Exit Execution Workshop

Alliance of Angels Education Workshop
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Introduction

- This is the second Exits Workshop
- The first is now called Exit Strategies
- Originally called Early Exits
- You don’t need to see that workshop first, to get full value from this one
- The Early Exits workshop is available online at:
- http://www.exits.com/blog/early-exits-workshop-videos/

The Exit Strategies Workshop

- The Exit Strategies workshop is about:
- Changes in the entrepreneurial ecosystem,
- Why early exits are so common now,
- Optimum financing,
- Pro and cons of VC follow-on financings
- How to know when to exit, and
- Why we aren’t good at exits yet.

This Exit Execution Workshop

- This Exit Execution workshop is about:
- Everything you need to know once you’ve determined it’s time to start the exit process
- We’re going to discuss how:
- Long it will take and what the steps are
- To design the optimum exit team
- Much it will cost
- To ensure you get a fair price and terms

Section 1

The Most Important Take Away

The Most Important Point

- That I want you take away from this workshop
- Is that:
- <u>Only 25% of saleable companies successfully exit</u>

Exit Probabilities for Saleable Companies

For Saleable Angel Backed and Bootstrapped Companies

Most Owners Sell Below Market

- About half of the people who succeed in selling their companies get less than they should have
- I’ve seen companies sold for tens of millions less that the price they should have received
- And many times the sellers don’t even realize they left millions of dollars on the table

That’s terrifying … but

- And depressing.
- You’re probably thinking:
- But why haven’t I heard that before?
- Why isn’t this more widely known?

We Don’t Have Hard Data

- Entrepreneurship is 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 on entrepreneurship
- 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

Unfortunately That’s Not Easy

- I’ve discussed this with some of the top entrepreneurship and finance professors
- We almost immediately agree 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 It’s So Difficult

- We’d need to track each company
- And develop uniform ways to measure and capture their corporate strategies
- At every stage in the companies evolution
- And include their product strategy and execution, HR philosophies and environment
- And even the quality of the CEO and Board
- So we could learn about what worked and didn’t

And the World is Changing

- Imagine that we 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 focus on public financings
- That would have been the absolute worst strategy to follow for the next 10 years

Not All Exits Are Happy Ones

- And even when companies do have an exit
- Many of the “exits” we hear about
- Are actually failures
- Some are distressed sales at valuations much lower than the investors paid
- Some exits that people talk about in the press or their resumes were really orderly wind-downs

And Many are Sub-Optimal

- In addition to the unhappy exits, many are what I call sub-optimal
- Usually because the shareholders had no idea that they sold their company <u>for far less than it was worth</u>
- Today, I want to focus on successful exits
- The type of exit you want for your companies
- An exit that happens and is fair to your shareholders

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)
- <u>We have to rely on 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 works in today's economy
- To challenge ourselves and each other
- To apply our collective observations
- To build the best practices for today

Section 2

Recent 'Accidental Exits'

Three Recent Transactions

- Here are some anecdotal observations from three recent exits I was involved with
- 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

Section 3

Goals for Today
Take Home Value

What Does This Mean for You?

- We are all still learning to be entrepreneurs and 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%

My Goal for Today

- What I hope to accomplish today is to provide you the take-home knowledge and skills
- To increase the probability that your companies
- Have successful exits
- So you'll have more exits
- Better returns on your investments
- And more fun.

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
- This workshop is about what actually works today - in our current economy

Companies Are Sold, Not Bought

- I often hear ‘companies are bought, not sold’
- People think that when ‘it’s time’ someone will knock on their door asking to buy their company
- While that has happened, it’s almost never a good thing for the shareholders
- It’s not just that the price will be much lower
- More importantly, the probability of success decreases because there is usually one bidder
- Optimum exits require strategy and planning

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
- The exit strategy is the plan for the business – the entire business
- The plan should start at the end (the goal)

Developing an Exit Strategy

- Where do you start?
- The first step is to develop your exit strategy
- That drives all of the other elements in your business plan
- The exit strategy affects a surprising number of daily business decisions

Your Exit Strategy

- “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]_.”
- The optimum exit strategy depends on the:
  1. Type of company
  2. State of the economy
  3. The M&A market

Check The Alignment

- It’s surprising how often there is a serious mis-alignment between key stakeholders on the exit strategy
- The only way to check is to get a ‘signoff’ on a written exit strategy
- Often requires at least one offsite planning retreat to build full alignment
- Even after, check alignment annually
- Some now reaffirm it at every board meeting

Exit Strategy Summary

- The exit strategy is the highest level strategy in the organization
- It’s the foundation for the entire company plan
- It aligns the team on the most important goal:
  1. The maximization of shareholder value
  2. The optimum timing of it’s monetization

Videos on Exit Strategy

- Videos of some of my talks on exit strategy
- http://www.exits.com/blog/start-at-the-end-your-exit-strategy
- http://www.exits.com/blog/exit-strategies-for-angel-investors
- And what not to do:
- http://www.exits.com/blog/how-not-to-sell-a-business/

Section 4

Exit Timeline

Timing - Often the Biggest Question

- Many times in exits I have been involved with,
- The question which seems most important to the team and the board is
- Not “How much can we get?”
- But “How soon can we complete a deal?”

