The Optimum Exits Workshop
Section 1 - Introduction
Exits Are The Best Part

Acetech
Vancouver, BC
December 9, 2010

Basil Peters

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- Part 1 – Introduction – Exits are the Best Part
- Part 2 – Every Company Needs an Exit Strategy
- Part 3 – Financing Your Company
- Part 4 – How Early Can You Sell?
- Part 5 – Planning for Your Exit

Workshop Outline - 2

- Part 6 – Exit Valuation
- Part 7 – Exit Timelines
- Part 8 – The Exit Team
- Part 9 – Maximizing Value
- Part 10 – Closing and Life Strategies

Exits are the Best Part

- I believe exits are the best part of being an entrepreneur or investor
- It’s when we get paid for all of our hard work and risk capital
- But it’s also the least well understood part of being an shareholder
- Simply because it doesn’t happen very often
- Our goal today is to provide information to help you design and execute better exits

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
- The economy has also changed – a lot
- This workshop is about what actually works today - in our current economy

Ways to Exit

- Eventually every company needs an exit
- There are only two ways to sell your company:

1. An IPO (going public)
2. An M&A transaction (private sale)

- These days it's still almost entirely M&A

What Happened to IPOs?

- There have been very few big IPOs
- Not just for the past few years, since the mortgage crisis
- There have been very few IPOs since the tech equity bubble burst in 2000
- And it’s not likely that the IPO market will ever return to what it was in North America
- Until Sarbanes Oxley is repealed or modified

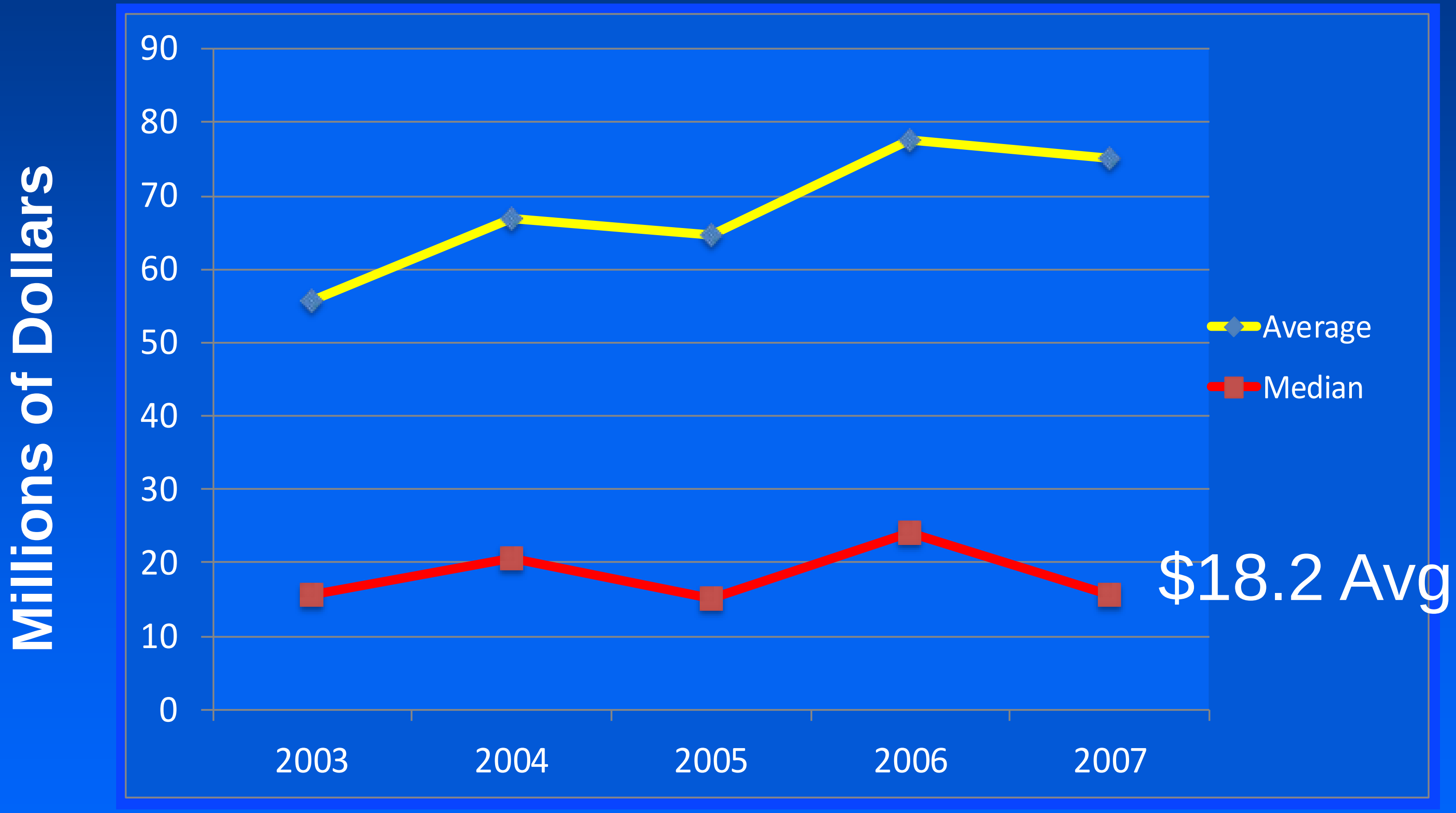
What About Big M&A Exits?

- The media distorts our perception by focusing on the multi-billion dollar M&A deals, like
- YouTube and Skype
- The dirty secret is those huge transactions rarely work out well for the buyers
- And corporate America is figuring that out
- So huge M&As aren’t happening as often either

The New Big Story

- It’s human nature to get excited when you read about big transactions in BC like:
- Club Penguin’s $350 million sale to Disney, or
- Customs House $370 million sale to Western Union
- The ‘new’ big story is the much larger number of small exits

US M&A Transactions
(private sellers only)



Mergerstat® Review - 2008

Most Exits Are Under $20 Million

- Mergerstat database shows the median price of private company acquisitions is under $20 million, when price is disclosed
- But the price is not disclosed in most smaller transactions
- I estimate the median price to be lower
- Probably below $15 million

Why This Is Happening Now

- One of my friends from a Fortune 500 company explained it this way:
  - We (big companies) know we aren’t good at new ideas or start-ups
  - We basically suck at building business from zero to $20 million in value
  - But we think of ourselves as really good at growing values from $20 million to $200 million or more

Under $20 Million Is Easy

- A company priced at $100 million is already out of our sweet spot to buy
- $100 million also requires board approval
- But at $20 million, it's really easy for me to get it approved just inside my division

- Many big companies are spending more on M&A than internal R&D
- Today, it's the best way for them to grow
- It's also what their shareholders want

Big Companies Have Cash

Many big companies have so much cash that it's a problem – shareholders complain

- Cisco has $40 billion
- Google has $30 billion
- Microsoft has $35 billion
- Apple has $25 billion
- Oracle has $20 billion
- Intel has $18 billion

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.angelblog.net/Google_Wants_Even_Earlier_Exits_Than_in_Early_Exits.html

Who Else Is Buying?

