How Not to Blow the Biggest Deal of Your Life

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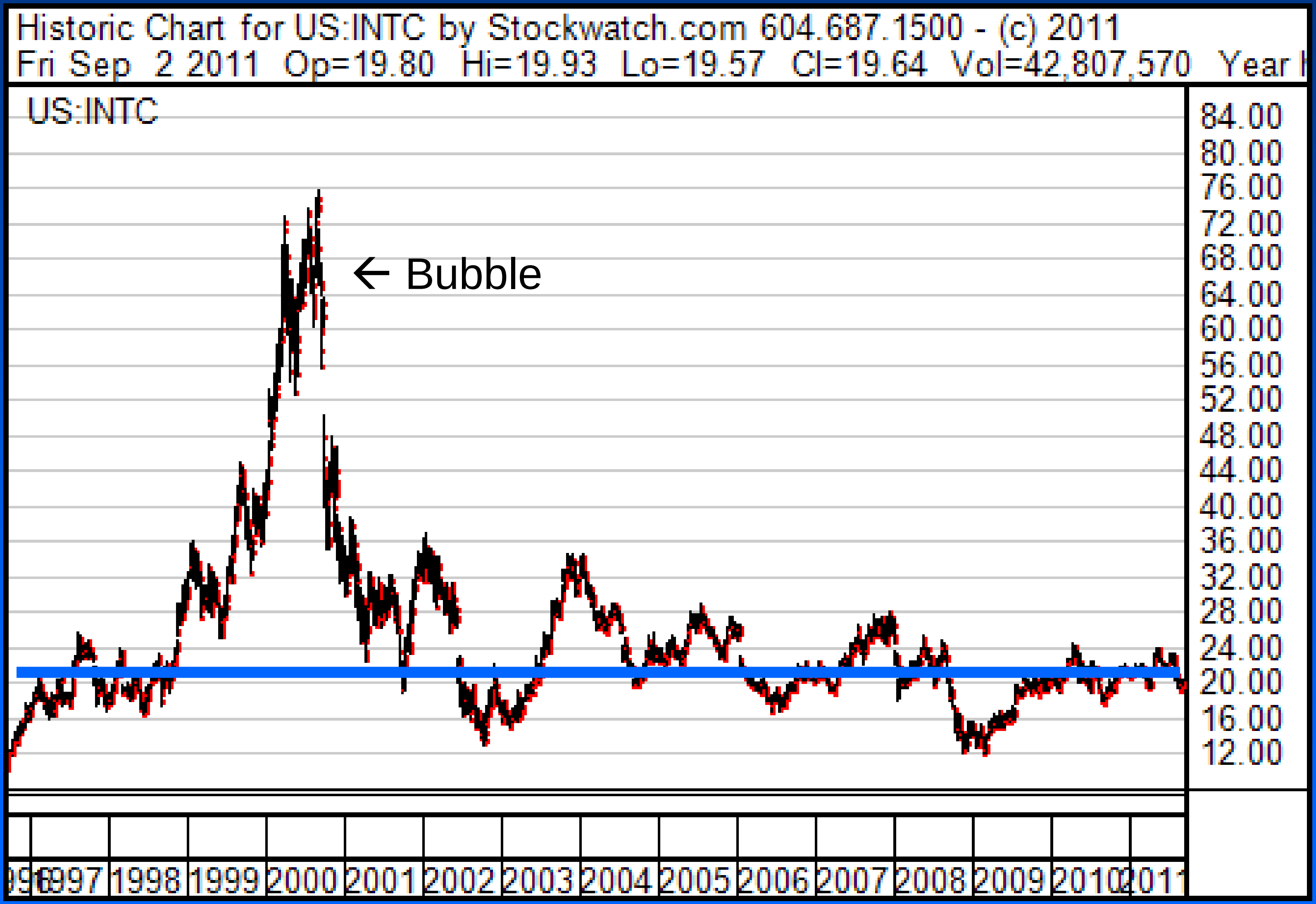
Most Important Message Today

- In tech, only about 25% of all companies that could have been sold, actually end up exiting.
- Yes, the probabilities are around 75% that if a startup succeeds, and becomes valuable,
- It will still fail to exit.
- My personal goal is to help to increase the percentage that succeed.