How Long It Usually Takes

- The short answer is usually 6 to 18 months
- From the time you engage the M&A professionals
- Until the cash is in the bank
- But it can often take longer if the company isn't ready, or if the structure needs to be cleaned up, or if the financials need improvement
- Be wary of M&A firms that promise it faster

Part 1- Before Talking To Buyers

- About a quarter of the work includes:
  1. Building alignment around exit strategy
  2. Financial history and projections
  3. Creating all of the sales collateral
  4. Cleaning up the corporate structure
  5. Preparing the due diligence
- Usually takes 1 to 5 months

Part 2- Building The Sales Funnel

- The second phase includes:
  1. Research on best prospects - globally
  2. Developing tactics on strategic value
  3. Initial contacts to 50 – 250 companies
  4. Responding to 10 - 50 interested
  5. Starting due diligence with 5 - 8
  6. To get to an ideal short list of 3
- Usually takes 2 to 6 months

Part 3 - The Bidding Process

- The third phase is the most exciting and most intense
- Ideally three buyers will be in due diligence
- And actively negotiating, simultaneously
- The CEO will be fully engaged - and the limiting factor
- Can take up to 2 to 4 months

Part 4 - Negotiating and Closing

- Even after there is signed agreement on “the deal” and possibly a deposit
- It can take months for the board, shareholders, M&A professionals, lawyers and tax advisors to agree on the set of definitive agreements
- And obtain all of the approvals from boards, shareholders and regulators
- This final phase is usually 1 to 3 months

When To Tell The Team

- Many CEOs have difficulty determining when they should tell the rest of the team
- Some worry about the employee anxiety
- Others think it is ‘none of their business’
- Most of the time the internal grapevine is so efficient that they already know
- Best practice is to tell everyone fairly early
- But don’t under-estimate the impact

CEO Deal Fatigue

- It is very difficult to convey to someone who has not been through a dozen, or so, exits
- Just how intense, and how stressful, the exit process is for the CEO
- Even the toughest CEOs can be incapacitated
- In my experience it is almost always a factor
- A good M&A advisor will explain, minimize, watch for and work around

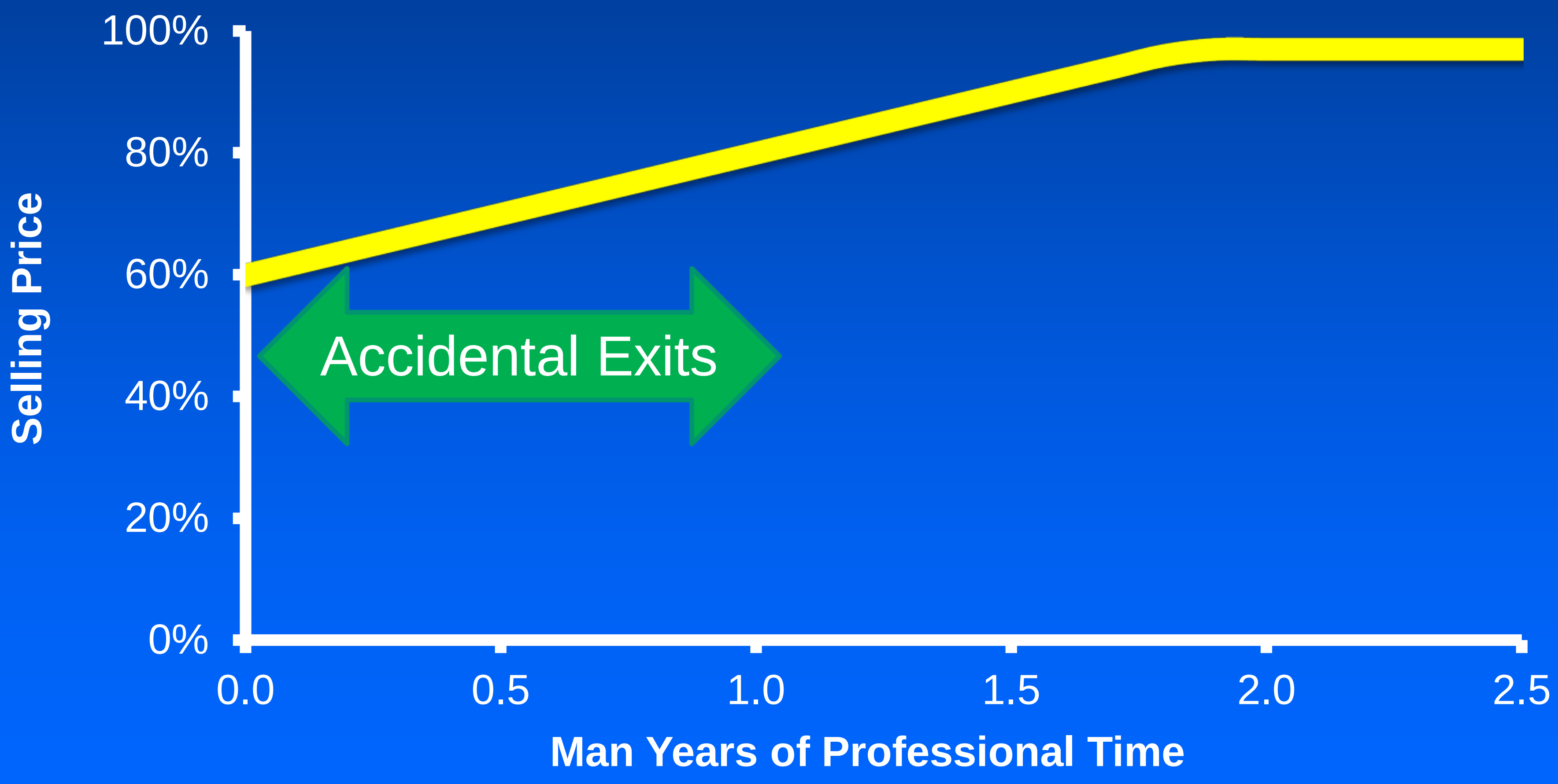
Section 5

How Much Work is an Exit?