- The most familiar buyers are Fortune 500 companies
- But medium sized companies are also aggressive buyers – especially public ones
- Private Equity funds are also coming back into the market now that debt is available
- Also many individuals not ready to retire
- Combining to create a <u>very</u> healthy market for companies under $30 million in value

The Economy Has Changed

- What works in today’s economy:
  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 gains
- This is not a preference, theory or philosophy
- It’s an observation – a fact

Questions on:

Section 1 - Introduction
Exits are the Best Part

The Optimum Exits Workshop Section 2 – Every Company Needs an Exit Strategy

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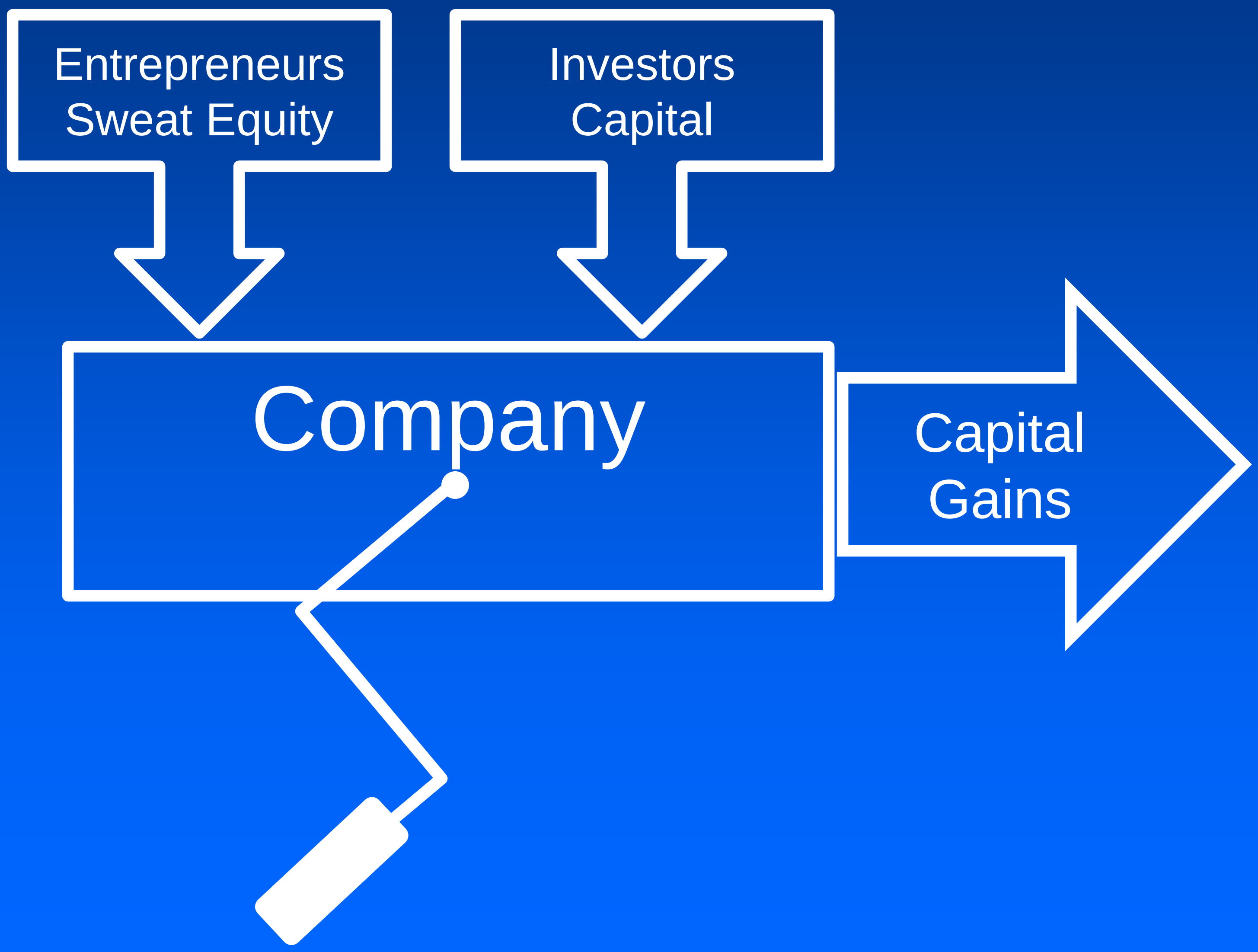
Think of Your Company This Way



Exits Are Not Well Understood

- Exits are the least understood part of being an entrepreneur
- Not surprising because it doesn't happen very often
- From Scott Shane, author of *Fools Gold*:
  - 1 to 1.5% of Angel backed companies exit
  - 5.9% of Angel group deals exited in 2008
- (Not yet clear if this is a trend)

New BC Data on Exits

- Thomas Hellman from the Sauder School of Business at UBC
- Released an important study in October 2010
- “An Evaluation of the Venture Capital Program in British Columbia”
- Figure 10, for BC companies 2001-2008:
- 1.9% of the companies did an IPO,
- 7.3% of the companies were acquired

Focusing on Successful Exits

- I believe entrepreneurs and angel investors would have better returns
- And more fun
- If we designed and built more companies with a focus on the exit
- We'd exit more often
- Works particularly well in today's economy
- Where do we start?

Developing an Exit Strategy

- The most important element in the business plan
- Every company has an exit strategy
- Even if nobody realizes it
- Even if it’s a lifestyle business without investors
- It affects many daily business decisions

The Exit Strategy

- An Exit Strategy can be as simple as:
- “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 type of company
- Entrepreneurs usually need advice on this

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
- Usually takes at least one offsite planning retreat to build full alignment
- Even after, check alignment annually
- Vesting is powerful in maintaining alignment

Share and Option Vesting

- Vesting is the most important part of structure
- All stock options, and all nominally priced previously issued shares, will vest on the following basis:
- 50% of the shares will vest daily and linearly over a three year period; and
- The other 50% will not vest unless and until there is a sale of the Company
- Vesting accelerates on a sale

Our Species is Evolving

- Today, vesting is even more important than it was a decade ago
- Our species is evolving quite quickly
- People under 30 years old have much shorter attention spans
- If want to appreciate this change in mankind, speak with a university dean
- They tell me its very hard to get students to focus long enough to read a whole book

The “Equity Effect”

- One theory is that it’s caused by the internet
- The flip side is that the younger generation are much better multi-taskers (watch your kids)
- This is having a very significant effect on startups
- This shorter attention span means that most of the team will want to move onto the next thing after two or three years

The “Equity Effect”

- Psychological vesting is about 2/3 of the time
- That means that the smart portfolio decision for the employees is to move to the next company at: Time = 0.67 Vesting Period
- The best and brightest go first
- These combine to mean that many modern companies at two or three years from startup
- Are ‘middle aged’ and starting to decline
- http://www.angelblog.net/Corporate_Structure.html

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)
- Every company should have an exit strategy