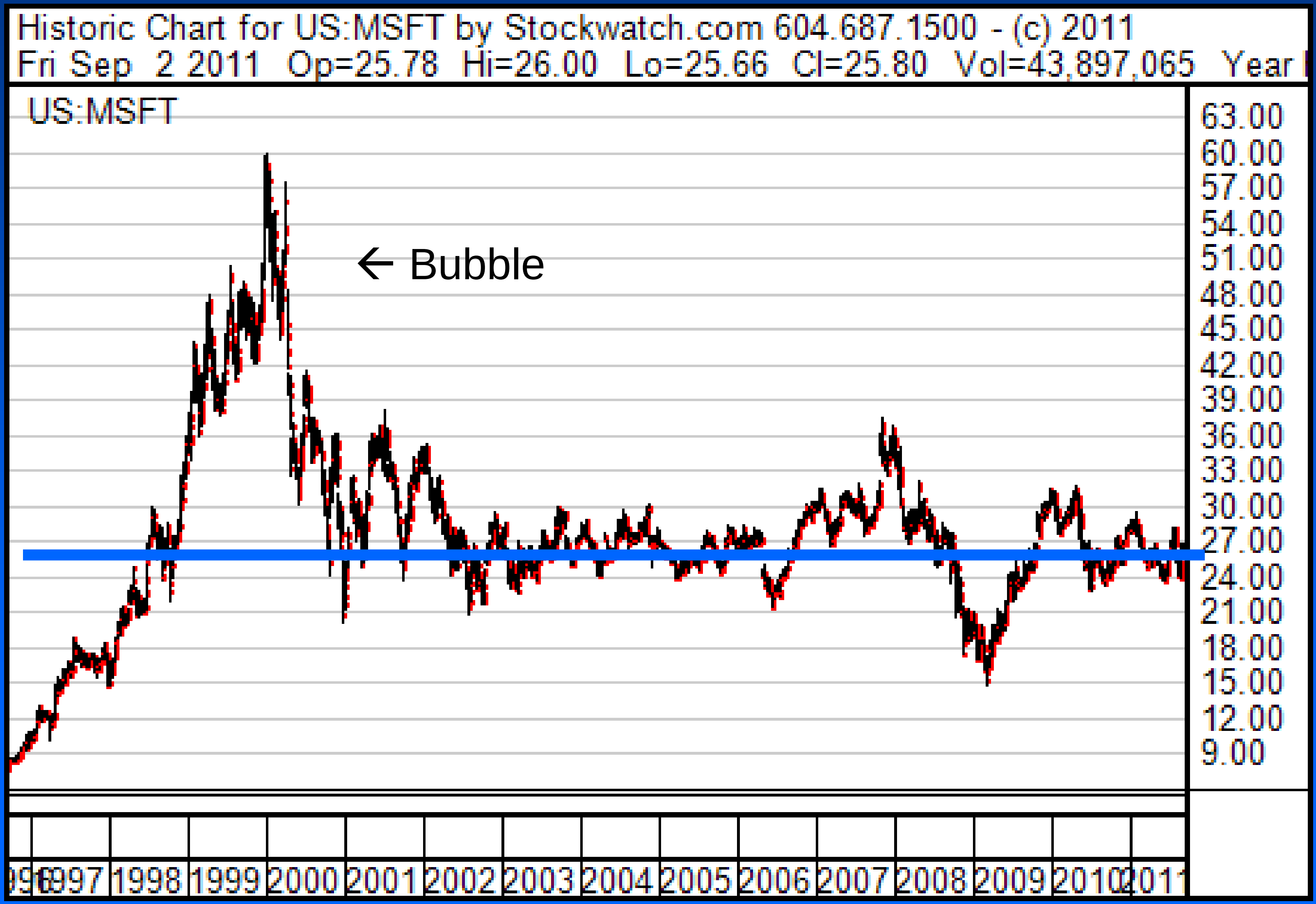
The World Has Changed

- Many big parts of the financial ecosystem
- That worked for a hundred years
- Don’t work at all anymore
- The economy has changed
- The whole world is changing
- Faster than ever before