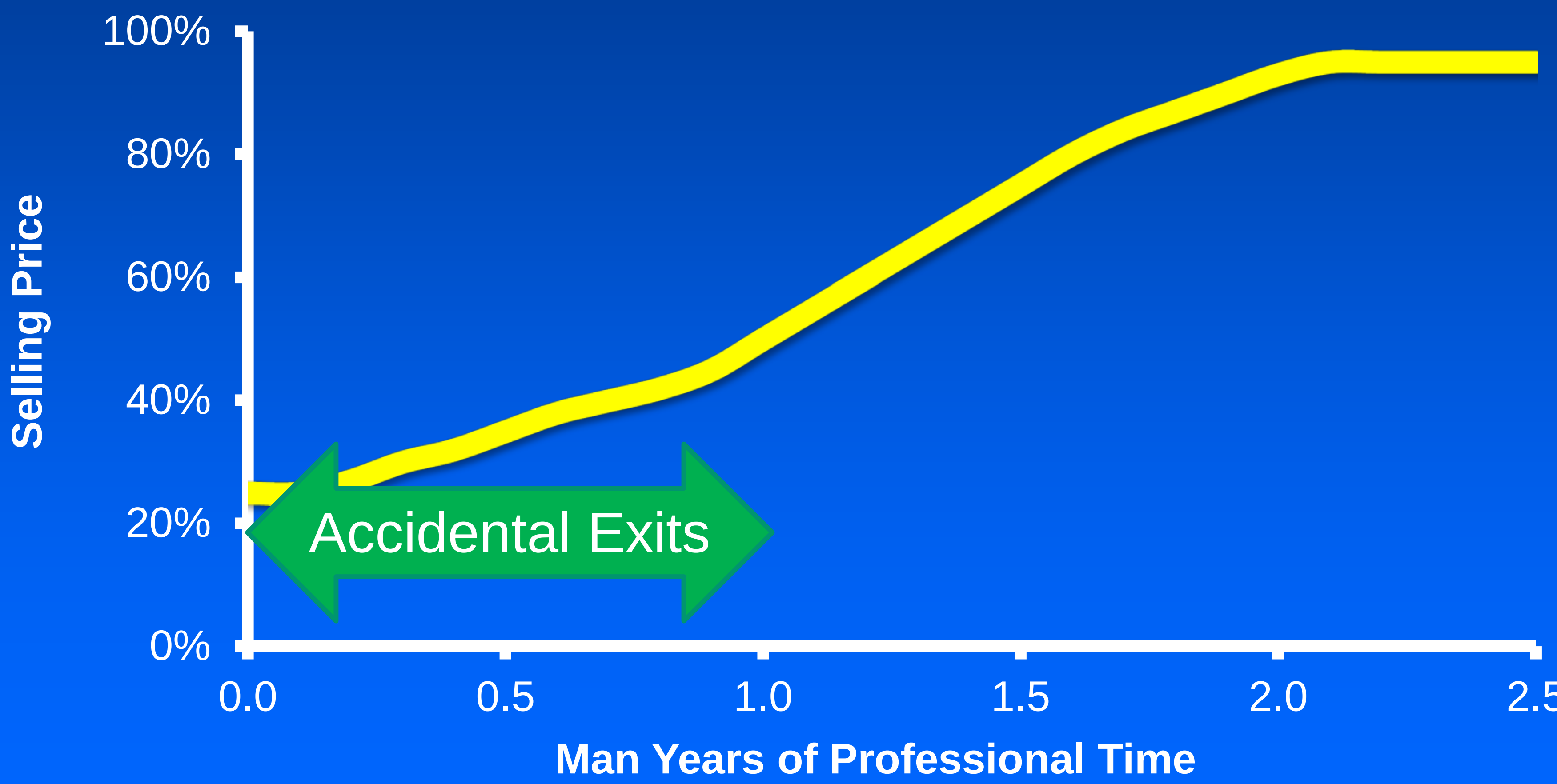
How Much Work is an Exit?

- Like so many things in work, and life, it depends
- But a good estimate for a <u>fully marketed</u>, competitive transaction is about 1 to 2 man-years
- Excluding legal and accounting time
- That estimate does not include learning time
- If a very smart CEO and CFO wanted to learn enough to do a reasonable job themselves,
- I'd triple the time estimate – at least