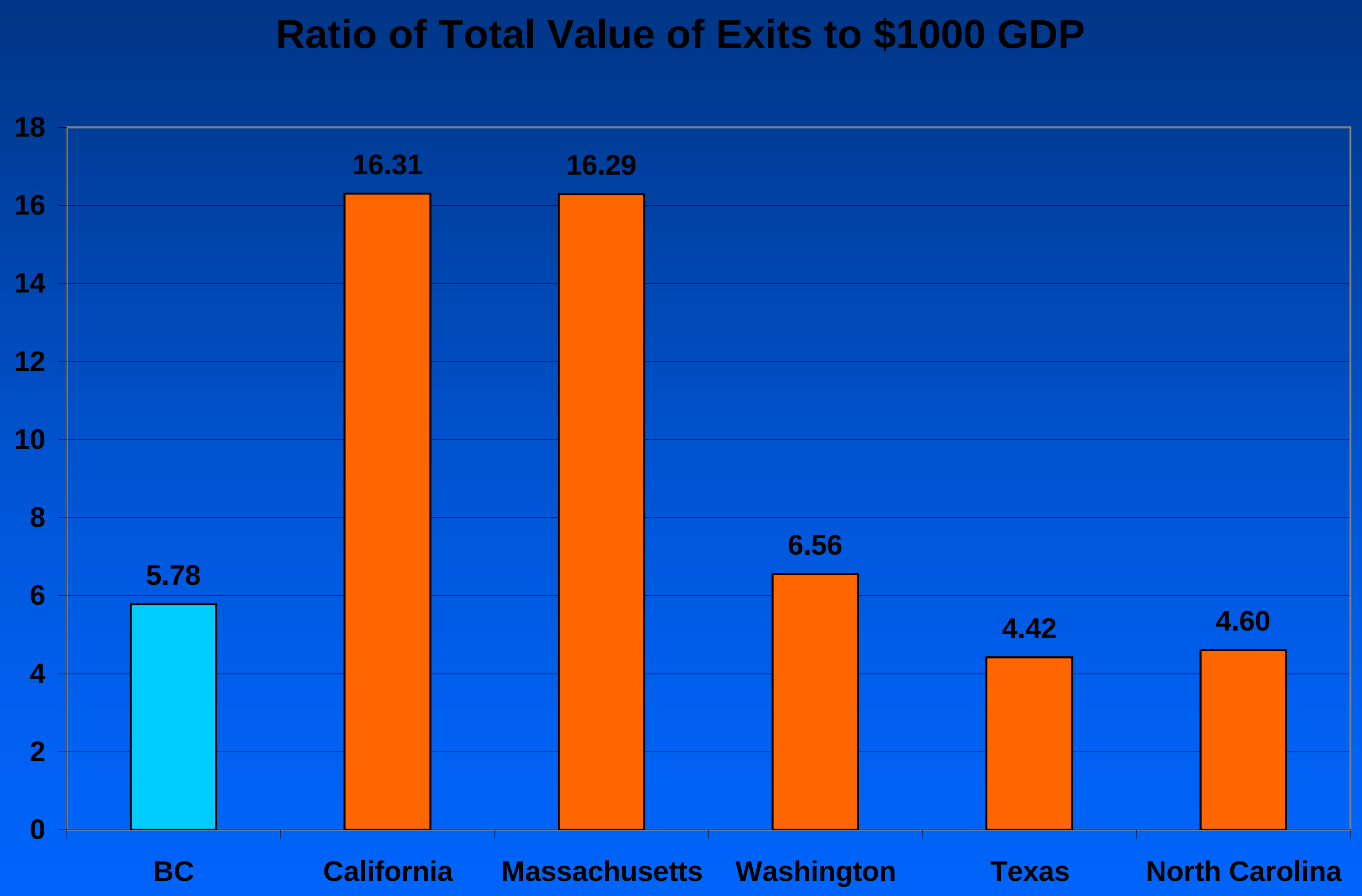
Focusing on Exits is Healthy

- Another misperception you often hear repeated is that entrepreneurs should focus on the business and not worry about the exit
- Well, in my opinion, that’s just plain wrong
- A focus on exits is healthy – it does not detract the team from their primary function of maximizing shareholder value
- In fact, it does just the opposite

We Are Very Good at Exits in BC

- UBC Sauder School of Business
- Joint research by Thomas Hellmann, Edward Egan and James Brander
- Hellman is world renowned for his research
- “A comparison of exit values across Canadian provinces and US states”
- The results may surprise you
- These are some of Thomas Hellman’s slides

BC is highly competitive on a per GDP basis, relative to comparison US states



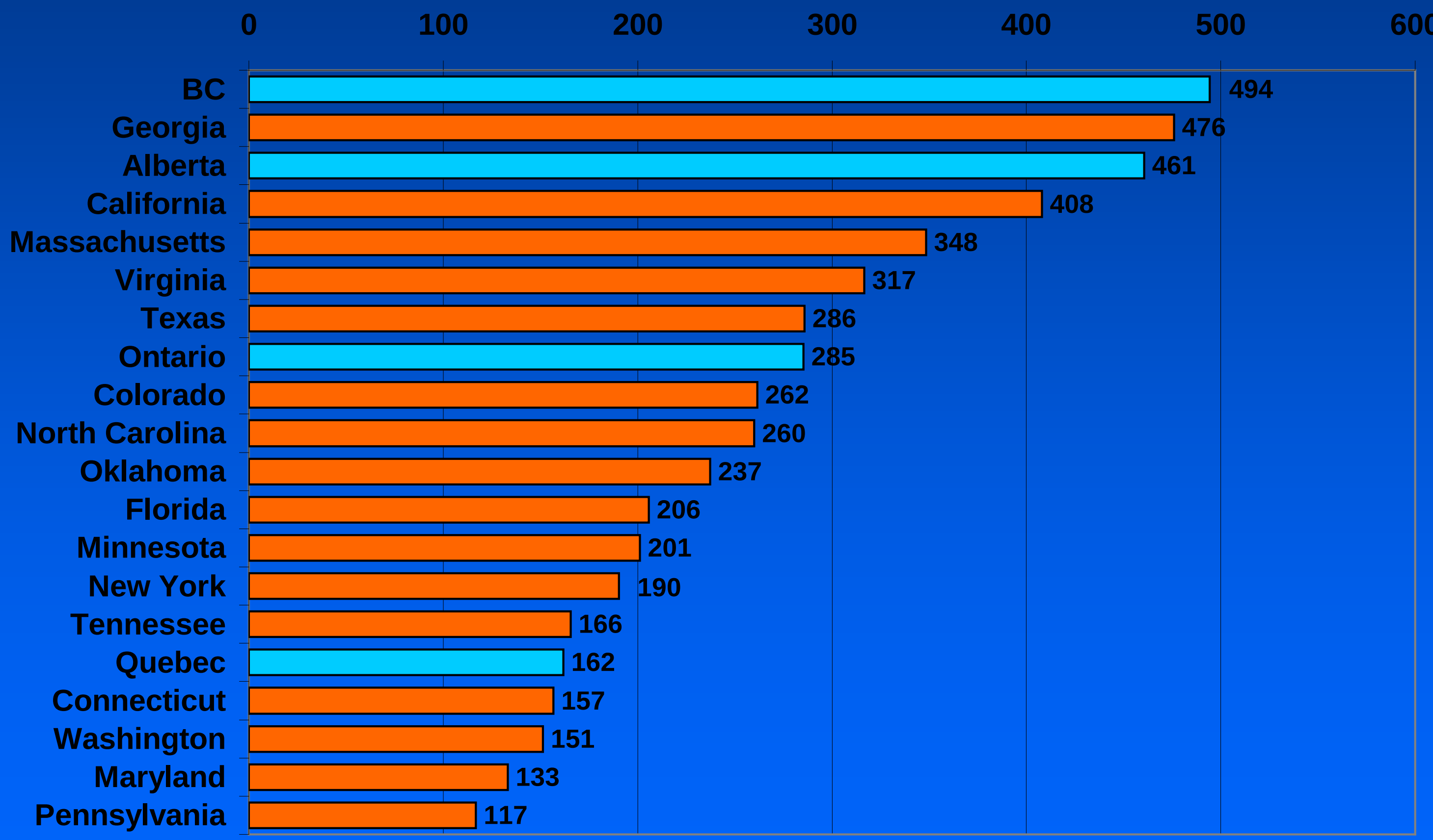
SAUDER School of Business

VenturesCanada

In fact, BC is the #1 jurisdiction in North America for creating Exit value from R&D spending!