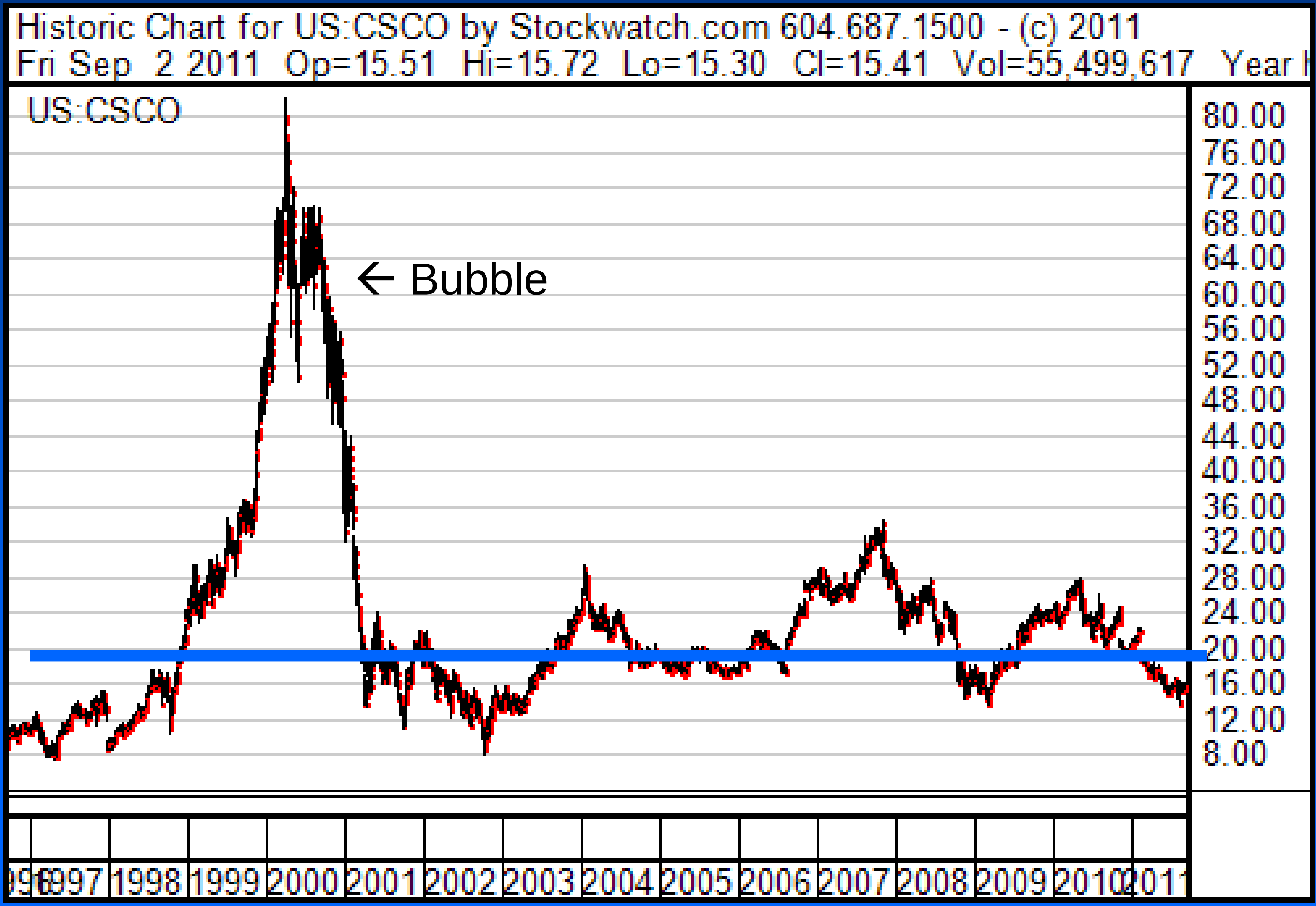
Intel – 15 years



Microsoft – 15 years



Cisco – 15 years



None Are Creating Wealth

- For their investors,
- And more importantly for their employees
- For decades, these greats were all built on the increasing value of their stock options
- That’s what used to bring, and retain, the best and the brightest
- To these big companies

Innovation in Smaller Companies

- The best and the brightest now work in startups
- Small companies create opportunities
- Where the smart people create the innovations
- That’s why all the economic and employment growth is created by mid market companies
- It wasn’t like this 10 or 20 years ago
- New research is helping us understand why this change has occurred

The New Big Story

- The media always reports the really big exits
- Like YouTube selling for $1.6 billion,
- Club Penguin selling for $350 million, or
- AdMob selling for $750 million
- Those exits are relatively rare occurrences
- The ‘new’ big story is the much larger number of small exits

Most Exits Are Under $15 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
- Today, I estimate the median price to be well under $20 million
- And probably <u>below $15 million</u>
- That was a surprise to me just a few years ago

Google Wants Even Earlier Exits

- I was also surprised recently to learn just how early Google wants to make 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

New Startup Economics

- It’s amazing how little it costs to build a tech company today
- Back when I was an entrepreneur, hardware and software companies needed $10s millions
- Which gave rise to the huge VC funds
- And was one of the reasons innovation used to happen primarily in big companies
- Today, entrepreneurs can build companies for $100,000s and, in some cases, $10,000s

Why It Costs So Little Today

- It's the internet
- Fundamentally changing how we work
- And build companies
- Instant access to the entire global market
- Another example - open source software
- More importantly - virtual companies

Many Startups Need No Capital

- After being an investor for 20 years,
- I’m amazed by how many of the most successful companies I see
- Or have helped to sell
- Have raised no capital at all
- Or just a little from friends and family
- These bootstrapped companies are usually stronger and produce higher returns

Tech Company Exits Then and Now

Most 1980s & 90s tech company exits

Friends, Family or Angels → Venture Capital Investors → Public Market Investors → Exit to Fortune 500

10 – 15 years

Today's tech company exits

Friends, Family or Angels → Exit to Fortune 500

2 - 3 years

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

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

A B.C. Really Early Exit

- This Vancouver company asked me to keep their details confidential – for now
- They wanted to test the idea 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

Acquisition Before Demo Day

- Techstars is a startup accelerator in Bolder
- Demo days are for entrepreneurs to debut their businesses to media and investors
- In August 2013 one of their startups was acquired before the demo day
- Intuit acquired GoodApril for “under $20 million”
- That had never happened before
- They’d raised just $18,000 and a $100,000 convertible note

A New Really Early Exit

- Anyone heard of the company PumkinHead?
- How about their product - About.me?
- About.me was acquired by AOL
- Just four days after its public launch
- That may be a new record
- Better way to measure is from startup (= 1 year)
- This illustrates what experienced entrepreneurs and investors can accomplish in this market