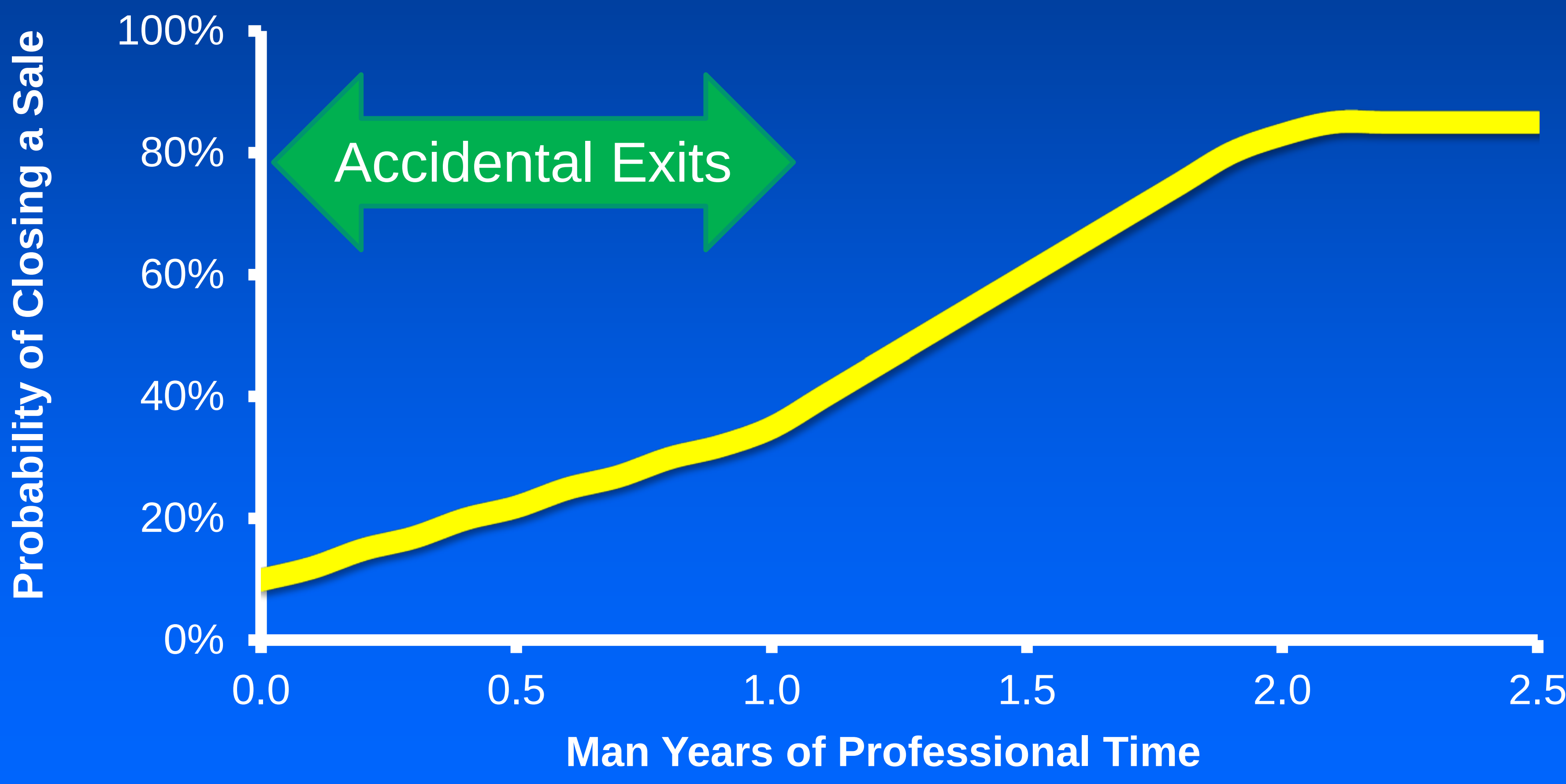
Valuation for EBIDTA Multiple Sale vs Man-Years of Professional Time



Valuation for IP or Strategic Sale vs Man-Years of Professional Time



Probability of Completing a Sale vs Man-Years of Professional Time



Section 6

The Exit Team and What This Will Cost

Probability of Completing a Sale

- The overall probability of a company actually exiting depends on two independent variables:

  1. The probability that the company will be ‘saleable’ (when the buyers are ready)

  2. The probability that the exit team actually executes and completes a transaction

Saleability – Many Factors

- There are dozens of success factors, and a large component of luck,
- That all contribute to whether a company is saleable at a point in time
- The recent financials are of course important
- Others include the economy, M&A market, current CEO, competitive environment, market timing, patents and other external market conditions
- Every company has a different mix of factors

The Exit Team's Capability

- The single most controllable factor in determining whether a saleable company will actually be sold is the capability of the exit team
- The members of the team with the greatest influence on success are the:
  1. CEO
  2. M&A advisor

The Ideal Exit Team

- Almost every company needs a team dedicated to maximizing the price and ensuring the transaction completes
- The ideal exit team is:
  - The CEO
  - An M&A Advisor
  - A small committee of the board
  - Legal and Accounting Professionals

The M&A Advisor’s Functions

- The M&A advisor is really ‘the sales guy’
- Whose important functions are to:
  - Plan and coordinate the process
  - Reduce the time to closing
  - Improve the probability of success
  - Protect the CEO (for as long as possible)
  - Maximize the price and terms
  - Do the selling and be the ‘bad guy’

Why The CEO Should Not Lead

- There are several reasons the CEO should not lead the exit process, they:
  - Rarely have the exit experience
  - Needed to maximize the financial results
  - Should be held in reserve for the final negotiation of price and terms
  - If not the owner, can be “conflicted”
  - Need a good relationship with the new owners (cannot be the ‘bad guy’)

Selecting The M&A Advisor

- There is almost nothing written about selecting M&A advisors
- I believe it should be a full day course
- Relationships are always <u>exclusive</u>
- The most important criteria are:
  - Transaction completion rate
  - Track record of maximizing price
  - Proximity, knowledge and compatibility

