Angel investors try their wings

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Sheng Lu of TÜV Rheinland Rail Sciences Inc. works on a laser-camera device on a train car in Lincoln. MRail Inc., a Nebraska startup that received a $500,000 investment from Nebraska Angels to work on the device, is partnering with Rail Sciences for development work. The device detects problems with rails on train tracks.

Robert Slezak retired from TD Ameritrade in his early 40s, his pocket full of the financial rewards of helping a small company grow into a national leader in the investment industry.

Today he's still helping figure out business strategies, keeping an eye on business finances and interacting with top executives. But he's also apt to take phone calls from a beach in Florida, not at an office. When it comes to the heavy lifting of running a business, that's somebody else's job.

Slezak is one of a small but growing number of Midlanders who are angel investors — wealthy individuals who invest their own money in startup companies led by entrepreneurs with bright ideas.

"I'm too young a man to sit on the front porch and whistle," said Slezak, now 54. "This allows me to keep doing the part of my job that I enjoyed most, the strategy stuff and thinking about markets and about new opportunities. But I don't have any day-to-day responsibilities. This is a great middle ground for me.

"I really enjoyed taking a small company and making it grow and making it real successful. Angel investing is sort of my way of trying to experience that again."

Both Nebraska and Iowa have relatively new government policies that encourage such investments. States offer tax incentives because a successful business creates jobs.

Slezak belongs to the Nebraska Angels, a five-year-old nonprofit network of investors, mostly from Omaha and Lincoln. Other angel investors evaluate and finance deals on their own, and the Midlands has other angel investment groups, including the 16-year-old Kearney Area Ag Producers Alliance cooperative.

In Iowa, state laws encourage communities to form venture capital funds, and so far there are 19 such funds around the state. Some of the funds have angel components so individuals can make their decisions on investing in startups. As those businesses become larger, they may qualify for higher-level financial support from the venture capital funds.

"We anticipate they will find good deals in Iowa," said Mark Huston, a manager for Cimarron Capital, which helps coordinate the Iowa investment system.

These folks are not angels in the biblical sense, but if you're a cash-strapped entrepreneur, a person with a sack of money may seem like a visitor from God.

Businesses that have benefited include MRail Inc., which is developing safety equipment for railroad tracks; Skyvu Entertainment, an Omaha animation company; Hudl of Lincoln and Omaha, a sports software company; Virtual Incision, a surgical robotics company; and Nitride Solutions of
Wichita, Kan., which makes advanced materials for lighting and computers.

Since the Nebraska Angels began in 2006, its members have invested slightly more than $4 million in 10 companies. Two of the companies have shut down. One was doing well enough that it received a profitable buyout offer. It was turned down because the company's board thought the company had more growth potential.

Nebraska was somewhat late in joining more than 20 states that offer tax incentives to encourage angel investing. Starting last October, investors who put money into startup businesses in Nebraska can get 35 percent back in state income tax credits, 40 percent if the investment goes to a business in a disadvantaged area.

Last year, Nebraska investors requested $4.9 million in credits, and $3.1 million was approved by the state. So far this year, $1.6 million has been requested and $1.5 million approved.

The credits reduce the investors' risk, but it's still not the place to bet money you can't afford to lose. The Nebraska Angels requires its members to be "accredited investors" — generally, people whose net worth exceeds $1 million, not counting a primary residence, or who earned more than $200,000 in each of the past two years ($300,000 for a married couple).

Most angel investors limit their investments in startups to 5 percent or 10 percent of their total investments. While they hope to make a profit, angels say that's only part of the reward for putting their money at risk. They enjoy the challenge of building a business, are stimulated by learning about new ventures and relish advising the high-energy people trying to turn ideas into jobs.

"It's like I'm getting an executive MBA on my own time," said retired Omaha surgeon Steven Clinch, one of 36 people who pay $2,000 a year to belong to the Nebraska Angels.

Angels come from a range of occupations, including medicine, law, finance, insurance, construction, software, manufacturing and transportation. Pete Ricketts, another former TD Ameritrade executive and 2006 candidate for the U.S. Senate, is a member.