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

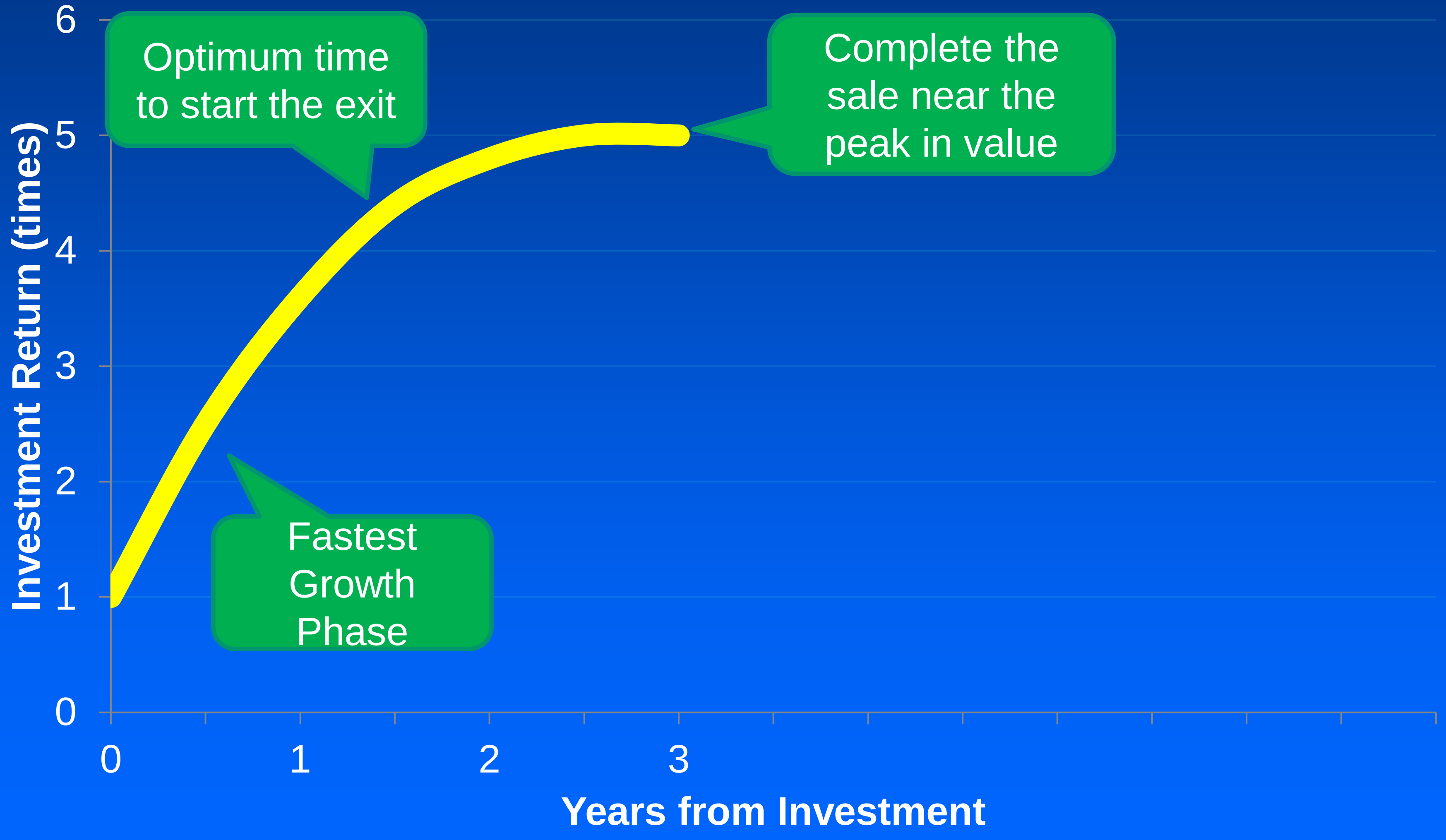
How Long It Usually Takes

- 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

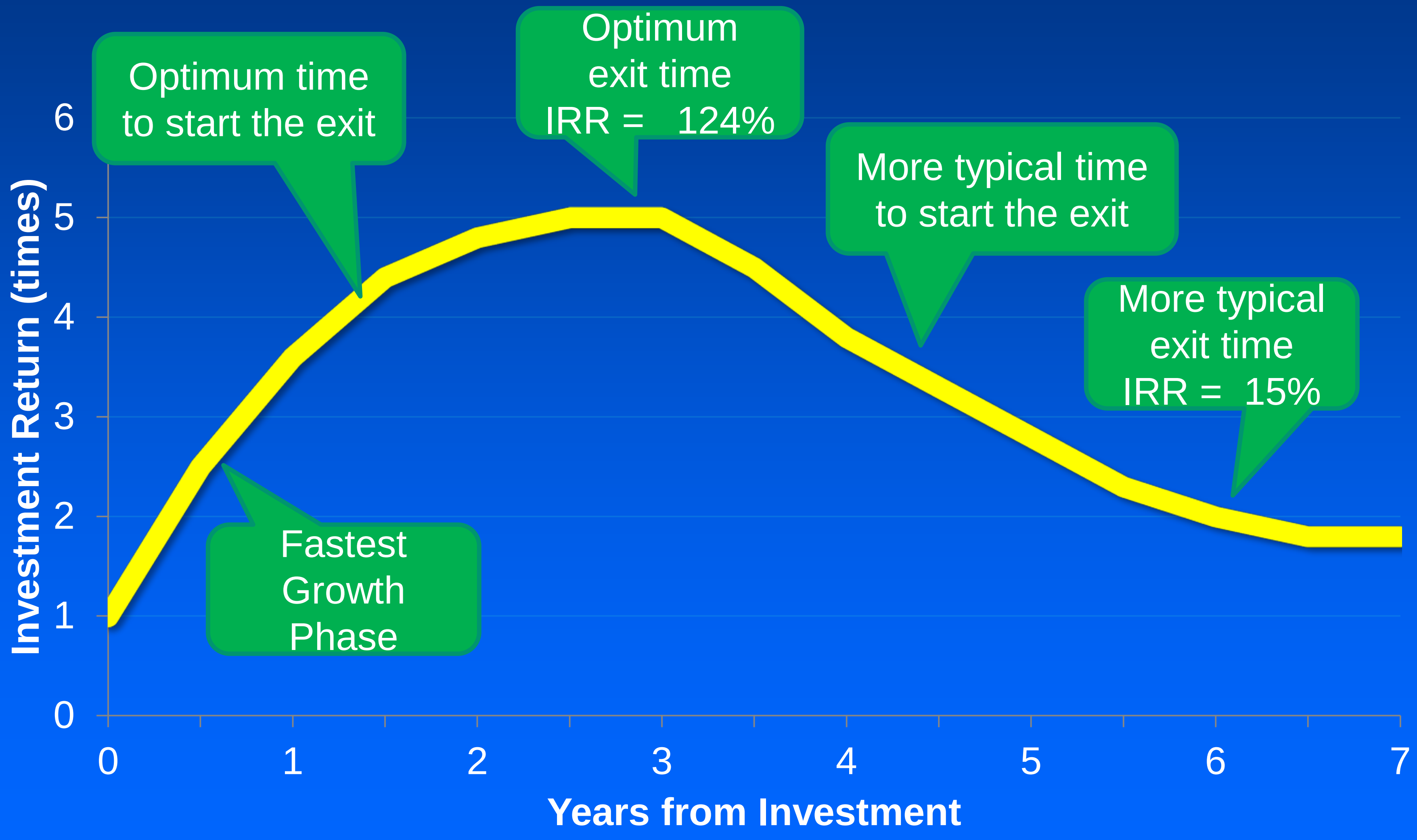
Ideal Exit Timing

- In an ideal situation, the company board would incorporate this 6 to 18 month delay
- Into the company strategic and operating plans
- Look forward in time and then start the exit
- 12 to 18 months before the peak in the company's exit value
- This is one of the most important ways to prevent blowing the biggest deal of your life

