Accidental Exits –
Lessons from Recent Transactions

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Learning To Be Angels

- Angel investors and entrepreneurs are very important to our economy
- Our combined entrepreneurial activity is the innovation engine that drives future job creation
- What we do is not easy
- Most companies we invest in fail completely
- We’re still learning how to be better angels, and
- To be more helpful to our investee companies

We Don’t Have Hard Data

- Entrepreneurship and angel investing are exploding all around the world
- Many universities are now offering undergrad and graduate courses in entrepreneurship
- A few professors are starting to conduct serious research
- A few non-profits are funding some early research to capture data
- But we still don’t have the hard data we need

The Data We'd Like To Have

- What we wish we had is a big database
- That tracked startups all the way through their corporate life cycle
- And included data on how the companies were financed,
- And what their strategies were at different stages and how well they were executed
- And what the eventual outcomes were

Then If We Had the Hard Data

- Then if we had this big database
- We could start to do some analysis
- And determine which strategies were correlated with different outcomes
- Which strategies resulted in the highest probabilities of entrepreneurial success
- And then start to develop some best practices

Why It’s So Difficult

- We’d need to track each company through its entire lifecycle – an average of 10 years
- And develop uniform ways to measure and capture their corporate plans and strategies
- And quantify their financing strategies
- And incorporate their product strategy and execution, HR philosophies and environment
- And even the quality of the CEO and Board

And the World is Changing

- And even if we could gather this data
- The world is constantly changing
- For example, if you collected this data through the 1990s,
- I am sure the result would have been that companies with a strategy focused on
- Public market (i.e. IPO) financings and exits would have been the most successful

And a Decade Later That was Fatal

- Imagine we’d built this database in the 1990s
- We’d have learned the best strategy was IPOs
- And then we published that around 2000
- With the conclusion entrepreneurs and investors should focus on public financings
- That would have been the absolute worst strategy to follow for the next 10 years

So How Do We Learn?

- So how do we learn to be better entrepreneurs and investors?
- We can’t wait for the academic research (which is still decades away)
- We have to rely on <u>anecdotal observation</u>
- We have to make the most important decisions in our businesses based largely
- On our observations and discussions

That’s Why Meetings Like This

- Are so important
- They are an opportunity to share and discuss our observations
- Exchange ideas on what’s working in today’s economy
- To challenge ourselves and each other
- To apply our collective observations
- To build the best practices for today

Three Recent Transactions

- Here are some anecdotal observations from three recent, local exit transactions
- One where I’m fortunate to be able to share everything – including the price
- And two other of the more common type where I can only share the story, not the details
- Because those transactions are under NDAs

Vineyard Networks

- OEM Provider of Deep Packet Inspection (DPI)software
- Categorize internet traffic by type i.e. web browsing, email, video, etc.
- Based in Kelowna BC - in the interior of British Columbia
- Two financings by angels, friends and family
- $1 m equity, $350k loan from local funds

Vineyard Timeline & Revenues

- Company was founded in Aug 2008
- Dec 2011 was $1.3 million in revenue
- Dec 2012 was $3.1 million in revenue
- 2012 was the first profitable year

Development of the Exit

- Initial vision – Sell the Company for $25M in 3-5 years
- But after the founding, never discussed the exit - ever
- Vineyard had a lot of active “inbound” M&A enquiries
- So they did not take the buyer seriously for the first few months

The Buyer - Procera

- Procera Networks is a Swedish and Silicon Valley based Network Infrastructure Provider
- NASDAQ listed about $60 million/yr. revenue
- They approached Vineyard about an acquisition in February 2012
- Talks got serious by September 2012
- Signed an LOI in October 2012
- The sale closed January 8 – only 4 months later

Price Negotiations

- Initial offer from Procera was $18M
- Vineyards “firm” counter was $30M
- Negotiations converged quickly at $28M
- About 6 x Revenue (not EBITDA)
- That price was CDN $3.14/share
- The first angel round was $0.36/share
- Founders and angels were all very happy

A B.C. Really Early Exit

- This Vancouver hardware company asked me to keep their details confidential – for now
- They wanted to test the market for their first product, so called on a medium-sized US corp
- The prospect soon asked to buy the company
- The CEO called me for help
- Three months later the money was in the bank
- Company was less than 12 months from startup and still hadn’t launched the first product

BC Pre-Revenue Software Exit

- This local software company was sold just a couple of months ago
- This company was also pre-revenue, the software was still 6 months from beta
- In this case, the entrepreneurs called on a mid sized US company in their market
- Looking for financing to complete their software product

BC Software Company

- They only needed a million dollars or so
- So should have approached angels not corporate strategics
- The larger company wasn’t interested in investing (virtually none are)
- But they were very interested in acquiring the company
- The founders are very happy and working hard to complete the product

The Common Element

- These are three successful exits
- Perhaps I should call them “happy exits”
- But they were also “accidental exits”
- None of these exits was planned
- They all occurred by fortunate circumstance

About Half of Exits are “Accidental”

- Just to remind ourselves, we don’t have the data we need
- But based on my observations
- I think about half of today’s tech company exits can be characterized as “accidental”
- They completed more by chance than by design
- More by serendipity than strategy and planning

Just Imagine How Many We Miss

- If somewhere around half of exits are accidental,
- Just imagine how many we miss!
- Successful, happy exits that never happened simply because the serendipity wasn't there
- Because the company decision makers didn't appreciate what was possible in today's M&A market

The M&A Market is Hot

- This is certainly best M&A market we've seen for at least the past 15 years
- Transactions can complete in just 3 – 4 months
- Valuations are favorable to sellers
- Transactions are happening every day that I would not have thought possible five years ago
- I think most company boards should be at least thinking about whether this might be an opportune time to exit

These Companies Were Lucky

- These three stories all ended happily
- But they're exceptions
- It would not be fair for me to share the unhappy exit stories, all of those are just too painful
- These examples illustrate how active and fast the current market is
- But they don't adequately describe how fortunate these companies were to complete a transaction

Being Pro-Active Not Reactive

- Doing what these companies did is risky
- Proceeding with only one buyer has a low probability of success – probably around 25%
- A single deal element can derail a transaction
- A well executed, pro-active exit process can have a 75 to 85% probability of completion
- Companies should have well thought out exit strategies and plans

In Summary

- This is the best M&A market in 15 years
- Transactions can happen very quickly
- And at exceptional prices
- All companies should be at least considering their exit strategy and timing
- Proceeding with only one buyer is risky but can occasionally produce a very good result
- Optimum exits require strategy and planning

My Anecdotal Observations

- I’ve been an active investor for 25 years
- Primarily focused on tech in Vancouver
- For years when I was a VC I had a team whose job it was to look at every investment
- Realistically we probably saw half
- I’ve been following many of those companies, and speaking with their investors, for decades

Exit Probabilities for Saleable Companies

For <u>Saleable</u> Angel Backed and Bootstrapped Companies

Why Do Only 25% Exit Well?

- Luck?
- Not a major factor
- Lack of knowledge
- Resulting in:
  1. Poor exit strategy - or no exit strategy at all
  2. Bad exit timing – Riding it Over the Top
  3. Under resourcing the exit process