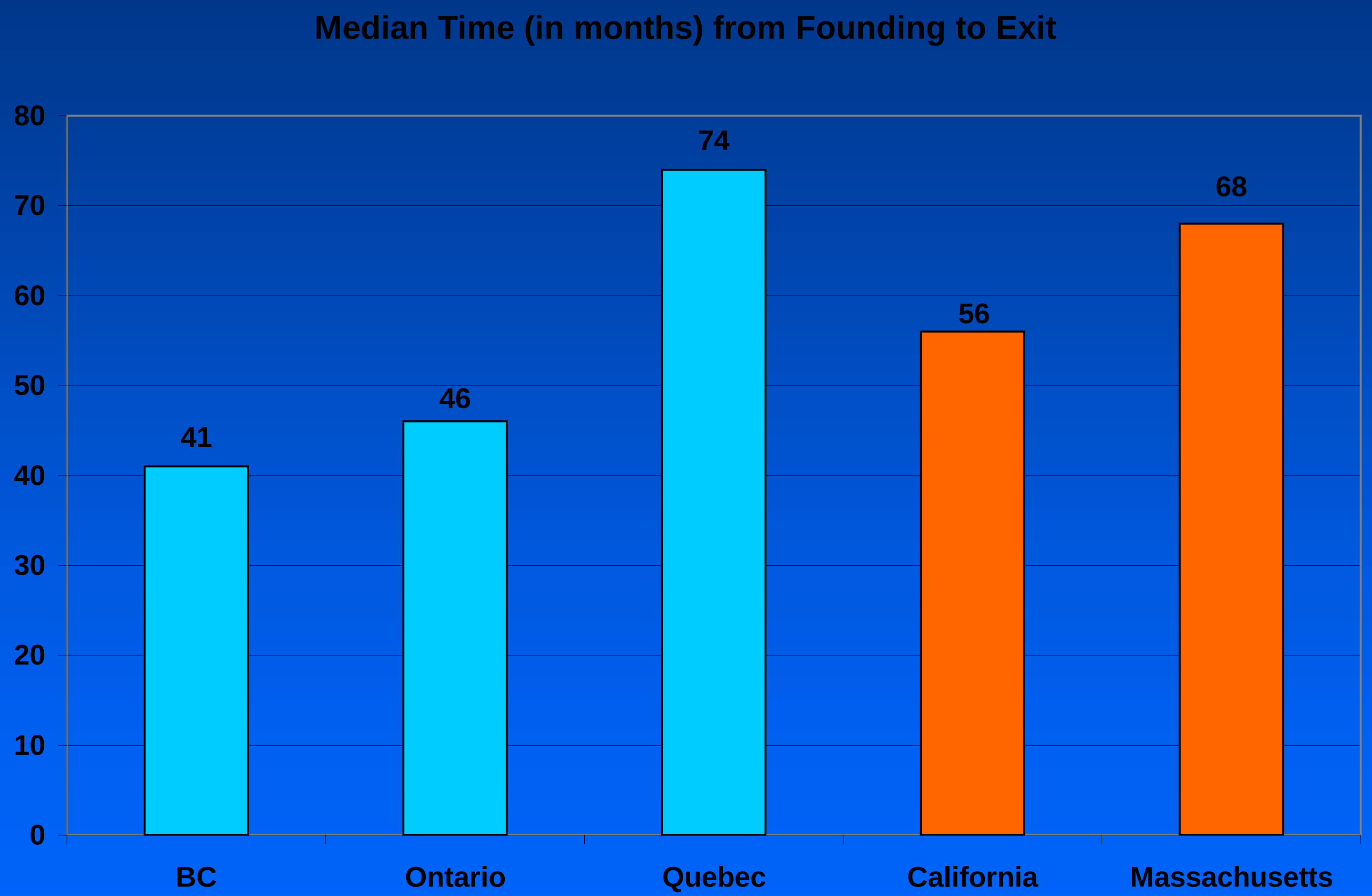
Top 20 Jurisdictions by GERD*

(Red indicates US states, Blue indicates Canadian Provinces)



* Data excludes all states and provinces with less than $1 billion of total exit value

Canadian Provinces have fastest time from founding to exit



* Canadian calculations are based on federally incorporated companies only

SAUDER School of Business

VenturesCanada

Videos on Exit Strategy

- Online videos of my recent talks on strategy
- www.angelblog.net/Start_at_the_End_Your_Exit_Strategy.html
- www.angelblog.net/Exit_Strategies_for_Angel_Investors_Video.html
- And what not to do:
- www.angelblog.net/Dont_Blow_the_Biggest_Deal_of_Your_Life.html

Questions on:

Section 2
Why Every Company
Needs an Exit Strategy

The Optimum Exits Workshop
Section 3
Financing Your Company

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- Financing is easy
- Exiting is hard

First Exit Strategy, Then Finance

- This doesn’t happen most of the time
- But the right way to build a company is
- Determine the type of business
- Build alignment on the exit strategy
- THEN develop the financing plan
- And then start to contact investors

Why The Exit Strategy Comes First

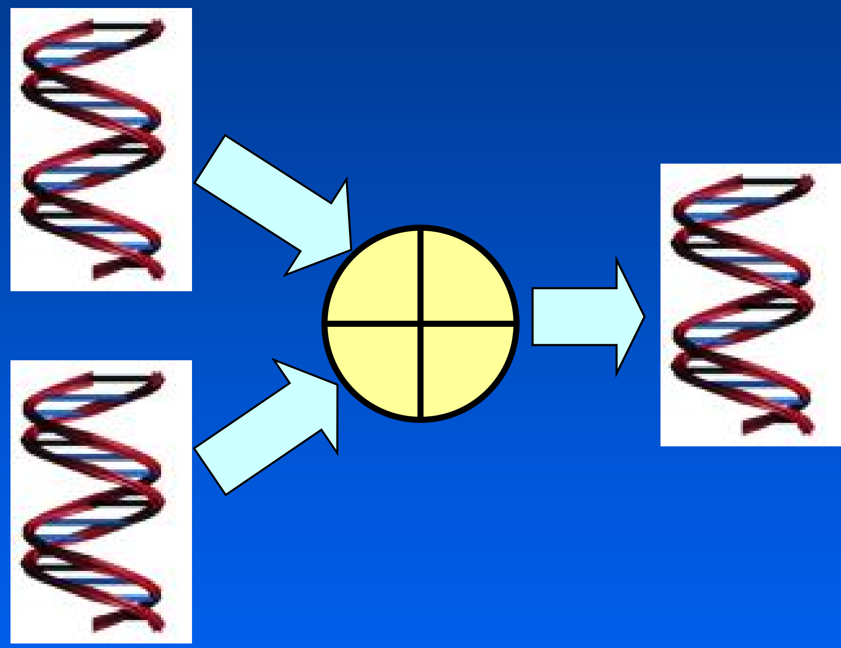
- Different types of investors are compatible with different types of exit strategies!
- Making a mistake about this early on can easily cost you your entire company
- It almost cost me my first
- A video of my war story is online at: http://www.angelblog.net/How_Not_to_Sell_a_Business.html

Check Financial DNA Before

Entrepreneurial DNA

Combined with

Investors' DNA



Resulting Corporate DNA is a Hybrid of Entrepreneurs' and Investors' DNA

Check the compatibility first

Startup Economics Have Changed

- An even bigger change than the disappearance of big exits is
- How little it costs to build a tech company today
- Back when I was an entrepreneur, hardware and software companies cost $10s millions
- Which gave rise to the huge VC funds
- Today, entrepreneurs can build companies for $100,000s and in some cases $10,000s

Why It Costs So Little Today

- The biggest change in the history of man
- Is not the railroads, the telephone or air travel
- It’s the internet
- It’s not just instant access to the entire global market,
- The internet is fundamentally changing how we work
- For example, open source software

What are your options – really?

- Use your own resources – even if you don’t have any money
- Bootstrapping should <u>always be your first choice</u>
- (yes, I am an investor, but that’s the truth)
- Some business models just can’t be bootstrapped

Who Actually Finances Startups?