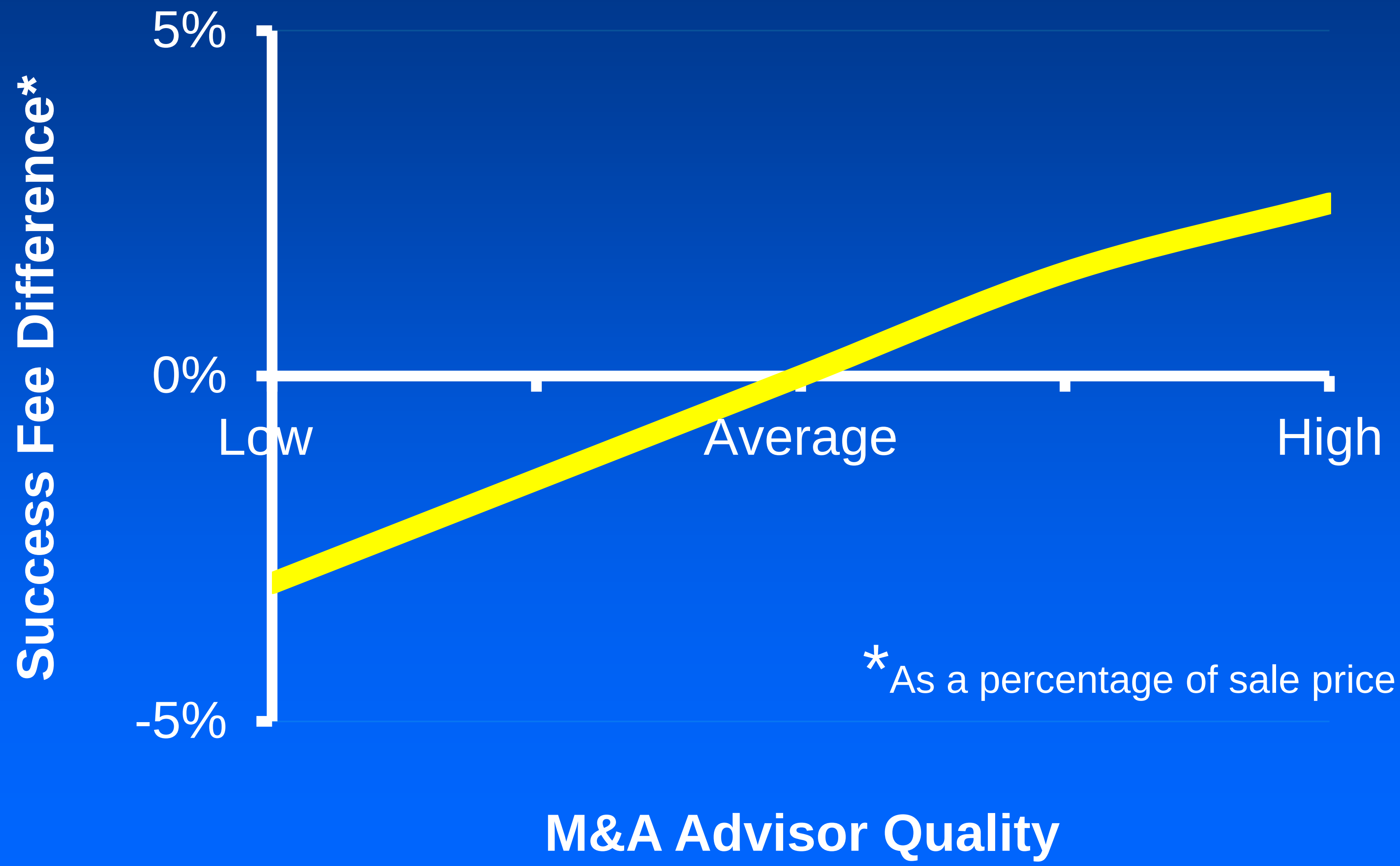
Every Deal Needs A Bad Guy

- M&A transactions are usually fun
- They always involve big money
- The job of both sides is to get the best price
- At some point in almost every transaction, things will get tense - or worse
- Every transaction needs a bad guy – a very good bad guy (who is not the CEO)

