

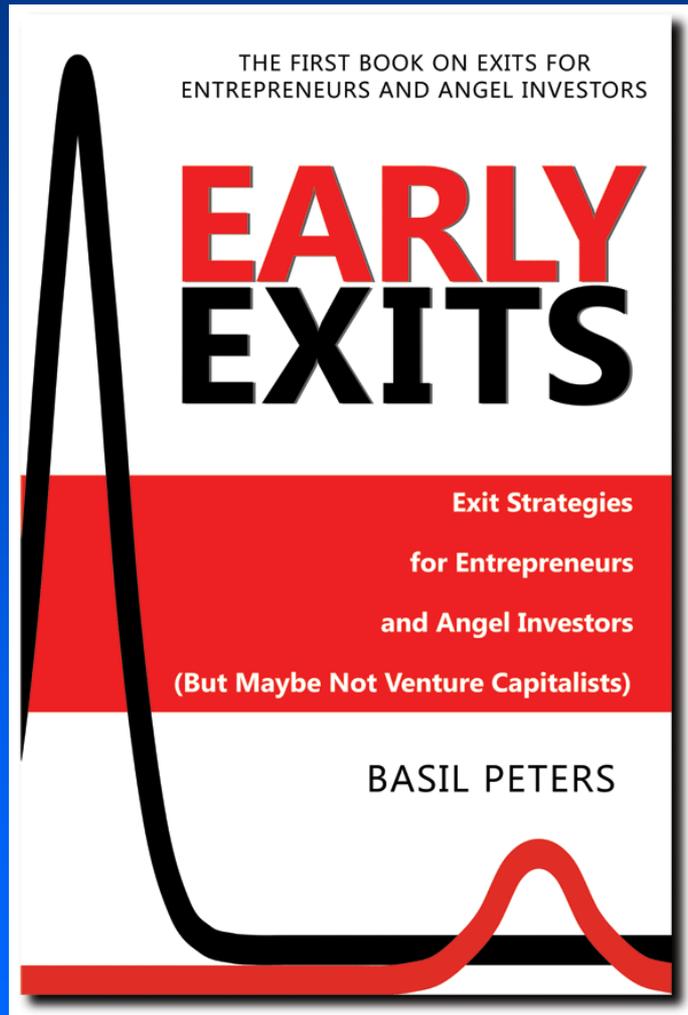
Early Exits Update

Keynote at the Colorado Capital
Conference 2015: Early Exits

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Early Exits – The Book



- Started with my own research on how to generate higher returns in my VC and angel funds
- Wrote the book in 2009
- I was surprised by the book's popularity

A Clarification for the 2nd Edition

- I'm hoping to get a 2nd Edition out soon.
- From the many conversations I've had since writing the book,
- I want to start by emphasizing that:
- Early Exits is not a theory, “entrepreneurial preference” or a “portfolio strategy”
- It's a “macro-economic observation”

The Convergence to Early Exits

- We understand now that the early exits trend is being driven by the convergence of :
- The Internet
- Changes in Big Companies
- Changes in Startups
- Changes in our Global Economy
- Possibly even changes in our Species

The Internet

- Biggest change in mankind's history
- Accelerated everything
- Reduced the cost of almost everything
- Dramatically increased access to information
- And a significant factor in the increase in early exits

Changes in Big Companies

- Big companies aren't growing very well
- They openly admit they aren't good at innovation
- They've needed to evolve to be good at only one thing – scaling up businesses
- But they desperately need innovation to grow
- Their other problem is way too much cash
- www.exits.com/blog/why-big-companies-cant-innovate/

Changes Big Companies

- Their solution is obvious
- They are acquiring - at amazing rates
- And want to acquire earlier than ever before
- But won't pay much more for scaling up
- Because they're much better at scaling up
- Are now the VCs worst competitors (quietly)
- www.exits.com/blog/the-best-people-are-leaving-the-big-companies/

