Start at the End - Your Exit Strategy

New Ventures BC Seminar

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Qualifiers on This Presentation

- I was a technology entrepreneur
- And now I am a tech exit strategist
- My comments are from that perspective
- Financing and exit strategies are different for life science and energy companies
- I am not including ‘public market’ financial strategies until those markets recover

Congratulations on Being An Entrepreneur

- For those few among us that can,
- I think it is the best business-life choice.
- I’d like to start by having you ask yourself:
- Why are you doing this?
- Seriously.

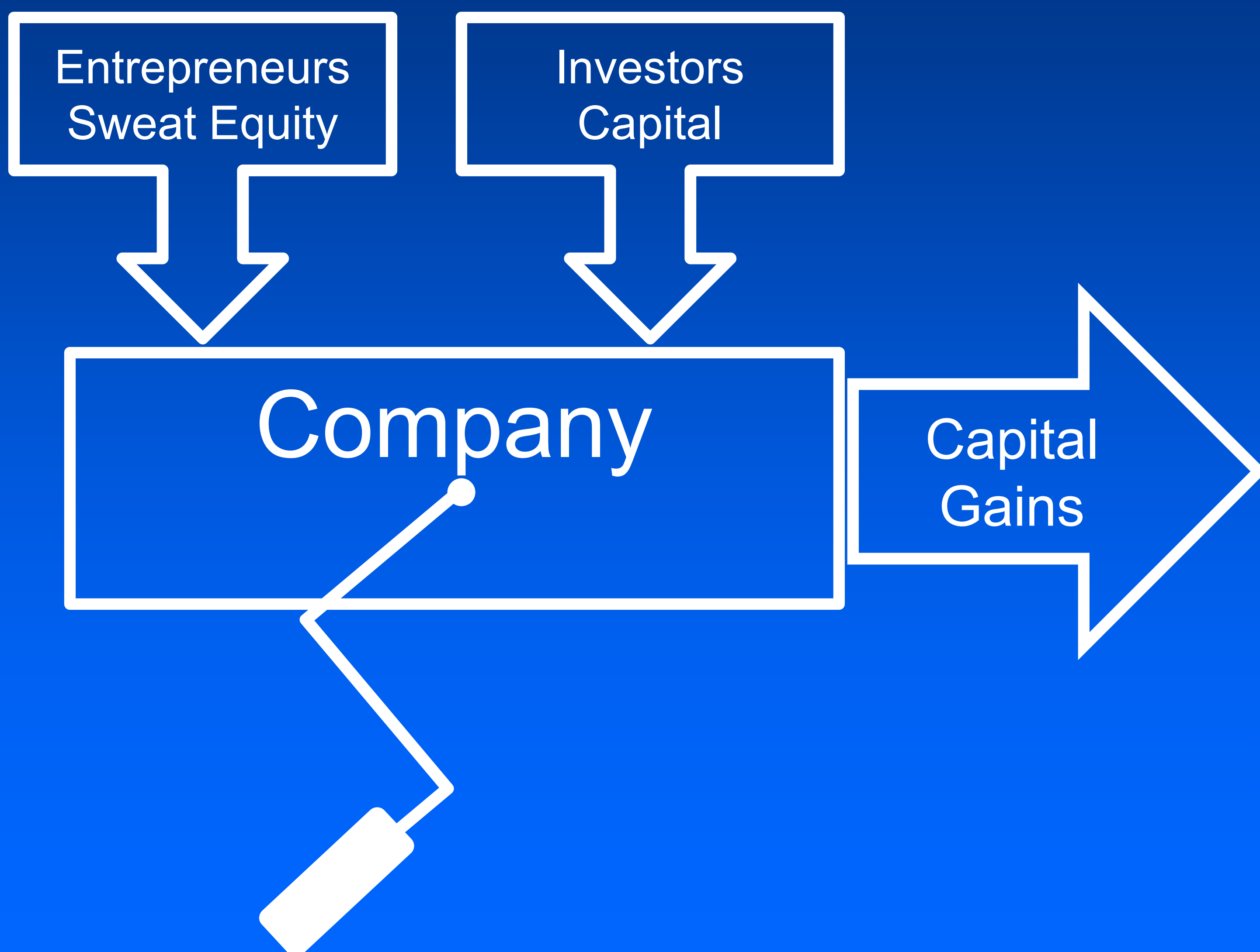
Entrepreneurs Have Complex Motivations

- To what extent are you doing this because:
- You can’t get a paying job?
- It’s the most exciting thing you can think of?
- (that’s legal)
- You like learning so fast it feels like your head might explode – most days?
- To make a truly huge amount of money?