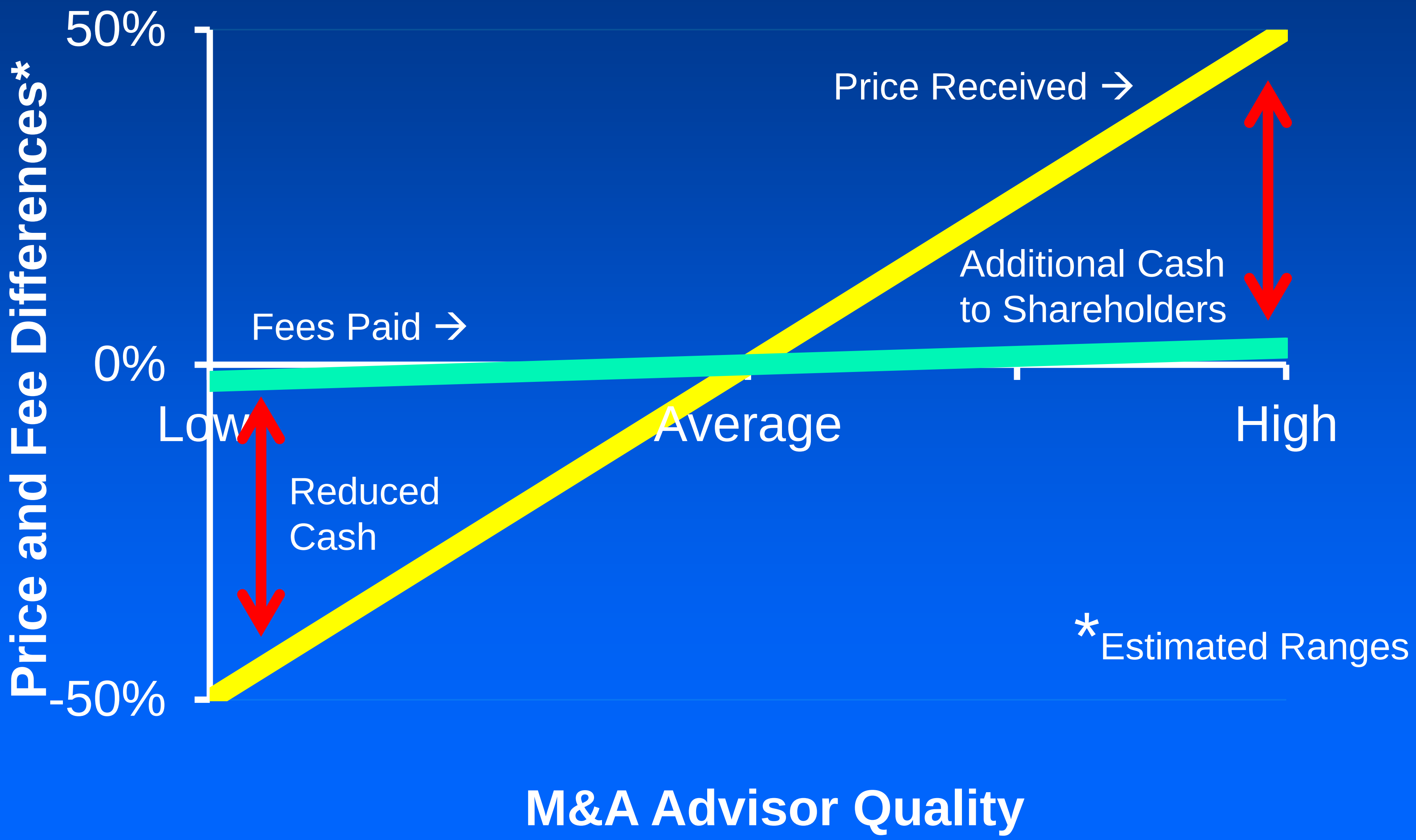
M&A Advisory Fees

- Fees for selling companies are competitive
- Work fees usually $50,000 regardless of the company size (less if not busy)
- Success fee, including the work fee, from:
  - 8 to 10% for sales under $5 million
  - 5 to 7.5% for sales from $10 to 30 million
  - 2 to 3% in the $100 million range
  - http://www.exits.com/blog/ma-advisor-fees-selling-business/

Success Fee Range and M&A Advisor Quality



Price Received and M&A Advisor Fees



Legal and Accounting Fees

- Legal and accounting fees vary widely depending on the complexity, not the size
- For a simple, clean transaction legals might only be $25,000
- But for a complex deal can easily be $1 million or more
- Accounting costs can be a few thousand to over $100,000 if audits haven’t been done

Section 7

Probability of Success

M&A Advisor Success Rate

- One of the secrets of the M&A business is that paid M&A professionals very often fail to complete a transaction
- There are no statistics available on this and the professionals almost never talk about it
- I have been gathering data on this for years
- The fault is usually the seller's side and the cause is often the same - communication

Probability of Completing a Sale

- I attended a half day presentation by one of the world’s largest mid-market M&A firms
- There were about 100 people in the room
- The presenter stated that “only 8% of planned exits actually close”
- I was enthusiastic to learn more about that statistic
- The presenter and I emailed several times, and then phoned, to discuss the 8% number

Probability of Completing a Sale

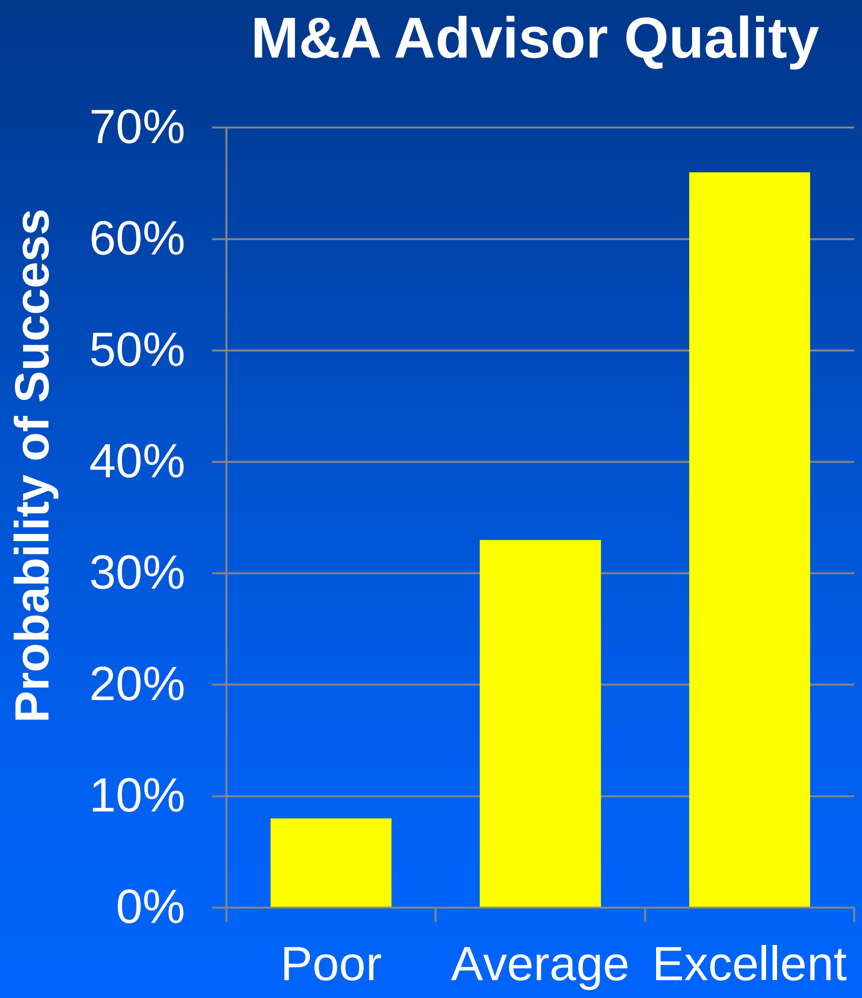
- The presenter confirmed 8% twice by email
- And wrote that it was ‘borne out by what [he’d] generally seen”
- He was quite definite about it
- I asked if I could quote him – he said “<u>No</u>”
- That puzzled me, so I asked a few friends
- One suggested that the speaker was sure of the 8% because <u>it was his firm’s</u> success rate

Probability of Completing a Sale

- Could it be true that after you hire a leading M&A advisory firm, the probability of completing a sale is only 8%?
- A few people have told me they believe it is
- Some firms, even big ones, will collect a large number of work fees,
- But only a small number of success fees
- That can be a profitable business model
- Some good firms brag about a 30% success rate

M&A Advisors and Probability

- The most important criteria for selecting your M&A advisor is
- The probability they will succeed in completing your sale
- Based on the 8% and my observations it looks something like:



The Lawyer Can Make or Break It

- Many people are surprised when I speak about how important the lawyer is to transaction success
- It’s another one of these things that you have to learn by observing enough real life examples
- A good M&A advisor might rescue a deal several times during the transaction
- But a good lawyer will also execute a few saves
- Some deals almost die ten or more times