- The majority of entrepreneurs still believe traditional VCs finance most startups
- Probably due to the NVCA's PR program and lobbying efforts
- The data shows that Angel Investors finance 27x more startups than traditional Venture Capital Funds
- More at: www.AngelBlog.net/Angels_Finance_27_Times_More_Start-ups_Than_VCs.html

Financing Today's Companies

- In America, Venture Capital Funds invest about $20 billion/year – and declining
- Angel investors also invest about $20 billion each year – and I think that number is growing
- Canada is about 10% of the US
- Even more surprising, Friends and Family investors invest about 3 to 5 times more than either VCs or Angels
- From "Fools Gold" by Scott Shane 2009

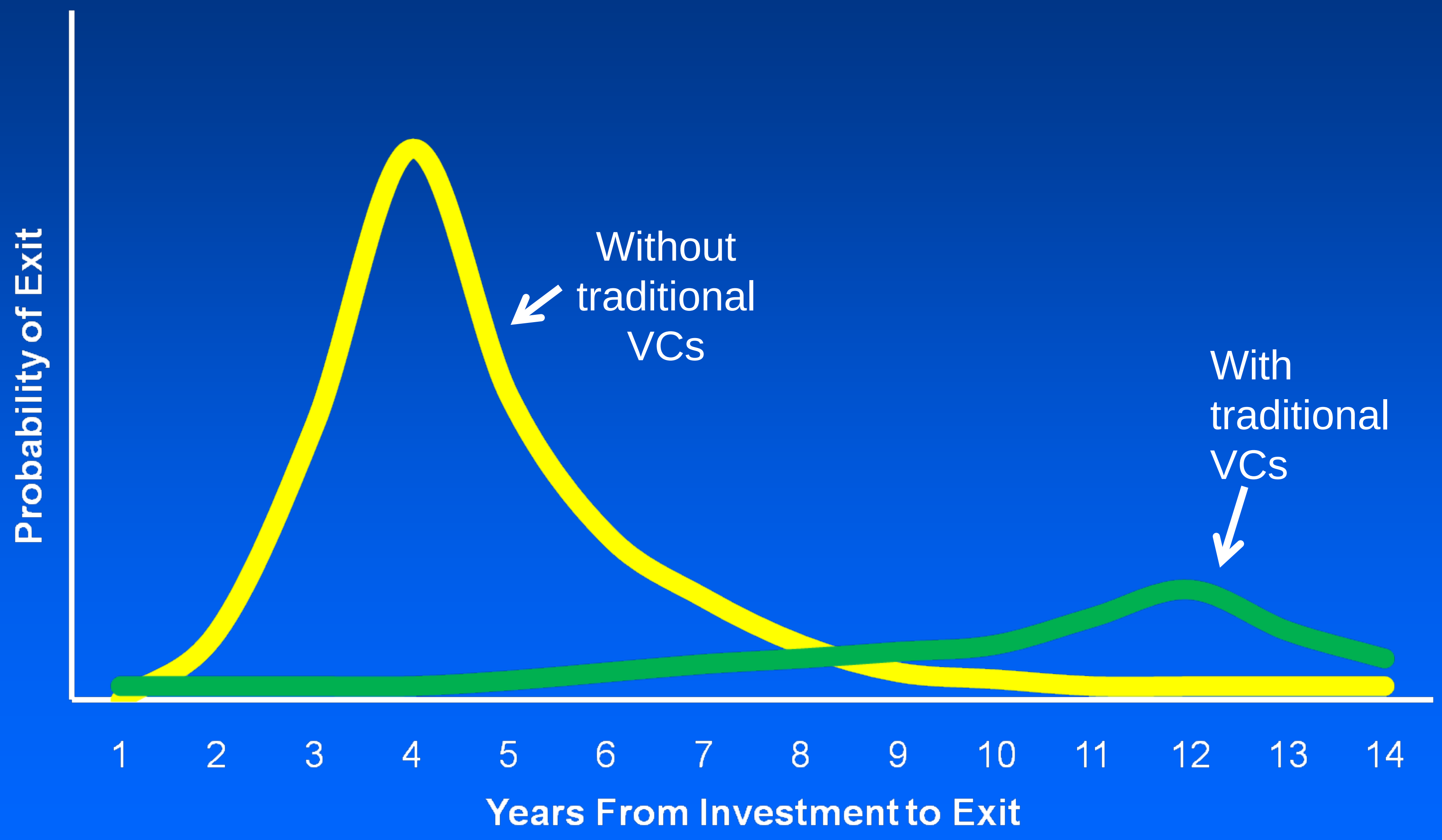
Angel Syndication

- Just a couple of years ago, the conventional wisdom was that angel investment topped out at around $1 to 2 million per company
- ACEF and ACA started talking about co-investment just a couple of years ago
- Now I often see groups of angels investing <u>$5 million to $10 million</u> in one company, over several rounds
- More than enough for today’s companies

Think Carefully About VCs

- When traditional Venture Capital funds follow on in angel investments, statistically:
- It takes about a decade longer to exit
- The risks increase substantially
- We don't have data yet, but I believe today the extra time, higher risks and dilution mean <u>lower average returns</u> for both the angels and entrepreneurs when traditional VCs invest

Exits Without and With VCs



Are VCs Ever a Good Idea?

- Does this mean angels should never let traditional VCs invest in their companies?
- Is it ever a good idea to invite VCs to invest?
- Please remember, these are statistics
- There are, of course, situations where the best decision is to have traditional VCs follow on
- It all depends on the type of company

When Do VCs Make Sense?

	Angels Only	Old VCs
Amount of capital required to prove the business model	Under $5 -10 million	Over $5 -10 million
Years before being able to exit	2 to 5 years	Over 10 to 12 years
Most likely value of the company at the time of the optimum exit	Under $50 million	Over $100 million

Not an option, or preference, this is determined by the ‘type’ of company

Summary on Financing

- Before you even think about financing, please have a clear exit strategy
- Bootstrap if you possibly can
- Friends and Family are the biggest source
- Angels can finance to $5 or 10 million
- Really understand the implications of VC funds
- Check the DNA compatibility first

References on Financing

- http://www.angelblog.net/Is_Angel_Or_VC_Financing_Best.html
- http://www.angelblog.net/Exits_with_VC_and_Angel_Investors.html
- http://www.angelblog.net/Financing_Strategy.html
- http://www.angelblog.net/How_to_find_an_angel_investor_in_Vancouver.html
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Questions on:

Section 3

Financing Your Company

The Optimum Exits Workshop
Section 4
How Early Can You Sell?

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How Early Can You Sell?

- A common misperception about M&A exits is that you have to grow the company to be profitable
- Or grow it to be larger than $X millions of revenue or value
- A myth perpetuated by M&A advisors
- The real threshold is to ‘prove the business model’

What it Means to Prove the Model

- In a recurring revenue business, for example, you have a spreadsheet that clearly shows actual results for:
  1. Gross margin per customer
  2. Customer lifetime (or churn)
  3. Cost of customer acquisition
- In other words, how much is a customer worth and what do they cost to acquire?