For Investors – It’s Easy

- I am also an angel investor
- Unlike you entrepreneurs, I just want one thing
- That makes it simple from my perspective
- This is what your company looks like to me
- And every other investor

Simple Model of a Company



The Truth About Investors

- We are a pain in the a__s!
- We will want:
- A ton of documentation and financial reports
- Board meetings
- To help (not always a good thing)
- To get our money back
- You need an exit strategy before you ask us

Exits are the Best Part

- I believe exits are the best part of being an entrepreneur or investor
- It’s when we get paid for all of our hard work and risk capital
- But it’s also the least well understood part of being an entrepreneur
- Simply because it doesn’t happen very often
- My goal today is to provide information to help you design and execute better exits

Much of What You Hear is Wrong

- It’s surprising how much of what you hear about exits is wrong – dangerously wrong
- There are so many myths and misperceptions
- And so many ‘experts’
- And quite a few dirty secrets
- The economy has also changed – a lot
- This seminar is about what actually works today - in our current economy

Ways to Exit

- There are basically only two ways to sell your company:

  1. An IPO (going public)

  2. An M&A transaction (private sale)

- These days it’s almost entirely M&A

What Happened to IPOs?

- There have been very few big IPOs
- Not just for the past few years, since the mortgage crisis
- There have been very few IPOs since the tech equity bubble burst in 2000
- And it’s not likely that the IPO market will ever return to what it was in North America
- Until Sarbanes Oxley is repealed or modified

What About Big M&A Exits?

- The media distorts our perception by focusing on the multi-billion dollar M&A deals, like
- YouTube and Skype
- The dirty secret is those huge transactions rarely work out well for the buyers
- And corporate America is figuring that out
- So huge M&As aren’t happening as often either

The New Big Story

- It’s human nature to get excited when you read about big transactions in BC like:
- Club Penguin’s $350 million sale to Disney, or
- Customs House $370 million sale to Western Union
- The ‘new’ big story is the much larger number of small exits

Most Exits Are Under $20 Million

- Mergerstat database shows the median price of private company acquisitions is under $25 million, when price is disclosed
- But the price is not disclosed in most smaller transactions
- I estimate the median price to be well under $20 million
- And probably below $15 million

Why This Is Happening Now

- One of my friends from a Fortune 500 company explained it this way:
  - We (big companies) know we aren’t good at new ideas or start-ups
  - We basically suck at building business from zero to $20 million in value
  - But we think of ourselves as really good at growing values from $20 million to $200 million or more

Under $20 Million Is Easy

  - A company priced at $100 million is already out of our sweet spot to buy
  - $100 million also requires board approval
  - But at $20 million, it's really easy for me to get it approved just inside my division
- Many big companies are spending more on M&A than internal R&D
- Today, it's the best way for them to grow
- It's also what their shareholders want

Google Wants Even Earlier Exits

- I was surprised recently to learn just how early Google wants to do acquisitions
- Charles Rim one of the top Google M&A guys:
- “90% plus of our transactions are small transactions. … less than 20 people, less than $20 million and that is truly the sweet spot”
- “we do prefer companies that are pre-revenue”
- http://www.angelblog.net/Google_Wants_Even_Earlier_Exits_Than_in_Early_Exits.html

Big Companies Have Cash

- Many big companies have so much cash that it's a problem – shareholders complain
- Google has $20 billion
- eBay has $5 billion
- Amazon has $3 billion
- Yahoo has $3 billion
- Microsoft has $35 billion
- Apple has $25 billion

Who Else Is Buying?