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.exits.com/blog/google-wants-even-earlier-exits-than-in-early-exits/>

Changes in Startups

- Entrepreneurship is exploding globally
- Today 'best and the brightest' are much more likely to be in startups than big companies
- Capital efficiency has increased almost beyond imagination – by orders of magnitude
- Startups are being built many times faster than ever before – 10 years is now only 2 or 3 years
- Startups are creating 'all' the innovations

This is a Golden Era

- I believe history will describe this time as a
- Golden era for entrepreneurs and angel investors
- Never before has it been so easy to create such valuable companies
- Using so little capital
- And sell them so early
- For so much money
- www.exits.com/blog/this-golden-era-for-entrepreneurs-ubc-sauder-school-of-business/

Changes in Our Species

- This may be another result of the internet
- Today young people have shorter attention spans
- Ask a University professor how challenging it is to get students to read an entire book
- Young people don't stay as long with a company as we did or our parents did
- 3 year old companies often feel 'middle aged'
- www.exits.com/blog/early-exits-and-internet-acceleration/

Changes in the Economy

- There has never been so much money
- And such low interest rates (same thing)
- And so many investors looking for a return
- Private Equity is the bright spot for returns
- There have never been so many types of buyers for private companies
- And so many international M&A buyers
- www.exits.com/blog/the-exit-strategies-workshop-2011-part-4-types-of-buyers/

Changes in Patents

- Another important non-monetary change in the global economy is patents
- Most of the legislated changes in patents in America over the past few years have been excellent news for entrepreneurs and angels
- But the changing global attitudes of big companies have created terrifying risks for small company patent owners
- Have a good patent? Please sell the company!
- www.exits.com/blog/got-a-patent-sell-the-company/

Converging to Make Exits Earlier

- All of these macro changes
- Are converging to make exits happen earlier
- And there are very few counter-balancing forces delaying exits
- All creating the best – and fastest - M&A market we've had for 15 years - and possibly forever

Maximizing Economic Growth

Scaling Companies

Innov

tups

Maximizing
Economic
Growth

Our 21st Century Economy

- What's working in our economy today:
 1. Startups and young companies innovate
 2. Rapidly, often virtually and without capital
 3. Big companies, and others, buy them early
 4. The buyers then scale up the business
 5. Entrepreneurs recycle the gains, do it again
 6. The M&A transaction is the transition from innovation to scaling up

We Don't Have Hard Data

- I want to emphasize:
- We don't have the hard data to statistically prove this type of business or investment strategy
- What we wish we had is a big database
- That tracked hundreds of startups all the way through their corporate life cycles
- And captured what the eventual outcomes were – for example, acquisition, failure, IPO, etc.

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
- Identify strategies resulting in the best outcomes and the highest investment returns
- And then start to develop some best practices

Unfortunately That's Not Easy

- When my fellow researchers (who are the some of the top entrepreneurship professors) and I discuss what we'd need
- We almost immediately also realize this is an extraordinarily difficult data set to capture
- First because it would require following companies through their entire life cycles
- Which probably still averages 10 years

Why This Would Be Difficult

- We'd need to track each company
- And develop uniform ways to measure and capture their corporate strategies
- At every stage in the company's evolution
- And include their product strategy and execution, HR philosophies and environment
- And even the quality of the CEO and Board
- To analyze what generated the best outcomes

And the World is Changing

- And even if we could gather this data
- The world is constantly changing
- For example, if you ran this experiment through the 1990s,
- I am sure the result would have been that companies with a strategy focused on
- IPOs would have been the most successful

And a Decade Later That was Fatal

- Imagine that we built this big database in the 1990s
- And discovered the best strategy was IPOs
- And published that around 2000
- With the conclusion entrepreneurs and investors should build toward an IPO
- 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 anecdotal observation
- To learn from case studies

