

Early Exits Workshop  
Part 3  
Exit Execution

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# Increasing The Number of Exits

- We can all increase our successful exits by:
- Focusing on exits before we invest
- Helping entrepreneurs build alignment on the exit strategy (also before we invest)
- Designing our term sheets to facilitate the exit transaction - especially vesting
- Really understanding VC follow-ons

# Steps to Completing an Exit

- The basic steps to completing an exit are:
  1. Build alignment on a realistic exit strategy
  2. Engage the best professionals
  3. Clean up the corporate structure
  4. Prepare for due diligence
  5. Do a secondary sale (in some cases)
  6. Build the sales funnel
  7. Manage the auction (multiple bidders)
  8. Negotiate and close

# Section 3.1

## The Exit Team

# 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
  - Possibly an Exit Coach
  - A small committee of the board
  - Legal and Accounting Professionals

# Role of the Professionals

- The most important jobs of the M&A advisor or business broker are to:
  1. Protect the CEO and rest of the team
  2. Add the experience and strategy
  3. Be the bad guy
  4. Maximize the price and terms

# 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
  - Are often conflicted
  - Need a good relationship with the new owners (cannot be the ‘bad guy’)

# The Exit Coach – A New Idea

- In the old, VC dominated, model CEOs and boards were less involved with the exit
- Very few directors, and fewer CEOs, have a lot of exit experience
- Often ‘new’ companies should start on the exit just a year, or two, after startup
- Exit knowledge and experience is even more critical for these young companies

# The Exit Coach

- This new environment has created a need for a new type of professional with the same depth of knowledge as an M&A advisor,
- Engaged on a financial model more typical of a 'coach' (\$0.5 to 2k /month)
- To work with the CEO before the company engages a full M&A advisor
- And to help select the M&A advisor

# Selecting The M&A Advisor

- There is almost nothing written about selecting M&A advisors
- The majority make sub-optimum choices
- Relationships are always exclusive
- The most important criteria are:
  - Transaction completion rate
  - Track record of maximizing price
  - Proximity, knowledge and compatibility

# The M&A Advisors Function

- The M&A advisor is really ‘the sales guy’
- Their 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’

# 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 – and often much 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 not published but are surprisingly uniform
- Work fees usually \$50,000 regardless of the company size (less if learning or not busy)
- Success fee, including the work fee, from:
  - 7 to 10% for sales under \$5 million
  - 4 to 6% for sales from \$10 to 30 million
  - 2 to 3% in the \$100 million range

# Failure is Quite Common

- One of the secrets of the M&A business is that M&A professionals often fail to complete the transaction
- There are no hard statistics on this and the professionals rarely talk about it
- I have been asking companies for years
- I am sure at least a third of transactions fail
- One industry expert says over 90% fail

# M&A Advisors Should Be Local

- CEOs and boards often start to look for an M&A advisor in the big financial centers
- The failure rate increases as the distance to the M&A advisor increases
- Failure is most often the company's fault
- The cause is usually the same: communication
- An M&A advisor relationship is intimate and intense – it requires a lot of face time

# M&A Advisors Should Be Local

- For the last third of the process, the M&A advisor will almost live with the company
- Some firms say they can do this remotely
- But for transactions under \$100 million, the fees are not enough for the travel required
- Local M&A advisors will also work much harder to protect their reputations
- And are easier to do due diligence on

# 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 \$50,000
- 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

Discussion on:

The Exit Team

# Section 3.2

## The Exit Timeline

# Often the Biggest Question

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

# 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 considerably longer if the company isn't ready, or if the structure needs to be cleaned up, or if the financials need improvement

# When To Tell The Team

- Many CEOs have difficulty determining when they should tell the rest of the team that the company is for sale
- 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

# Timing is important

- The most common mistake is to “ride it over the top”
- Best time to sell is when everything is going really well
- That’s when you will usually get the highest price, even if the business can grow further
- The difficult thing is to start the process a couple of years before the growth peaks

# Before You Start Selling

- About a third of the work includes:
  1. Building alignment around exit strategy
  2. Financial history and projections
  3. Selling document (like a business plan)
  4. Cleaning up the corporate structure
  5. Preparing the due diligence
- Usually takes 1 to 5 months

# Building The Sales Funnel

- The second phase includes:
  1. Searching for prospects that match
  2. Develop tactics on strategic value
  3. Initial contacts to 50 - 100
  4. Responding to 10 - 20 interested
  5. Starting due diligence with 5 - 8
  6. To get to a stable short list of 3
- Usually takes 2 to 6 months

# 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 become the limiting factor even if the M&A advisor is doing well
- Usually takes 2 to 4 months