- The most familiar buyers are Fortune 500 companies
- But medium sized companies are also aggressive buyers – especially public ones
- Private Equity funds are also coming back into the market now that debt is available
- Also many individuals not ready to retire

Our 21st Century Economy

- What works today:
  1. Small companies innovate
  2. Angels, Friends and Family finance them
  3. Big companies, and others, buy them early
  4. The buyers then grow the business
  5. Entrepreneurs and investors recycle the gains

A Common Misunderstanding

- A common misunderstanding about M&A exits is that you have to grow the company to be profitable
- Or grow it to be larger than $X millions of revenue
- The real threshold is to ‘prove the business model’

What it Means to Prove the Model

- In a recurring revenue business, for example, you have a spreadsheet that clearly shows actual results for:
  1. Gross margin per customer
  2. Customer lifetime (or churn)
  3. Cost of customer acquisition
- In other words, how much is a customer worth and what do they cost to acquire?

Proven Model and Value

- Some businesses have slightly different metrics to prove the model
- But when you prove the model you can build a credible projection that shows if:
  1. New owners added $X millions of capital,
  2. The business would have Y customers
  3. And be worth $Z millions

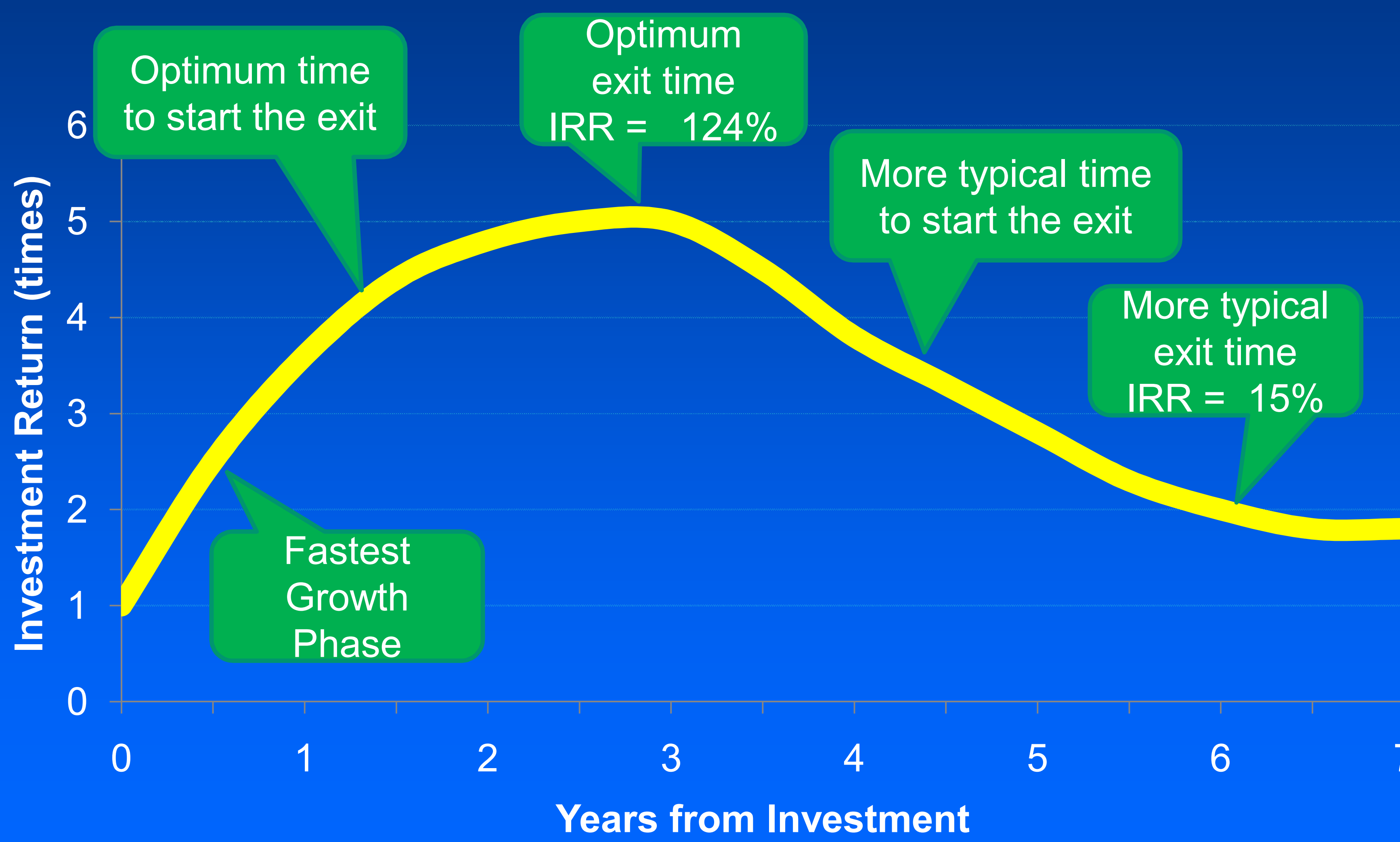
That’s When You Can Sell

- There are often additional factors like competitors and market changes
- But the important threshold to determine when you can sell is when you have proven the model
- That’s when you can have a reasonable negotiation on value
- And sell the business

It’s Often The Optimum Time

- As soon as you prove the model is often the <u>best time to sell</u>
- Always best to sell on an upward trend
- Sell on the promise not the reality
- Often when you can get the best price
- Very often ‘stuff happens’
- Most entrepreneurs ‘ride it over the top’

Don't "Ride It Over the Top"