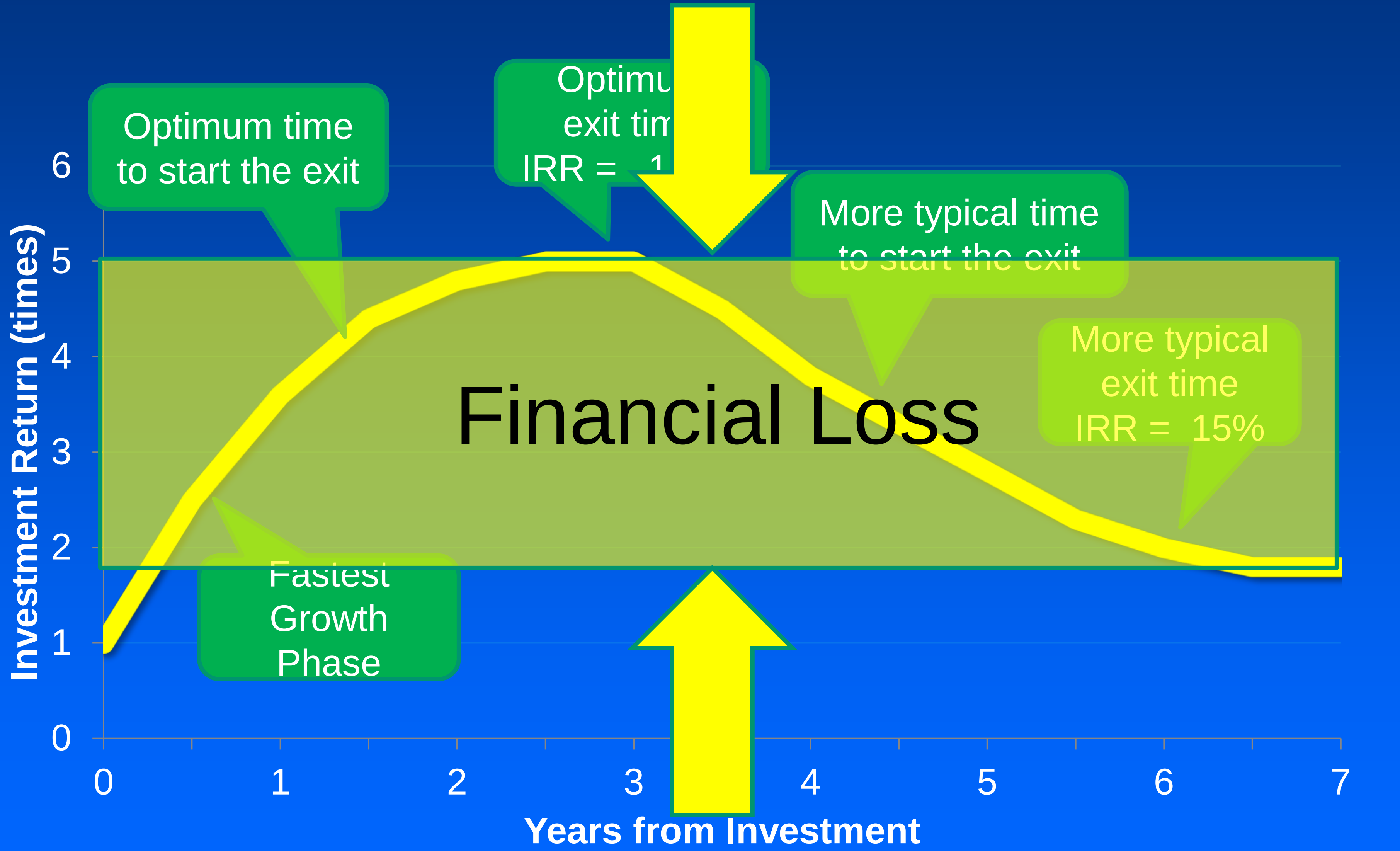
Ideal Exit Timing



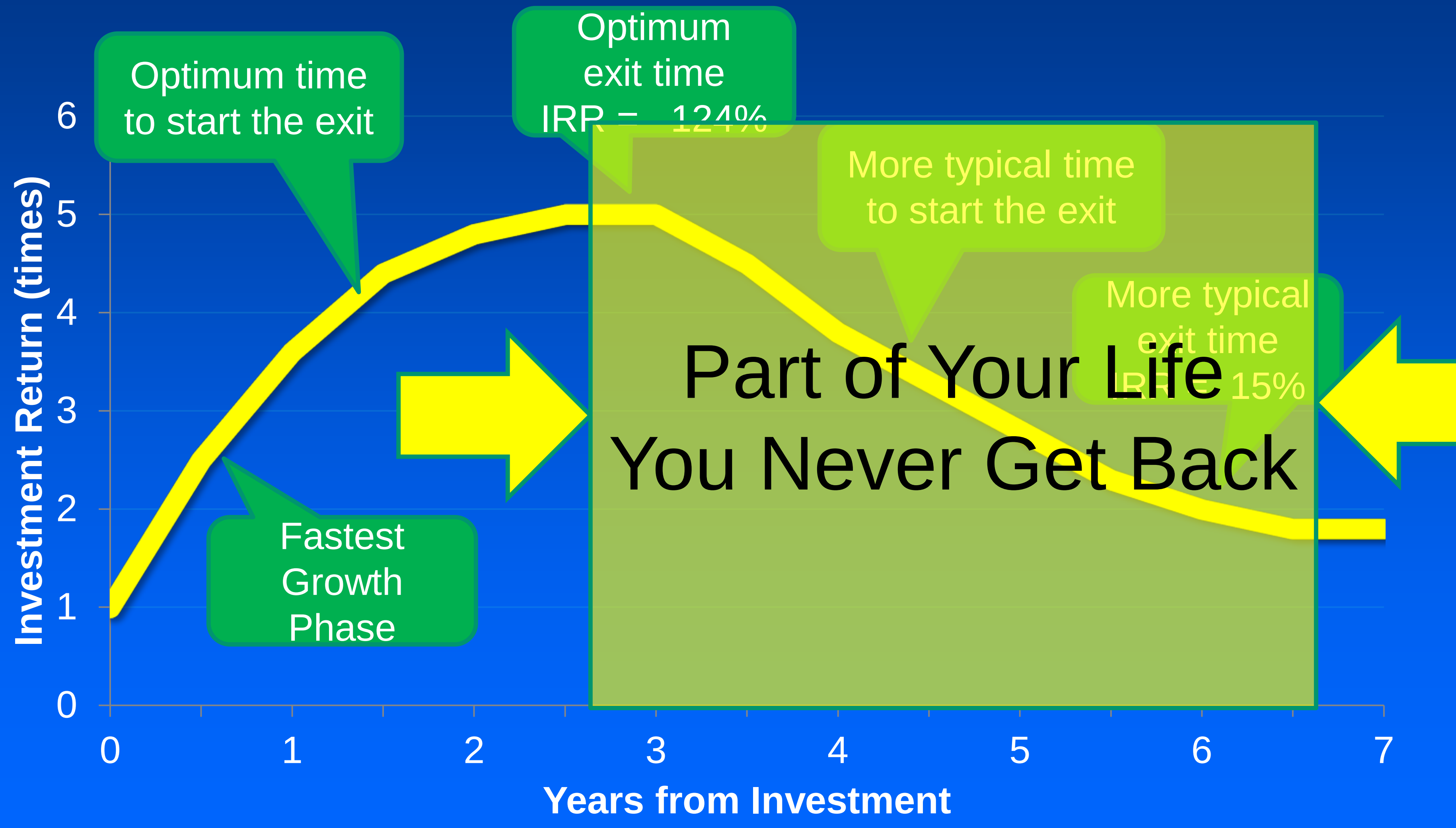
“Riding It Over the Top”