That's Why Meetings Like This

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

Exit Data - The Accursed NDAs

- My personal mission is to develop and share best practices on exits
- In part, to do that I run a boutique M&A advisory firm
- My hope is that each transaction we undertake will contribute to the knowledge that I can share
- Unfortunately I can't even mention some of the very best case studies
- Because most are under an NDA ☹️

A Few Valuable Case Studies

- After many years of work, I do have a few excellent exit case studies
- That I have permission to share
- They're on my blog, some with videos of the CEO or Chairman telling the war stories
- And providing valuable anecdotal observations
- www.exits.com/blog/category/case-studies/

The Most Important Take Away

- Now that we understand that we have to rely on anecdotal observation, not hard data,
- Perhaps the most valuable single point I hope I can convey today is that:
- Only 25% of saleable companies successfully exit

What?!

- Yes,
- I'm saying that 75% of the time
- When entrepreneurs and investors build
- A company that could have been sold
- We blow it.
- And fail to successfully exit.

Even worse...

- That's not even the worst news
- When a company fails to exit at around the optimum time
- There is a high probability that it won't just fail to exit
- But that it will fail completely (i.e. go out of business)

Exit Probabilities for Saleable Companies



For Saleable Angel Backed and Bootstrapped Companies

Remember This is Anecdotal

- Please keep in mind that this is anecdotal observation, not hard data
- I don't have a database that shows only 25% of saleable companies have good exits
- What I know is that it's far less than half
- And probably more than 10%
- "Saleable" is also a judgement
- 25% is the best observational data we have

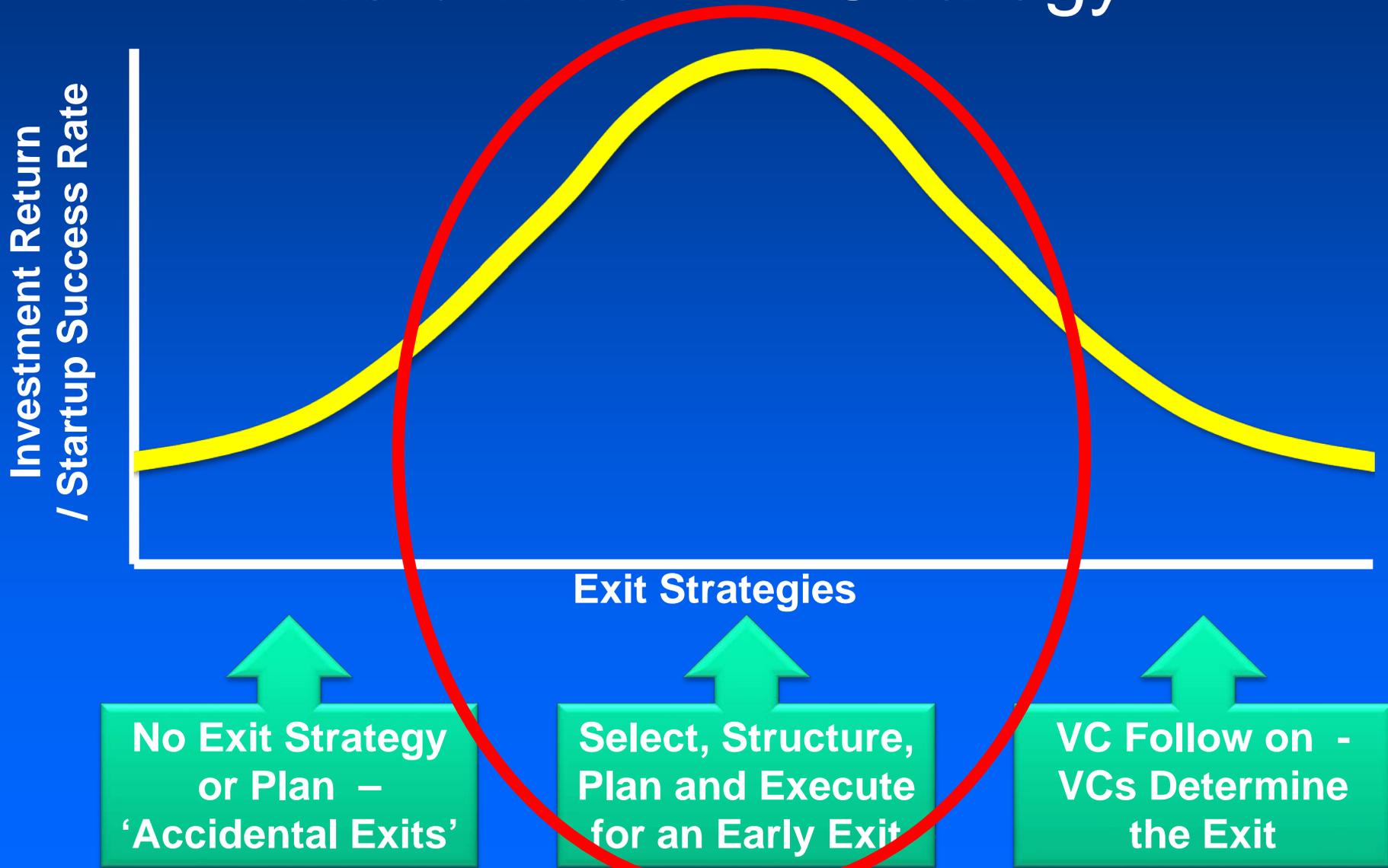
We Can Do Much Better!