Exiting in Internet Time

- The internet has accelerated everything
- It allows entrepreneurs to market and sell to hundreds of millions of prospects in just days
- The internet has also accelerated almost every other aspect of the startup lifecycle
- Entrepreneurs now have “Weekenders” where they build entire companies in a weekend

Weekender Sold in 10 Days

- In 2009 when I wrote “Early Exits”
- I speculated that one day: “They’ll probably define an early exit as selling the company before the end of the weekender”
- That almost happened in November 2009
- A team of entrepreneurs in London built a business in one day and sold it online in ten days: www.24hour-startup.com <– great video
- Not an isolated example, see www.Flippa.com

More Exits In Just 2 – 3 Years

- Flickr sold for $30 million at 1.5 years old
- Delicious sold for $30+million 2 years from startup
- Club Penguin for $350 million at 2 years old
- YouTube sold for $1.6 billion at 2 years old
- Playfish sold for $275 million at 2 years old
- Mint sold for $170 million at 3 years old
- AdMob sold for $750 million at 3.5 years old

Do you even need investors?

- A hundred years from now, this will be recognized as a golden era for entrepreneurs
- Hey, why are you laughing. I am serious!
- Never before has there been so many huge opportunities
- That were so easy to capitalize on
- It’s all because of the internet

The Olden Days

- When I was a young entrepreneur,
- back in the 1980s (yeah, I know… wow… are you old)
- Companies cost tens of millions to build
- Didn’t matter if it was a hardware company or a software company
- That created an enormous venture capital industry (more about this in a minute)

You know what a mashup is ☺

- It’s harder for me when I talk to groups of investors – they often don’t get it
- The internet, open source and this huge, hungry global market means that
- Today, very valuable companies are being built on just tens of thousands of dollars
- Club Penguin, Plenty of Fish, MetroLyrics for example