# Negotiating and Closing

- Even after there is a binding term sheet and possibly a deposit
- It can take months for the M&A advisor, lawyers, accountants and board to complete the fine points of the definitive agreement
- And obtain all of the approvals from boards, shareholders and regulators
- This final phase is usually 1 to 3 months

# Timeline Summary

- Once an M&A advisor has been engaged
- The exit usually takes 6 to 18 months
- Depends mostly on the company
- Most of the time is spent preparing the due diligence and sales collateral
- The next biggest time sink is scheduling
- Then waiting for lawyers

Discussion on:

The Exit Timeline

## Section 3.3

# Cleanup and Preparation

# Before Contacting Buyers

- A common, and expensive, mistake is engaging with prospective buyers before the company is ready
- Then realizing that there is a lot to be done before due diligence can complete
- At worst, the buyer loses interest
- At best, it costs the company hundreds of thousands in professional fees

# Clean Up The Structure

- In almost every exit I have seen
- There are structural defects that need to be cleaned up before the exit can complete
- Some are built into the corporate structure
- Others are contracts with unforeseen consequences during an exit
- Fix these before contacting buyers

# Employment and IP Agreements

- Do the deep patent and IP work early
- Every buyer will want senior and technical employees to have signed a good, modern employment agreement
- Many companies miss the contractors
- Both are essential for IP ownership
- Don't get held for ransom at the closing by an employee who doesn't want to sign

# Corporate Records and Taxes

- Have a very experienced M&A lawyer review all of the corporate records early
- Shareholder and board meeting minutes are critical
- Taxes are different in each state and can be almost impossible to get certainty on
- Don't overpay your law firm to build the corporate record history at the last minute

# The Shares and Share Register

- About half of the companies I've seen start an exit don't have their shares properly issued or properly recorded
- Far too often the sale proceeds will be in the lawyers trust account before shareholders start to dispute the records
- And print out years old emails from the CEO
- Get everyone to sign confirmations early

# Review or Audited Financials

- Most companies have notice to reader financial statements
- Post Enron, audit costs have skyrocketed
- Some buyers will accept review engagements, but others need audits
- Don't pay your outside accountants double at the end to do the review or audit

# The Sales Collateral

- Should all be complete before contacting the first prospects:
  - Complete due diligence online
  - Teaser document (2 pages)
  - Selling document (20 pages)
  - Financial history and projections (Excel)
  - PowerPoint for online and boardroom
  - Possibly an online video

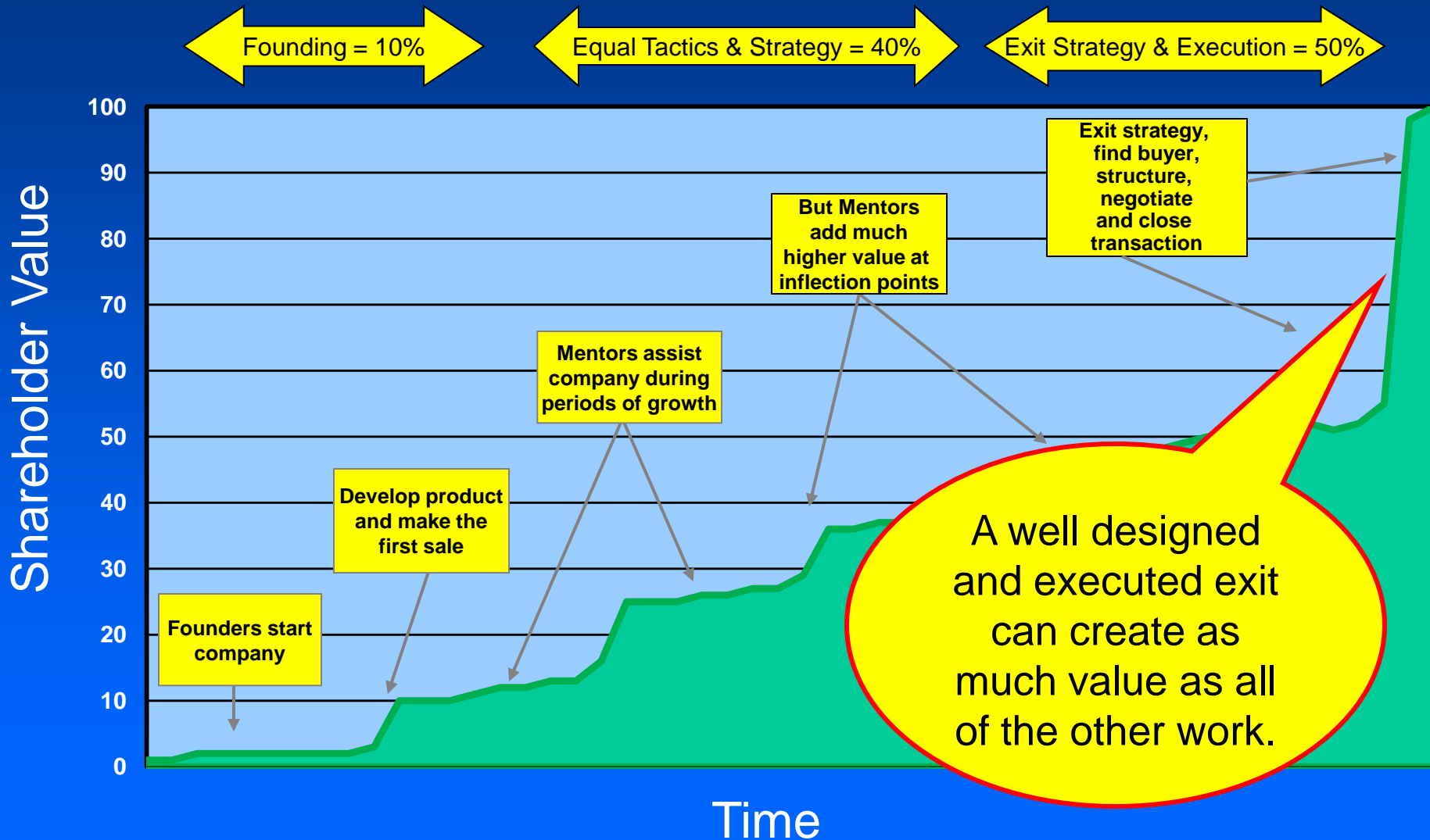
Discussion on:

Cleanup and Preparation

## Section 3.4

# Maximizing the Selling Price

# Building Shareholder Value



# Plan to Over-Achieve

- To get the best price for the business
- There should always be multiple bidders
- And a professional 'auction' process
- To maximize the price, the team should do everything possible to deliver results that are better than the projections
- An important reason the CEO shouldn't lead

# Maximizing Exit Value

- There are several non-operational ways to maximize the final selling price:
  1. Structural value increase
  2. Illuminating strategic value
  3. Capitalizing on Inefficient Markets
  4. Maintaining multiple bidders
  5. Sales and negotiating skill

# Structural Value Increase

- Often small tweaks in the corporate structure can increase the selling price by 10 to 35%
  - These can be balance sheet changes
  - Asset vs. share sales
  - Financing mechanisms like sub debt
  - Tax innovations
- Opportunities are almost endless but can often add \$ millions

# 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 very often has to be illuminated for the potential buyers (often very challenging)
- This can often be the most valuable contribution from the M&A professional

# Capitalizing on Inefficient Markets

- Markets for selling a business, especially for under \$100 million, are very inefficient:
  - Information is difficult to access
  - There are a small number of buyers
  - The market is illiquid
  - Often very few for sale (like yours)
- All of which can be big advantages for the seller

# Benefits of Multiple Bidders

- An unsolicited offer is almost always a lost opportunity
- Every business sale should have multiple bidders to:
  - Increase 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 help to increase the final price by 50% or more

Discussion on:

Maximizing the Selling Price

# Section 3.5

## Closing and Life Options

# Reps and Warranties

- A lawyer friend says more M&A transactions fail on reps and warranties than price and terms
- Basically a personal guarantee from the CEO and other major shareholders
- To protect the buyers against future liabilities or misrepresentations
- Start coaching the team early in the process

# Closing and The Party

- Once everything is completely agreed to
- It still takes forever to close (4 to 8 weeks)
- There are hundreds of small sticking points
- And fate will have it that their lawyer is working on three closings simultaneously
- M&A closing parties are always the best parties (that I am allowed to go to)

# Exits and Life Options

- I think exits are the best part of being an entrepreneur and investor
- It's when we get paid for all of our hard work and risk capital
- It's also when entrepreneurs and angels have the option of doing it all again,
- Or doing something entirely different with our money

# Videos on Executing Exits

- [Selling a Company – Guide for Angels](#)  
National Angel Capital Organization, Toronto
- [How Not To Sell a Business](#)  
Entrepreneurs Organization, Vancouver
- [Maximizing Exit Value Workshop](#)  
Angel Capital Association Summit, Atlanta
- All available from [www.AngelBlog.net](http://www.AngelBlog.net)

# Resources on Exits

- [www.Early-Exits.com](http://www.Early-Exits.com) – my book on exit strategies for angels and entrepreneurs
- [www.AngelBlog.net](http://www.AngelBlog.net) – my blog for entrepreneurs and angel investors
- [www.BasilPeters.com](http://www.BasilPeters.com) – for videos of my previous talks on exits (free and in high def)
- The Exit Strategies Newsletter (free) from the AngelBlog homepage

Good Luck With  
All of Your Exits!