Proven Model and Value

- Some businesses have slightly different metrics to prove the model
- But when you prove the model you can build a credible projection that shows if:
  1. New owners added $X millions of capital,
  2. The business would have Y customers
  3. And be worth $Z millions
- Then you can successfully sell the business

It’s Often The Optimum Time

- As soon as you prove the model is often the <u>best time to sell</u>
- Always better to sell on an upward trend
- Sell on the promise not the reality
- Often when you can get the best price
- Very often ‘stuff happens’
- Most entrepreneurs wait too long to start

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

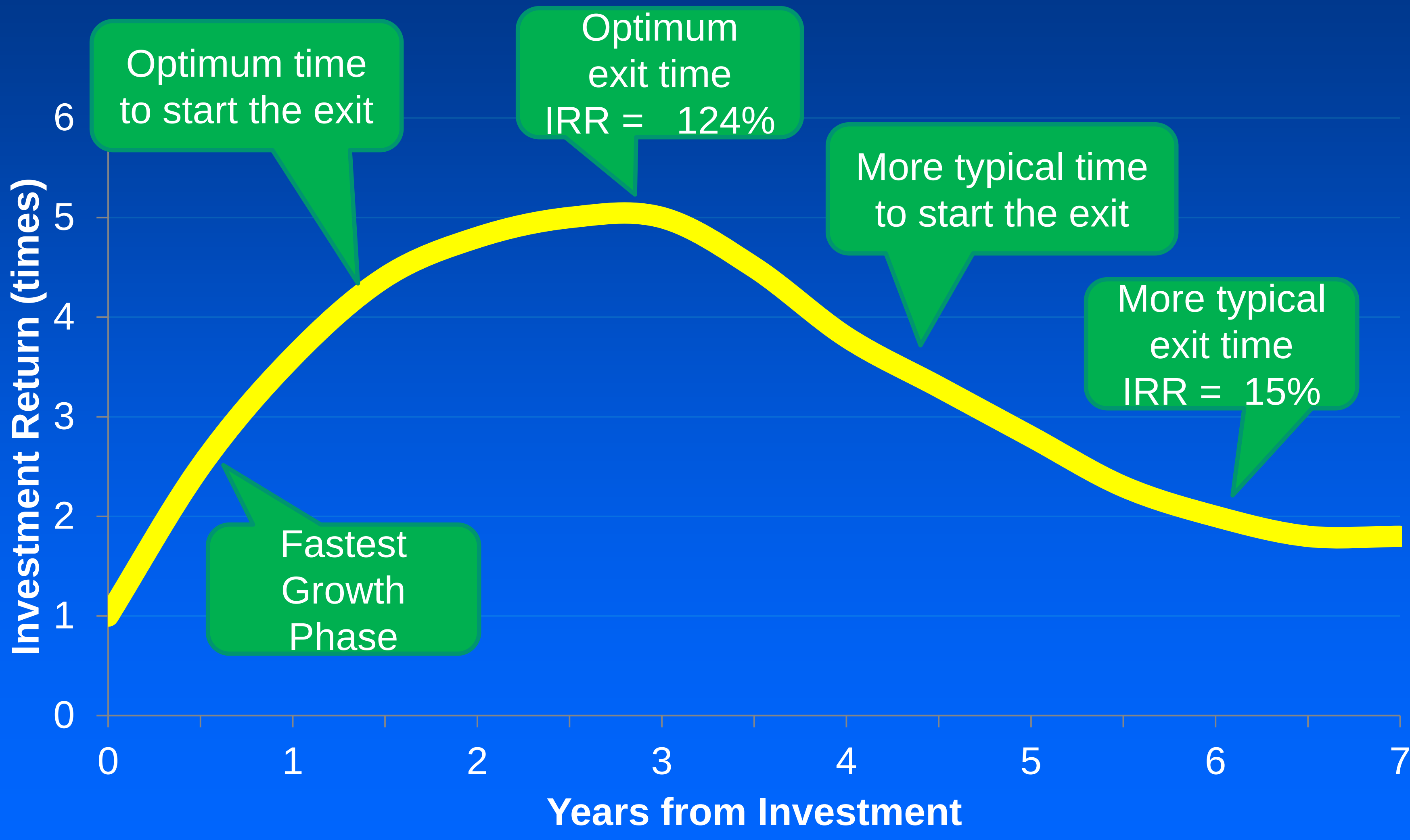
More Exits In Just 2 – 3 Years

- 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

The Most Heartbreaking Error

- The most heartbreaking error I see entrepreneurs and boards make is to exit too late
- It's caused by our fundamental human nature
- And happens primarily due to a lack of education
- In my opinion, more at the director level, than company management
- This is probably the single factor that could most improve the returns of angel and VC portfolios

Don’t “Ride It Over the Top”



This Happens Most of the Time

- Yes, most of the time boards and entrepreneurs miss the optimum time to exit
- Usually miss by a very large factor
- And depressingly often never end up exiting
- Exits are an underutilized business and life strategy
- For more on how not to miss your optimum exit:
- http://www.angelblog.net/Timing_Your_Exit_-_Dont_Ride_It_Over_the_Top.html

Local Example of an Early Exit

- I'd like to share an excellent example of an early exit within a few blocks of where we are now
- This transaction closed this quarter
- Unfortunately, I'm under a non-disclosure so I can't tell you the name of the company
- The company was less than 12 months old
- And had only two employees

Local Example of an Early Exit

- The CEO pitched a large, public US company on a paper design for their product
- He wanted to see if they might order some if he could deliver a prototype
- A couple months later, the US corp started to ask about acquiring the company
- The CEO contacted me for help
- And three months later, the cash was in the bank
- This was not a fluke – it happens all the time

The Tech M&A Golden Era

- There has never been a time before when
- It was so easy for entrepreneurs to create
- Such valuable companies
- On so little capital, and
- Sell them so early
- For so much money

Questions on:

Section 4
How Early Can You Sell?

The Optimum Exits Workshop
Section 5
Planning Your Exit

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The biggest misperception

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 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 an active sales process

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

Before Engaging with Buyers

- A common, and expensive, mistake is talking with potential 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

Add a Drag Along to the Articles

- To ensure that a return can be provided to all of the shareholders
- The investors require a "drag-along" right be added to the Company's constating documents
- To allow the holders of 51% of <u>all</u> the issued shares of the Company to cause the sale of the Company
- Please think carefully about this and get advice

Employment and IP Agreements

- Do the deep patent 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
- Consider reporting in US currency
- Don’t pay your outside accountants double at the end to do the review or audit

Tax Planning

- Tax planning is a very important part of planning every exit
- Especially in Canada because we now have some of the best tax benefits related to exits
- The $750,000 lifetime capital gains tax exemption for example
- And our improved tax integration and roll overs
- It’s mind numbingly complicated
- Every company needs professional help early

Consider a Secondary Sale

- A secondary sale is where new investors buy founders’ and early investors’ shares
- A secondary share sale can be almost ‘magical’ in finalizing alignment and solving structural defects
- Considered almost impossible a decade ago
- Today, secondaries are much easier to do
- Buyers are usually Angels and small funds

Successful Secondary Sales

- Secondaries can be successful, if:
  - The price is reasonable (-30 to - 40%), and
  - There is a clear exit strategy, and a
  - Good team in place to execute the exit
- For example, the ParaSun case study
- In that case, the buyers were angels and other accredited investors (about a dozen)
- ACA Webinar on Secondary Markets

Unsolicited Offers

- What if you get an unsolicited offer?
- Most of the time it’s not good news
- Yes – it’s a bad thing 90+% of the time
- Even if you aren’t sure, get help immediately
- Need to make a very fast decision and you will need expert help

Two Choices

- If you get an unsolicited offer you can:
  1. Risk trying to close it, or
  2. Gamble that you can delay long enough to generate competitive bids
- The buyers are usually more experienced
- They'll know what you are thinking
- And are usually a few moves ahead

Unsoliciteds Shouldn’t Happen

- If you get an unsolicited offer, then 90% of the time you weren’t paying attention
- It usually means you’ve waited too long to start your exit
- Even if you don’t want to accept you should engage a pro and start your exit
- Of course, there are exceptions to every rule
- I’ll tell you about one in a few minutes

Videos on Planning Exits

- Early Exits Workshop – Part 2 – Exit Strategy
  ACA Annual Summit, San Francisco
- Exit Early – Exit Often
  South East ACA / Capital Connects, Greenville
- Exit Strategies for Angel Investors
  North West Energy Angels, Seattle
- All available from www.AngelBlog.net

Questions on:

Section 5
Planning for Your Exit

The Optimum Exits Workshop
Section 6
Exit Valuation

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It’s Usually Pretty Simple

- I have a whole shelf full of books on valuation
- But in 95% of exit transactions, it’s really not that complicated
- Valuation is based primarily on:
  1. Financial fundamentals
  2. Industry comparables
- It’s not an exact science
- Requires lots of experience to be good at

Valuation Principles

- Most valuation methods are based on discounted future cash flow (profit or EBITDA)
- Recognizes interest rates and the imperfect predictability of future earnings
- An easier way to think of it is to imagine that the buyers want to finance the entire purchase with debt
- And have the company pay off the entire debt in 5 to 7 years

Valuation Principles – No Growth

Zero Growth	Profit in the year	Present value of this year's profit
End of this year	1,000,000	$820,000
End of next year	$1,000,000	$672,400
Three years from now	$1,000,000	$551,368
Four years from now	$1,000,000	$452,122
Five years from now	$1,000,000	$370,740
Six years from now	$1,000,000	$304,007
Seven years from now	$1,000,000	$249,285
Eight years from now	$1,000,000	$204,414
Nine years from now	$1,000,000	$167,620
Ten years from now	$1,000,000	$137,448
Total Present Value		$3,929,403

In this zero growth example the value is about 4x the current year profit (EBITDA)

Valuation Principles - 25% Growth

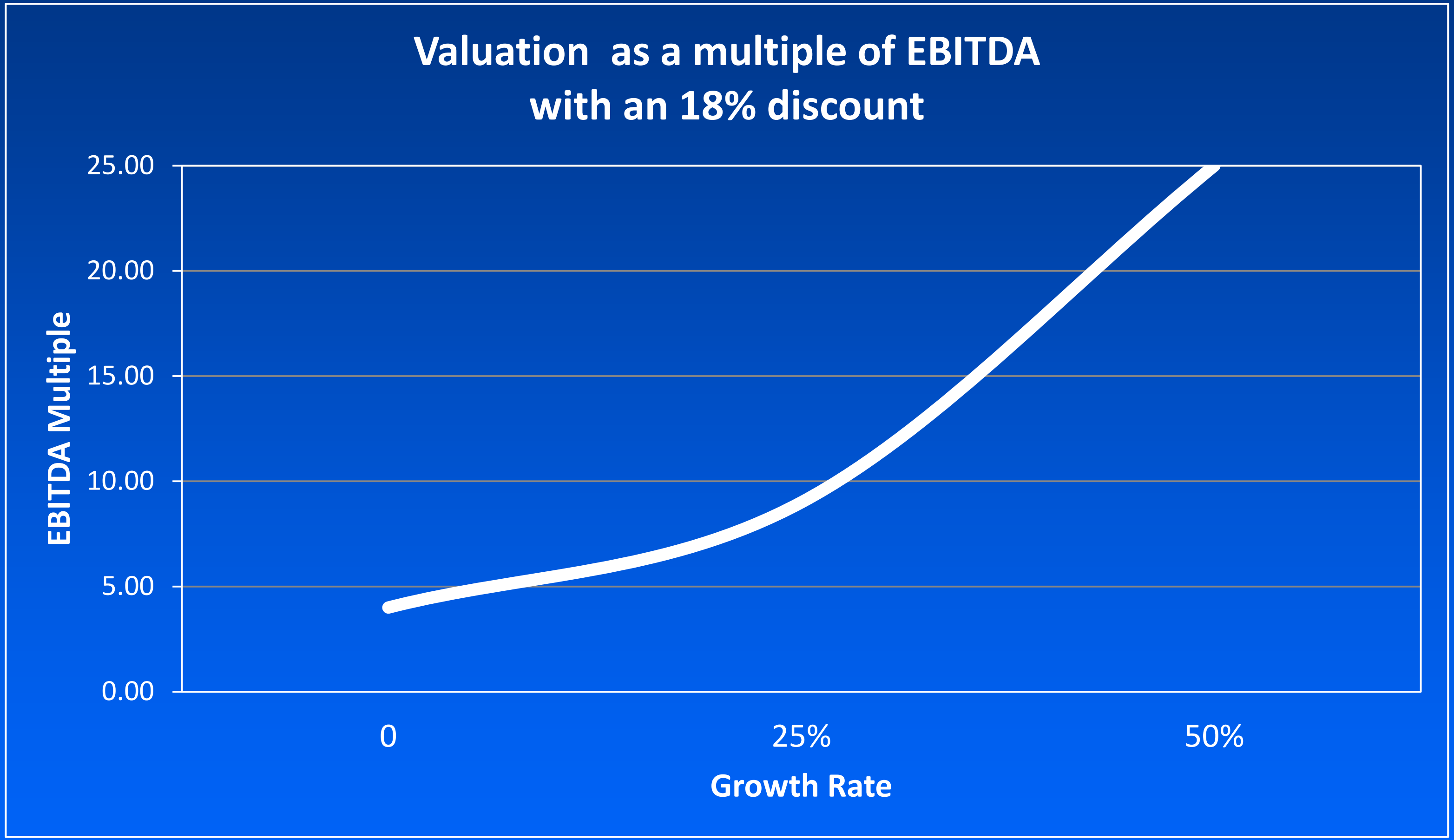
25% Growth	Profit in the year	Present value of this year's profit
End of this year	$1,000,000	$820,000
End of next year	$1,250,000	$840,500
Three years from now	$1,562,500	$861,513
Four years from now	$1,953,125	$883,050
Five years from now	$2,441,406	$905,127
Six years from now	$3,051,758	$927,755
Seven years from now	$3,814,697	$950,949
Eight years from now	$4,768,372	$974,722
Nine years from now	$5,960,464	$999,090
Ten years from now	$7,450,581	$1,024,068
Total Present Value		$9,186,773

In this 25% growth example the value is about 9x the current year profit (EBITDA)

Valuation Principles - Growth

- The $1 million profit, zero growth company was worth about $ 4 million
- The $ 1 million profit, 25% growth company was worth about $ 9 million – 2x more
- In the public markets rule of thumb is that the P/E ratio is about the same as the growth rate
- In other words a 10% growth company has a P/E ratio around 10x and a 20% closer to 20x

Valuation Principles - Growth



Valuation depends on the growth rate and the buyers perception of the profit predictability

Profit Predictability

- Predictability is a very significant factor in every valuation
- If the buyer is almost certain the future earnings will actually occur, valuation is close to the previous calculation
- But its never easy to predict the future – especially these days
- So the buyers will discount the price to factor in their perception of profit predictability

Liquidity and Control

- When looking at public comparables
- Remember that valuations for private companies are about 30 to 40% lower
- Called the ‘discount for illiquidity’
- A counter balancing factor is the ‘control premium’
- Buyers will usually pay significantly more for enough shares to have absolute control

Assets or Shares

- The same business can have a valuation that is a quarter to third higher depending on whether it is a share sales or an asset sale
- The difference is due to:
  1. Tax
  2. Risk
- Sellers usually prefer share sales and buyers often prefer asset sales

Market Factors

- The same business can also have a very different price depending on the market
- We can all see the macro economic effects on public market valuations
- Private transaction valuations are even more volatile
- Market illiquidity for private companies can be a significant

Please Don’t Pay for a Valuation

- There is an entire industry that charges companies for valuations
- Usually costs $15,000 to $50,000
- Those valuations are not to price exits
- They are more often for divorces or taxes
- If you really want to know what you company will sell for, find someone who sells companies like yours and ask them

Reference on Valuation

- For more detail on the previous examples
- And suggestions on the least expensive way to get an exit valuation for your company
- http://www.angelblog.net/Business_Valuation_-_What_will_your_company_sell_for.html

Discussion on:

Section 6
Exit Valuation

The Optimum Exits Workshop
Section 7
Exit Timeline

Acetech

Vancouver, BC

December 9, 2010

Basil Peters

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 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

