bet, and also collaborate with other investors, Mr. Navarro says. "The chances of a lone-wolf investor losing their money is quite significant. … We tell our members not to invest more than 5 or 10 per cent of their wealth in startups."

Common wisdom is that seven out of 10 early-stage companies fail, so investors should find firms that "can generate a greater-than-10-times return" to be worth the risk, he says.

"It could take seven to 15 years for an exit depending on the industry. Exits of two to five years are very rare but do happen."

Angel investors who have started their own companies often better understand the risks, and they fund startups to support the next generation of entrepreneurs, he says. They also use their business knowledge to help at the board level or to make introductions to their contacts.

An angel investor is usually cutting cheques from $5,000 and up, but the more common range is $50,000 to $150,000 for one startup, he says. "But you do see some investors who will cut $1- to $2- or $3-million cheques."

Investors can learn about financing early business ventures by joining a formal angel-investor group. It may have membership criteria, a structured pitch process for companies and due-diligence practices often supported by staff, says Mr. Navarro. Among groups in Ontario are Maple Leaf Angels, Golden Triangle Angel Network and York Angel Investors, while Anges Québec is active in that province.

There are also informal angel groups made up of peers or entrepreneurs who get along and just write cheques together, he says. The founders of Atlantic Canada-based East Valley Ventures, for instance, were involved in Radian6 Technologies Inc. before it was acquired in 2011 by San Francisco-based Salesforce.com Inc.

An angel investment fund – basically a hybrid between a venture capital fund and angel investing – may appeal to those who find it easier to commit to a portfolio of companies rather than a single startup. Vancouver-based E-Fund, which invests in technology companies in British Columbia, has attracted some 100 investors over the years, he adds.

Investors who are interested in financing emerging tech companies but don't have the time or inclination to do the due diligence might consider Toronto-based Brightspark Capital Inc., which offers funds that each invest in one startup. It now runs 14 such funds.

The goal is to find young companies with potential, "but we try to mitigate the risk through our research," says Sophie Forest, a managing partner and veteran angel investor. While Brightspark charges a management fee for the first three years, "the way we really get paid is the upside," or return, she adds. "We take 15 per cent carried interest [profit] from every deal."

Brightspark offers its deals to accredited investors who register on its website. Its funds are invested in startups such as Toronto-based Nudge Rewards Inc., whose mobile app enables companies to more easily communicate with front-line employees, Toronto-based Hubba Inc., which operates a business-to-business marketplace to connect brands with retailers, and Montreal-based Hopper Inc., whose travel-booking app can alert consumers to low-cost airfares.

While the minimum investment required per fund is $10,000, the average amount ranges from $35,000 to $50,000, Ms. Forest says. "Because what we do is super risky and you can lose your money, it is important to do numerous deals. Most of our investors do three, four or five of them."

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