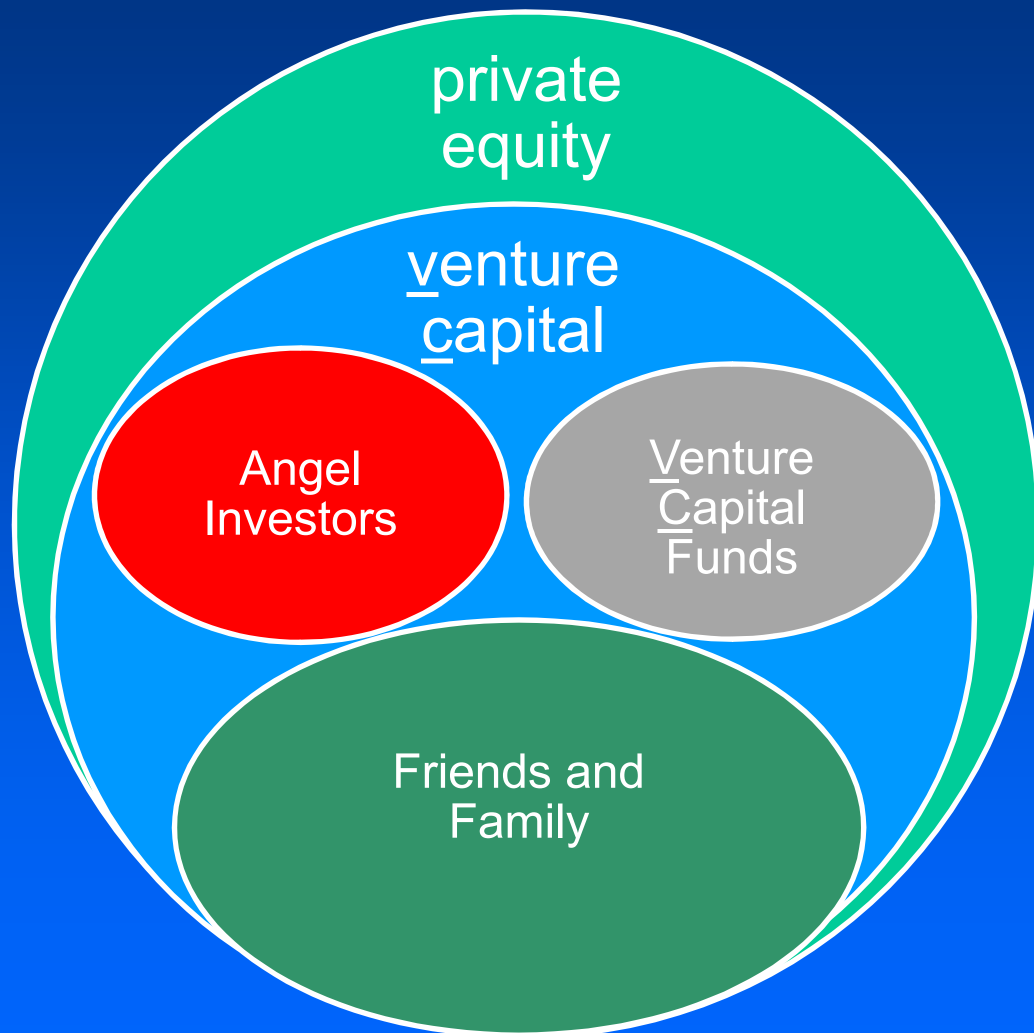
What are your options – really?

- Use your own resources – even if you don't have any money
- Bootstrapping should <u>always be your first choice</u>
- (yes, I am an investor, but that's the truth)
- Some business models just can't be bootstrapped

If you really do need investors

- If you really can’t bootstrap,
- Then what are your options to raise private capital for your startup?
- How many of you are planning to go to a venture capital fund to raise your startup capital?
- How many are planning on angel investors?
- Before I tell you – we need some definitions

What is venture capital?



Who Actually Finances Startups?

- I asked how many of you were planning to raise your startup capital from VC funds
- Don’t feel bad, most entrepreneurs think VCs finance startups
- The actual data is that Angel Investors finance 27x more startups than VCs
- www.AngelBlog.net/Angels_Finance_27_Times_More_Start-ups_Than_VCs.html

Some Surprising Data

- In America, each year Venture Capital Funds invest about $20 billion
- Angel investors also invest about $20 billion each year
- Even more surprising, Friends and Family investors invest about 5 to 10 times more than either VCs or Angels
- From “Fools Gold” by Scott Shane 2009