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

Before Talk To Buyers

- 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

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

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 be fully engaged, and 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

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

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
- Plan, and watch carefully for, for deal fatigue

Questions on:

Sections 7
The Exit Timeline

The Optimum Exits Workshop
Section 8
The Exit Team

Acetech

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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

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’

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
- Might never have a 'real' board
- Exit knowledge and experience is even more critical for these young companies

The Exit Coach

- Has created demand 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’ ($1k to 6k /month)
- To work with the CEO before the company engages a full M&A advisor
- And to help select the M&A advisor
- http://www.Angelblog.net/The_Exit_Coach.html

Selecting The M&A Advisor

- There is almost nothing written about selecting M&A advisors
- The majority make sub-optimum choices
- 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 – and often 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:
  - 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
- http://www.angelblog.net/M&A_Advisor_Fees.html

Failure is Quite Common

- One of the secrets of the M&A business is that M&A professionals often fail to complete a transaction
- There are no statistics on this and the professionals never talk about it
- I have been asking companies for years
- The fault is usually the company’s and the cause is often the same - communication

M&A Advisors Should Be Local

- CEOs and boards often start to look for an M&A advisor in the big financial centers
- Dirty secret is that about a third of M&A engagements fail to complete a transaction
- And the failure rate increases as the distance to the M&A advisor increases
- 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
- http://www.angelblog.net/M&A_Advisers_Should_be_Local_to_Reduce_Transaction_Failures.html

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

Questions on:

Section 8

The Exit Team

The Optimum Exits Workshop
Section 9
Maximizing Value

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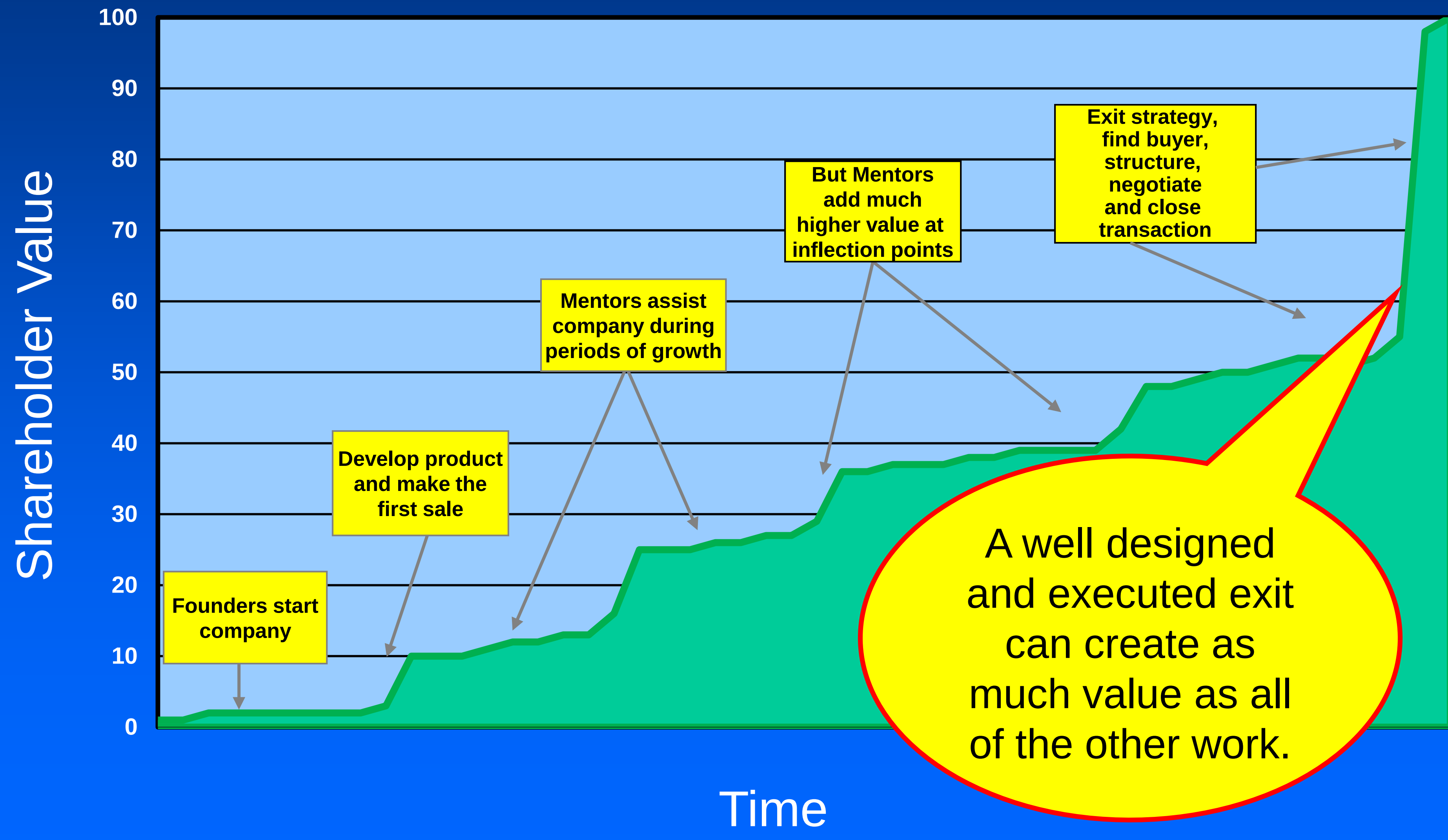
Vancouver, BC
December 9, 2010

Basil Peters

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 advisor

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 sellers
- Sellers often leave $ millions on the table – and not even know – most buyers are pros

Benefits of Multiple Bidders

- An unsolicited offer 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 help to <u>increase the final price by 50% or more</u>
- http://www.angelblog.net/Exit_Strategy_Selling_A_Business_Can_Increase_Its_Value_by_50pct.html

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
- Most of the time, everyone has to sign an NDA

Resources on Maximizing Value

- http://www.angelblog.net/Exit_Strategy_Selling_A_Business_Can_Increase_Its_Value_by_50pct.html
- http://www.angelblog.net/Exit_Strategy_Selling_a_Business_and_Inefficient_Markets.html
- http://www.angelblog.net/Exit_Strategy_Creating_Strategic_Value_When_You_Sell_A_Business.html
- http://www.angelblog.net/Exit_Strategy_Every_Company_Sale_Needs_Multiple_Bidders.html
- http://www.angelblog.net/Great_M&A_Advisors_Sell_Companies_for_More.html

Questions on:

Section 9

Maximizing Exit Value

The Optimum Exits Workshop
Section 10
Closing and Life Strategies

Acetech

Vancouver, BC

December 9, 2010

Basil Peters

Reps and Warranties

- A lawyer friend says more M&A transactions fail on reps and warranties than on price
- Basically a personal guarantee from the CEO and other major shareholders
- To protect the buyers against future liabilities or misrepresentations
- The scariest thing you will ever sign
- Start to really understand this 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)

We Need More Exits

- The world has changed
- The economy has changed – a lot
- Even our species has changed
- In my opinion, we'd all be financially better off
- And the economy would be healthier
- And there would more jobs for our children
- If we designed and executed more exits

An Underused Life Strategy

- I also believe exits are an under-utilized life strategy
- Very entrepreneurs even think about it
- Many fear it
- I’ve never met someone who wasn’t much happier after
- We have the freedom to do it again
- Or do something different with our lives

My Wish For You

- Exit Early
- Exit Often

Resources on Exits

- www.Early-Exits.com – my book on exit strategies for angels and entrepreneurs
- www.AngelBlog.net – my blog for entrepreneurs and angel investors
- 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

Questions on:

Section 10

Closing and Life Strategies