It’s Hard to Describe a ‘Save’

- It is difficult to describe how this feels if you haven’t lived through it yourself a few times
- Usually you are sitting around a boardroom table with 6 to 12 other guys
- Sometimes the deal breaker has been known for a while, other times, it just pops up
- The veterans all feel it in their gut,
- That’s it – this “deal’s dead”

The Save is Like a Light Turning On

- As soon as the “this deal is dead” feeling hits
- You can tell who the really valuable members of the two teams are
- The biggest skill in getting a transaction done is navigating through the deal killers
- The really smart veterans, with the battle scars from dozens of transactions, will usually be the ones to find the solution
- When it is discovered it’s like a light turned on

Summary - Team and Probability

- The capability of the exit team directly affects:

  1. The ‘price and terms’

  2. How long it takes to complete a sale

  3. And most importantly, the <u>probability of completing</u> a transaction

References on the Exit Team

- http://www.exits.com/blog/great-ma-advisors-sell-companies-for-more/
- http://www.exits.com/blog/ma-advisors-should-be-local-to-reduce-transaction-failures/
- http://www.exits.com/blog/ma-advisor-fees-selling-business/
- http://www.exits.com/blog/the-exit-coach/

Section 8

Maximizing Value

Maximizing Exit Value

Some of the generally applicable ways to maximize the final selling price include:

1. Increasing the growth rate
2. Structural value increases
3. Capitalizing on inefficient markets
4. Illuminating strategic value
5. Maintaining multiple bidders
6. Sales and negotiating skill

Increasing Growth Takes Time

- This is “Exit Planning” or “Growth Consulting”
- Many companies ready to sell aren’t operating at their maximum growth rates
- Our firm has succeeded in increasing the growth rate in about half of our transactions
- The challenge is that this takes time
- At least several quarters of actual results are required to be convincing to buyers

Structural Value Increase

- Tweaks in the corporate or deal structure can increase the selling price by 10 to 25%
- Sometimes called “Financial Engineering”
  - These can be balance sheet changes
  - Asset vs. share sales
  - Financing mechanisms or deal structures
  - Tax innovations
- Many possibilities and can add $ millions

Capitalizing on Inefficient Markets

- Markets for selling a business, especially for under $100 million, are very “inefficient”:
  - Information is difficult to access – no transparency
  - There are a small number of buyers
  - Very few for sale (like your company)
- All of which can be big advantages for sellers
- Monetizing these inefficiencies takes a great deal of skill and experience

Illuminating Strategic Value

- Identifying strategic value often creates the largest fundamental increase in selling price
- It’s not actually creating strategic value, it usually has to be there already
- But it often has to be “illuminated” for the potential buyers (often very challenging)
- This can often be the most valuable contribution from the M&A advisor

Benefits of Multiple Bidders

- Closing on an unsolicited offer (i.e. a single bidder) is almost always a lost opportunity
- Every business sale should have multiple bidders to:
  - Maximize the final selling price
  - Increase the probability of completion
  - Close the transaction sooner
  - Demonstrate good governance

Selling and Negotiating Skill

- There is no question that some sales people are just better – often much better
- Selling a company is just like any other sale – but bigger and more complex
- An outstanding M&A advisor can often <u>increase the final price by 50% or more</u>

Can You Really Get 50% More?

- I’ve seen a number of companies sold for 50% more than the sellers expected
- I’ve helped make it happen quite a few times
- Most shareholders find it difficult to believe that a really good M&A advisor can sell a company for 50% more
- 80 to 90% of the time, everyone signs an NDA
- So the stories very rarely get told

Resources on Maximizing Value

- http://www.exits.com/blog/selling-a-business-for-50pct-more-case-studies/
- http://www.exits-blog.com/selling-a-business-inefficient-markets-and-business-valuation/
- http://www.exits-blog.com/illuminating-strategic-value-when-you-sell-a-business/
- http://www.exits-blog.com/company-sales-need-multiple-bidders-to-maximize-business-valuation/
- http://www.exits-blog.com/great-ma-advisors-sell-companies-for-more/

Section 9

Case Studies and Valuation

Exit Case Studies

- Exit case studies with valuations are quite rare
- My team and I have been selling companies for many years
- In just a few cases, we've been able to obtain permission to share the exit stories of companies that we've helped to sell
- I hope you find these stories valuable
- Full case studies on: www.Exits.com

Parasun Case Study

- This Canadian company provided high speed internet over cable TV to about 140 communities, mostly in the US
- I invested $500,000 in April 2004 at a $3.4 million valuation = $0.40 per share
- Revenues were about $3.8 million with a $500k profit
- My angel fund also invested at $0.55 per share in June 2005

Parasun Exit Strategy

- I became Chair and signed on to execute the exit
- The board set a target exit price at the 2005 strategic planning retreat
- The plan was to sell the company in 2.5 to 3 years (late 2006 or early 2007)
- Most of the work was on growing the business

Parasun Exit Valuation

- Started the exit process in the fall of ’05
- Revenues $8.2 million, profit $781k with 30% growth rate, 10 million shares
- Approached 100 buyers and short listed 10
- Had several bidders through the final stages
- In Jan 2007 sold the company for 48% more than the target price

What was Parasun’s Selling Price?

- Gross selling price (before transaction fees)
-

What Happened Next?

- ParaSun’s exit strategy and execution were perfect
- But the ParaSun shareholders had no idea how lucky they were
- Within two months of the exit, the companies fortunes turned down dramatically
- Six months after the exit it wasn’t even profitable
- So what happened?