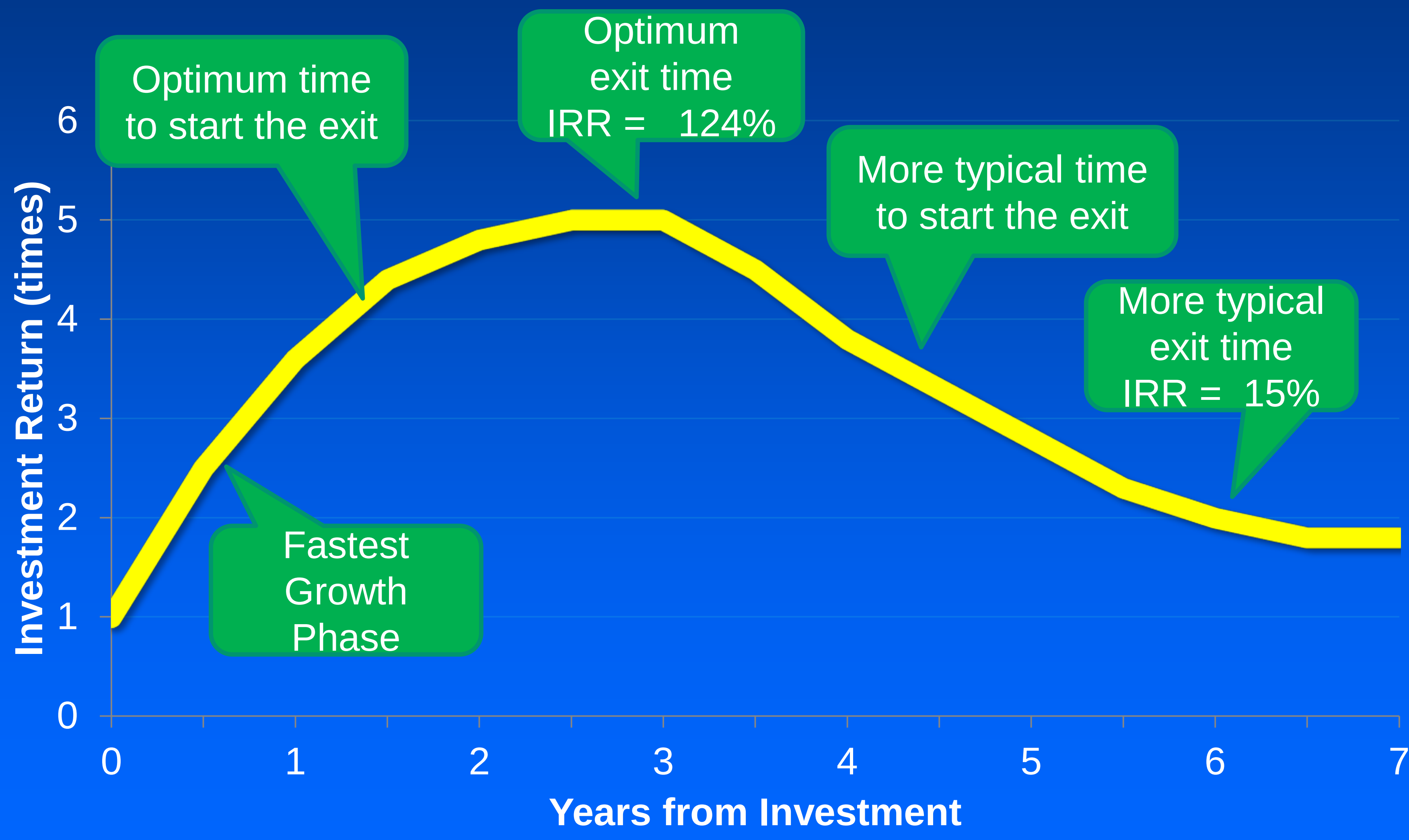
The Financial Loss



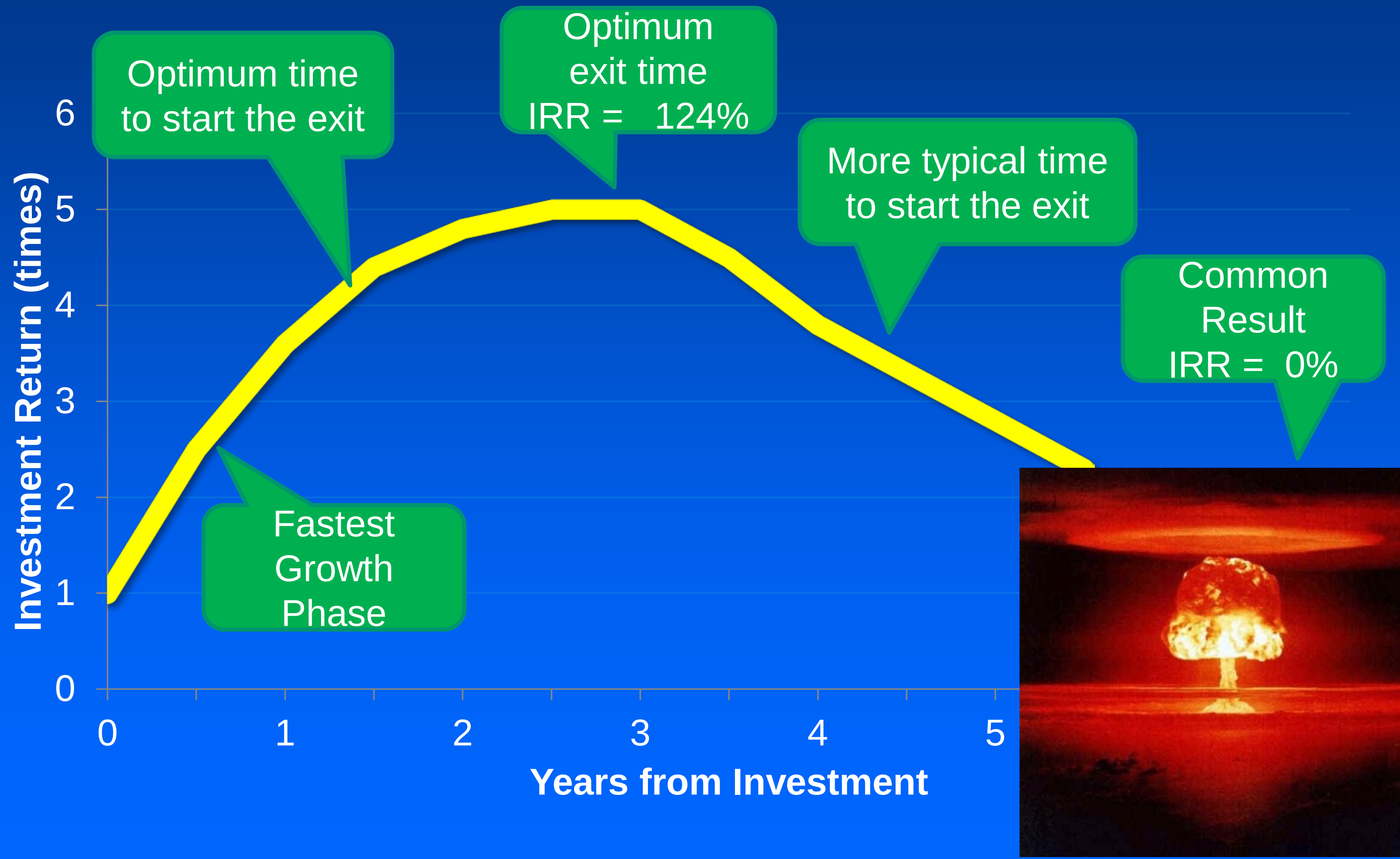
Part of Your Life You Never Get Back



This is Actually Optimistic



What Often Happens



Why ?