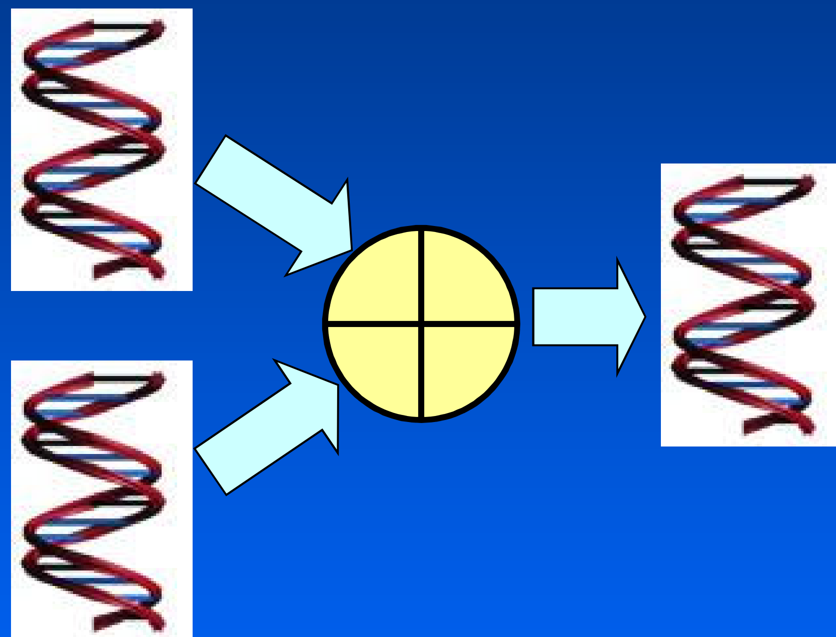
Angel Co-Investment

- Just a couple of years ago, the conventional wisdom was that angel investment topped out at around $2 million per company
- Kauffman and ACA started talking about co-investment just a couple of years ago
- Now I regularly see groups of angels investing <u>$5 million to $10 million</u>
- More than enough for today's companies

First Exit Strategy, Then Finance

- This doesn’t happen most of the time
- But the right way to build a company is
- Determine the type of business
- Build alignment on the exit strategy
- THEN develop the financing plan
- And then start to contact investors

Check Financial DNA Before



Check the compatibility first

Why The Exit Strategy Comes First

- Different types of investors are compatible with different types of exit strategies!
- Making a mistake about this early on can easily cost you your entire company
- It almost cost me my first
- A video of my war story is online at:
- www.angelblog.net/Dont_Blow_the_Biggest_Deal_of_Your_Life.html

Developing an Exit Strategy

- The most important element in the business plan
- Every company has an exit strategy
- Even if nobody realizes it
- Even if it’s a lifestyle business without investors
- It affects many daily business decisions

The Exit Is Just Another Process

- Whether it's a financing, product development, marketing or sales goal
- The chances of success increase dramatically if you have a good plan
- Your exit strategy is the plan for your business – the entire business
- Your plan should start at the end (the goal)

The Important Elements

- An Exit Strategy could be as simple as:
- "Our exit strategy is to [sell the company] in about __ years for around $ __ million.
- We plan to execute the exit by engaging a [mid market M&A advisor] by _[date]_."
- Or it could be an IPO or RTO and I-bank
- Formally check alignment at least annually

Check The Alignment

- It’s surprising how often there is a mis-alignment between key stakeholders on the exit strategy
- The only way to check is to get a ‘signoff’ on a written exit strategy
- Usually takes at least one offsite planning retreat to build full alignment
- Even after, check alignment annually

Summary

- Most acquisitions are under $20 million
- Modern companies don’t need much capital
- Bootstrap if you possibly can
- Angels can finance up to $5 to 10 million
- The optimum exit strategy is to target an exit for under $30 million
- <u>To maximize success - Start at The End</u>

Resources

- www.Early-Exits.com – book on exit strategies for entrepreneurs
- www.AngelBlog.net – blog for entrepreneurs and angel investors
- www.BasilPeters.com – for this PowerPoint and videos of previous talks