Members of the group have been "successful in their own right," Clinch said. "They don't have to be successful again, but they kind of like helping other people become successful."

The group holds meetings where entrepreneurs pitch their ideas. Members of the group research the proposals, often drawing on their own career experiences. Each member decides whether and how much to invest.

Shane Farritor helped persuade the Nebraska Angels to invest in two of the startup businesses, MRail and Virtual Incision. Farritor, a professor of mechanical engineering at the University of Nebraska-Lincoln, said profit is not the angels' only goal.

"I think their first priority is to contribute and to do good things and to give back to society, and maybe have fun, to live vicariously through young companies," he said. "They really, really want to help you. And there's not a dummy in the bunch. They bring a lot to the table."

He and Richard Arnold, an assistant professor of mechanical engineering, developed MRail's system of lasers, cameras and computers through grants from the Federal Railroad Administration, which supports safety-related research for the rail industry. The "M" in MRail stands, roughly, for measurement, since the system measures rail distortion under the weight of train cars and pinpoints rails that need replacing.

MRail's business side is headed by CEO Billy Spazante of Monterey, Calif., who has experience in turning new technology into viable businesses. He learned about the rail technology through a friend who is a UNL alumnus and worked with Nebraska Angels founder John Brasch, a UNL vice chancellor now with emeritus status.

Spazante could have raised money for MRail in California, which accounted for nearly 30 percent of the $18 billion in U.S. angel investing last year.

"There didn't seem to be a very compelling reason to just grab the patent and run," Spazante said, which sometimes happens with university research products that have national or international markets. The Omaha-Lincoln corridor has a strong rail-oriented industry, including Union Pacific Railroad, he said.

"It seemed like all the stars aligned to anchor the business where the technology was founded."

The pitch to the Nebraska Angels yielded a $500,000 investment in November 2010.

"The angels came in at a pivot point," Spazante said, providing money to "ruggedize" and improve the experimental technology and to bring it to market.

Two Nebraska Angels, Roy Schumacher and Louis Halperin, serve on MRail's board of directors, a common arrangement with angel investors who are able to add expertise to fledgling companies.

"The Nebraska Angels brought talent, understanding, guidance, connections for potential sale opportunities, a broad range of capabilities," Spazante
said. "This is a good situation. You hope for engagement, so when somebody invests in a deal they’re connected to the deal and not just writing the check."

So far, MRail has brought in some revenue but has no employees. Instead it is partnering with Rail Sciences Inc. of Omaha, a division of TÜV Rheinland Group, a German industrial safety testing company, for development work. Farrtor said it’s hard to predict when the company will break even or hire its own staff. "It’s an early-stage startup, is about all you can say."

Although most of the businesses backed by angel investors never blossom, the occasional big success can make up for the losses.

One such success is KAAPA Ethanol LLC, a 50-million-gallon-per-year ethanol plant near Minden that opened in 2002 with financing from the 500-member Kearney angel investment cooperative.

One of the investors, Milt Dahlgren of Minden, said the plant’s 2011 dividends alone equaled his initial investment.

"It’s working out great," Dahlgren said. "Let’s face it, agriculture’s been very good in recent years, and it’s a stable economy around here," generating cash for investments.

He also invested in an agriculture-oriented tourist business supported by the Kearney angel cooperative that didn't do as well, but then he understands the risks of angel investing. "Hopefully you diversify, you don’t put everything into one."

Margery Lauer, the group’s executive director, said the cooperative members are seeking more investments. "Maybe it’s the attitude of the farmers. They’re so used to risk."

Randy Nitz, executive director of the Nebraska Angels, said that on average, half of the businesses backed by angels lose everything and one-third keep operating but fail to grow. But the others make above-average returns — if you’ve picked the right ones.

Nitz said there’s room for a dozen or so more members in Nebraska Angels, and he expects interest will increase once there’s an investment success. It’s hard to measure the economic impact of the new law so far, but he guesses that the businesses might have created about 70 jobs thanks to angel investments that qualify for tax credits.

In the meantime, he said, the angels are sifting through the "deal flow" to find new places to put their money.

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