- After seeing this happen over and over again
- I started to recognize a few patterns
- And realized there were logical reasons
- Why, if a company misses the ideal time to exit
- There’s a significant probability it won’t just exit for less,
- But will <u>never exit at all</u>

Reasons This Happens

1. Over-investment by VCs
2. Competition
3. Negative momentum
4. Waves of Consolidation

Over Investment

- When a sector becomes “hot” many Venture Capital funds will invest simultaneously
- All hoping to fund one of the few winners capitalizing on the new technology or trend
- Most VCs have much more money than they can deploy well
- When they find a new opportunity, they typically invest very aggressively - $10s millions
- Often driving early innovators out of business

Competition

- Competition is a surprisingly common reason promising companies end up never exiting
- Startups often succeed early because they apply a new technology,
- Or recognize a trend or new market opportunity
- Often their own success generates awareness and attracts new entrants into the market
- Just as the market is maturing and becoming more expensive to operate in

Negative Momentum

- It’s not easy to see the stock price graph in a private company
- But after a while, the team gets a sense that value has peaked and is decreasing
- The fun and excitement are gone
- The best and brightest leave first
- Followed by the other most valuable people
- Ultimately causing the company to lose even more momentum

Waves of Consolidation

- A more devastating reason that companies that miss the ideal time often end up never exiting is
- “Waves of Consolidation”
- This is a relatively new phenomena driven by early exits and internet acceleration
- Unlike the earlier threats, missing this effect is
- Virtually impossible to fix after the fact, and
- Almost always fatal – even if it takes years

The Beginnings of a Wave

- Today, we are all connected by
- The internet and especially social media
- Lets us see what’s happening in the world and our businesses better and faster than ever
- In business today, most competitors have immediate access to the same information
- And make similar decisions at almost the same times

Large Company Growth

- Medium and large companies grow primarily through acquisition
- Many have more cash than they can deploy
- And are under pressure to acquire companies
- Partly to grow but also to keep new innovations from being acquired by their competitors
- And because the buyers are all connected
- They often make decisions at the same time

Hypothetical Example

- For simplicity, let’s imagine an industry where there are three large competitors
- All run by smart executives
- And all with lots of cash
- When technology or markets create a new opportunity to grow their businesses
- They usually all see it at about the same time
- Sometimes triggered by an external event

They All Decide to Acquire

- Often they all decide <u>at the same time</u>
- to acquire a company in a specific space
- In many situations, the impetus is external
- For example, created by an M&A advisor
- Who shows a specific company to all of the potential acquirers in the world
- And describes the strategic opportunity

They All Get Interested

- The buyers all work in the same global market
- If an acquisition makes sense for one of them
- It usually does for others too
- And what M&A advisors all hope for is that several buyers will get interested
- And a competitive bidding situation will develop
- Which is good from the seller’s perspective

But From the Buyers' Side

- Buyers are smart too
- Regardless of whether they got the idea from an M&A advisor, or some other way
- Once they decide they want to acquire a business in a certain area, they
- Look at most of the companies in the field
- Let M&A advisors know they are looking
- And make direct, unsolicited offers to acquire

Why The Buyers Do This

- Buyers have several motivations:
- To determine which company is most attractive for them to acquire – i.e. price
- To give them more choices and therefore more negotiating leverage
- To ensure that if they don’t win the auction on their first choice,
- They have a backup acquisition opportunity

And People Start to Notice

- This starts a cascade of events
- The big company’s competitors hear they are interested in acquiring a certain type of company
- They don’t want to be late, so they also start
- And get their corporate development teams and M&A advisors looking
- Soon every company in the industry has received some unsolicited interest

The Wave

- Which creates the beginning of the wave
- Buyer interest brings in more buyers
- And more M&A advisors
- Which flushes out more companies that could be acquired
- Starting them on their own exit process
- All building to a flurry of acquisitions in the niche or sector

It’s Too Late When You See It

- From the outside, it looks like this happened very quickly
- Often just within a quarter or two
- But it had actually been going on for much longer
- But because public companies and NDAs are involved it’s not easy to see from the outside
- Once a company sees the wave it’s usually too late to react

What Happens After the Wave

- The wave results in most companies who want to buy finding a company to acquire
- Almost overnight the buyer interest stops
- If a company did not get acquired during the wave, it is virtually impossible after
- And that’s not the worst news

The Market After the Wave

- After the buying crescendo
- Each of the successful buying companies have just paid a lot to enter this new sector
- Usually $10 – 20 million
- Most of the buyers will plan to invest a similar amount in growing their new acquisition
- And competing for market share against their traditional competitors

Killing the Small Companies

- The companies that were not acquired are now in a very difficult situation
- Their market has become much more competitive
- Instead of fighting with other small, underfunded companies, they are up against giants
- With enormous investment capability and highly effective brands

Killing the Small Companies

- The small companies cannot afford to compete
- Or to operate in an industry where everyone is willing to lose money – possibly for years
- Often small businesses that were very profitable become unprofitable almost overnight
- And at the same time, their ability to raise capital disappears because the investors saw the wave
- And don’t want to fund a fight with the big guys
- And know a future exit is very unlikely

Missing the Wave

- Missing the Wave of Consolidation is a particularly heartbreaking error
- Many of the companies that missed were very valuable and often extremely profitable
- The wave destroys both
- For CEOs that <u>have built</u> valuable businesses,
- <u>Not missing the wave might be their most important job</u>

The Right Side of the Wave

- Most CEOs are so busy operating the business it’s almost impossible to watch closely enough
- And the early signs are not easy to see even if you are looking
- The best way to get an early indication is to watch the trends that start the wave process
- Almost all CEOs need some help from M&A professionals to do this well

Summary on Exit Timing

- Like many parts of life, and business, “timing is everything” with exits
- Timing exits better will significantly reduce the probability of shareholders blowing the biggest deal of their lives
- Recommendations:
- Have a professional watching your M&A market
- Drive your exit process – don’t wait for an offer

A Golden Era for Entrepreneurs

- I believe history will call this a golden era for technology entrepreneurs.
- Never before has it been so easy to
- Create such valuable companies
- On so little capital
- And sell them so early for so much money

The Alliance - Making a Difference

- I believe, the most important missing ingredient is:
- “Awareness, education and information”
- Mike described how the Alliance is working on this
- I think they are doing a very good job
- Awareness and knowledge will increase the probabilities of valuable companies succeeding
- And contributing to the future of our economy