The Risk They Missed

- Everyone on the ParaSun board, including me
- And the company that acquired ParaSun
- Failed to adequately assess the currency risk
- ParaSun was a Canadian company, with Canadian expenses but with US$ revenue
- Within two months, the currency exchange rate started a historically large move
- If they had started the exit 2 months later, I don’t think it would have happened at all

Brightside Case Study

- Spin out from the University of British Columbia Physics Applied Optics Lab
- Technology to make LCD displays brighter and higher contrast
- $15 billion /yr market
- Biggest opportunity was large screen devices for home TV applications

My Investments in Brightside

- I first invested when it was just two people and a few patents
- My fund invested three times:
  - $100,000 at $3.2 million valuation = $2.33 /sh
  - $125,000 at $4.2 million valuation = $2.90 /sh
  - $100,000 at $12 million valuation = $5.00 /sh
- In June 2004, Oct 2004 and Aug 2005
- Each investment was based a further demonstration of progress with the technology

Brightside Financing History

- About $7 million was raised from angels
- Including one brokered round that used an Offering Memorandum to place with angels in Europe
- But despite being engaged with a dozen VC firms up and down the west coast, no VCs ever invested in the company
- The VCs wouldn’t invest in common shares

The Brightside Exit

- Without the capital to put the product into production, the only other strategy possible was to sell the company
- Still in R&D, zero revenues, 8 patents and 3.1 million shares
- The strategy was to sell to a large Asian consumer electronics manufacturer
- Dolby Labs acquired in Feb 2007 (2.75 yrs)

How Much did Brightside Sell For?

- Gross selling price (before transaction fees)
-

What Happened Next?

- Just a couple weeks after the sale to Dolby
- I was in Best Buy trying to convince myself I needed an even bigger TV
- Each of the three investments I made into Brightside were predicated on them showing me a better prototype of their product
- I'd seen dozens of their demos and was getting pretty good at recognizing the technology
- And there it was – right on the shelf!

I Called the Company

- Right there on the showroom floor, I called the company
- And before I finished my question, they were telling me what I was looking at
- A very big Asian display manufacturer had taken their technology and put it into production!
- Because of who it was, the company knew exactly what had happened

The Risk They Missed

- The Brightside team had visited this company a few quarters earlier to discuss a licensing deal
- Before they visited they invested in the very best NDA they could get from a very big law firm
- They disclosed the technology to this company
- As near as they could determine, because this was now only a few quarters later
- And because of the typical production cycles
- They must have put it into production that week!

Imagine What Would Have Happened

- If Brightside had delayed their exit even a couple of weeks, I don't think it would have happened
- The story I heard was that Dolby put 40 lawyers and others on a plane to 'visit' the company
- Dolby can do that – but entrepreneurs can't
- Unfortunately this story happens all the time
- And we entrepreneurs just aren't good at assessing this type of risk
- That's one of the scariest saves I've been part of

The Pacinian Case Study

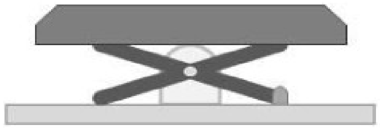
- Company in Coeur d’Alene, Idaho
- The CEO and Chairman both attended my Exit Strategies Workshop
- In November 2010
- Before they came to the workshop, they were not sure if they were going to:
  - finance the company to production
  - license their technology, or
  - work toward an early exit

The Original Idea for a Company

- Two founders - who had worked most of their career on keyboards
- They kept thinking there must be a better way than the conventional keyboard

Traditional Keyboards

- Thick
- Fragile
- Complex
- Inefficient to Backlight
- Little Innovation in 20 years



Rubber Dome / Scissor Mechanism

Pacinian's Mission

- To improve the human interface
- Specifically to provide tactile feedback
- On an ultra-thin keyboard or touch screen

Pacinian’s Funding History

- All angel investment
- About $4 million raised before there was an exit strategy
- Needed another round to fund to the exit
- In total about $6 million was invested

The Third Pivot

- Pacinian did three pivots (in other words…)
- The product was expected to be ready for production by the end of 2012

But It Was Acquired Before

- Even though the company had not yet built a production prototype
- Pacinian was acquired in August 2012
- And to give you a hint,
- The final price was 50% above the first offer

What was Pacinian's Selling Price?

- Gross selling price (before transaction fees)

What Happened Next?

- Pacinian executed their exit strategy brilliantly
- They finished the production version of the product
- The team is happy at their new company
- The board distributed the cash to the shareholders
- Founders, employees and investors are all very pleased with the outcome

The Risks for Pacinian

- I think Pacinian is the most interesting of these three case studies
- Even though the company still hadn’t been able to produce a production prototype
- They has several strategic options
- The Chairman and I spent about a year debating the company’s strategic options with the board
- Working to assess the future risks and rewards

Pacinian's Strategic Options

The Pacinian board had several options:

1. Accept the offers of Venture Capital and build a factory to produce their keyboards,
2. Proceed with one or more of the licensing offers and let other companies manufacture
3. Design and execute a pre-revenue early exit

Pacinian's War Story

- The valuable learning from Pacinian was what happened before the exit
- The process the board went through to weigh their strategic options and make the decision
- At times it felt like a war
- The board were all smart experienced people
- But at the start of the process nobody agreed
- Some very colorful language was used

Only One Person Voted to Exit

- At the beginning of the Pacinian exit, only one investor believed in the idea of an early exit
- That was the famous angel investor Bill Payne
- Bill convinced the Chairman and CEO to attend one of my workshops – just like the one we had here yesterday
- That got them thinking
- But rest of the board still thought a pre-revenue exit was impossible

That’s What’s So Challenging

- The Pacinian board were good, experienced people
- But none of them had even seen, or even heard about, a pre-revenue exit before
- Which is not surprising considering how uncommon they were just a decade ago

What Might Have Happened

- For me, I often wonder what would have happened to Pacinian if they had chosen one of the other strategic options
- We’ll never know for certain
- But I have no doubt that they made the best decision
- The early exit was certainly the lowest risk strategy
- Even though most thought it was impossible

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/

Thank you and Contact Info

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Thank you.