- Some of the reasons are:
 1. Boards don't realize the company is saleable
 2. The board was waiting for an unsolicited offer
 3. The exit team failed to execute
 4. The shareholders "Rode it Over the Top"
- www.exits.com/blog/only-25-percent-of-saleable-companies-exit/

What Does This Mean for You?

- We are all still learning to be entrepreneurs and angel investors
- The part we're the least good at is the exit
- On average, of the saleable companies we build,
- Today only 25% have successful exits
- The good news is that I believe we can easily increase that percentage to 50%
- And my ambition is to help get it closer to 75%

Entrepreneur Success / Investor Return vs Exit Strategy



Exit Strategies

No Exit Strategy
or Plan –
'Accidental Exits'

Select, Structure,
Plan and Execute
for an Early Exit

VC Follow on -
VCs Determine
the Exit

The Pacinian Case Study

- Pacinian was a startup in Cour d'Alene, Idaho
- Backed by the Frontier Angel Fund
- And angels in the Pacific North West
- Raised about \$6 million from angels
- In three rounds
- Their mission was to build a better thin keyboard for laptop computers

The Pacinian Case Study

- The CEO and Chairman both attended one of my Exit Strategies Workshops
- Before they came to the workshop, they were not sure if they were going to:
 - Finance the company to production
 - License their technology, or
 - Plan for an early exit
- After the workshop, the Chairman was convinced that an early exit was the best strategy

The Biggest Challenge

- The biggest challenge we had with Pacinian was
- Helping the board agree on the exit strategy
- There was long, loud debate on the benefits of:
 - Accepting some lucrative licensing offers
 - Agreeing to the VC financing being offered
 - Executing an early exit
- And, of course, there's no data to prove anything
- It took months and months to get a consensus

The Early Exit Strategy

- The good news is that Pacinian did complete an early exit
- Still didn't have a production prototype
- Still pre-revenue
- Did have some interesting patents
- Quick quiz: What price did we get?
- Gross selling price (before transaction fees)?

More from this Case Study

- The Chairman, Johnny Humphries, was very generous in sharing the war stories in video
- An excellent case study on how we increased the price from \$20 million to \$30 million
- <http://www.exits.com/blog/pacinian-pre-revenue-30-million-exit/>

Summary of Early Exits Today

- Based on many observations and discussions
- I believe an early exit is the best strategy
- For something around 98% of startups
- It's best for the founders and entrepreneurs
- And the business and the employees
- And the angel investors
- And the big companies
- And our economy

Questions?

- Thank you.