

Start at the End - Your Exit Strategy

New Ventures BC Seminar

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Outline

- Congratulations on almost completing the 13th annual New Ventures Seminar Series.
- This is the last module
- We'll be speaking about your exit strategy
- Using a real-life case study
- Singular Software
- Top 10 in New Ventures in 2008

Introductions

- For a talk like this, we believe it's helpful
- To know a little about us,
- Our backgrounds, and
- Experiences that helped us learn
- What we'll be sharing with you this evening

My Background and Perspective

- I am a geek, techie, nerd
- PhD in Electrical and Computer Engineering from University of British Columbia in 1982
- Started my first company at grad school
- Nexus grew to be the world's 2nd largest manufacturer of cable TV headends
- Sold in 1993 to Scientific Atlanta and is now part of Cisco

My Tech Investment Funds

- When we sold Nexus, it was the first time I had money to invest
- Been an enthusiastic tech investor since
- Founded and managed a:
 - Hedge fund – 1996 to 2000
 - Venture Capital Seed fund – 2002 to 2006
 - Angel fund – 2005 to 2011
- Now run a boutique M&A Advisory firm

My Investments and Financings

- I've made about 100 early-stage technology investments
- Slightly less than half produced a return
- I've been directly involved in over 100 technology company financings
- All were successfully completed
- I've worked directly on several dozen exits

My Background

- Ph.D. in Math from UBC in 1984
- MacDonald Dettwiler for 8 years
- Worked in digital signal processing
- Gravis, SoftQuad, BlastRadius, JustSystems
- Filmmaking, shooting video was a hobby

This is a Golden Era

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

Only 25% of Saleable Businesses Successfully Exit

- Yes, of the startups that actually succeed,
- And get financed,
- And scale up to be worth millions,
- Only one quarter actually successfully exit!
- The data does not yet exist to prove this,
- But I'm sure it's correct (approximately)

Ensuring You Succeed

- Why do 75% of successful businesses fail to exit?
- It's simply a lack of knowledge
- About what works today in the entrepreneurial economy
- Today, we want you to learn what's changed and what you need to do to be one of the successes.

Singular Software's Origins

- We started to shoot multiple camera videos
- Always with separate audio, for quality
- Multiple recordings have to be synchronized
- Hollywood uses “slates”
- Pro video (network TV) uses “timecode”
- But prosumer cameras don't have timecode
- That leaves... sync by hand (ugh)

The Pain

- We were getting paid to make videos
- Made sense to buy some software
- Surprise! Not available anywhere
- I believed there had to be a solution

Product Development

- Did much of the initial code work myself
- Took a few years
- Launched the first version of the product for Apple's Final Cut Pro at NAB in 2009
- Supported other video editing software packages: Adobe, Sony, Avid, Grass Valley
- Really looked forward to hiring first employee

Business Development

- 2007: Incorporated the company
- 2008: New Ventures BC (Top 10)
- 2009: Shipped first product
- 2010: Hit run-rate revenue of \$1M, 6 people
- 2012: Patent granted
- Was the first to market, always the leader
- Just as DSLR video hit the market (luck!)

The Two Types of Companies

- All companies can be divided into types:
 1. Companies built for cash flow to owners
 2. Companies designed for an exit
- Neither of us understood that when we started our first companies
- Only one type works for investors

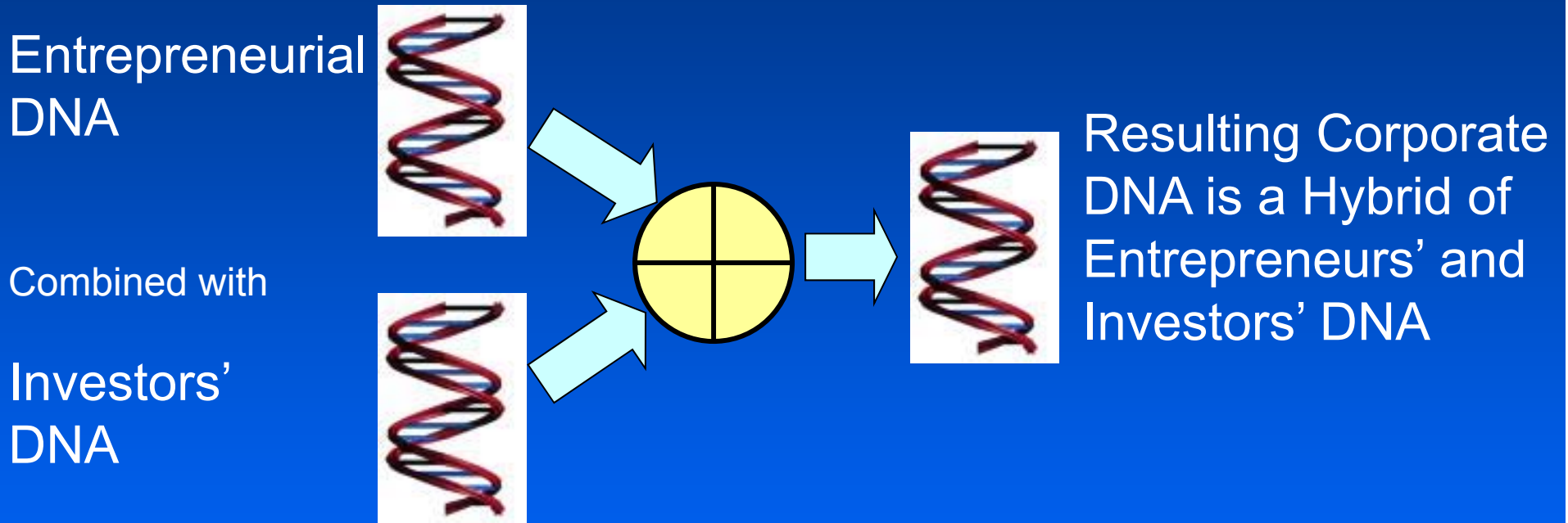
The Truth About Investors

- We are a pain in the a__s!
- We will want:
- A ton of documentation and financial reports
- Board meetings
- To help (not always a good thing)
- To get our money back
- You need an exit strategy before you ask us
- The rest of this talk will explain why

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

Check Financial DNA Before



Check the compatibility first

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:
- www.exits.com/blog/how-not-to-sell-a-business/

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

The Important Elements

- An Exit Strategy could 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]_.”
- Or it could be an IPO or RTO and I-bank
- Formally check alignment at least annually

Check The Alignment

- It's surprising how often there is a misalignment 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
- After, check alignment at least annually

Financing in Previous Times

- When I was a young entrepreneur,
- Didn't matter if it was a hardware company or a software company
- Most companies cost \$10s millions to build
- That created the enormous venture capital industry that's still around today
- And many common misperceptions...

What are your financing options?

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

If you really do need investors

- If you really can't bootstrap,
- What are your options to raise private capital for your company?
- How many of you are planning to go to a VC fund to raise your startup capital?
- How many are planning on angel investors?
- How many on bootstrapping?

Who Actually Finances Startups?

- I asked how many of you were planning to raise your startup capital from VC funds
- A surprising number of entrepreneurs still think VCs finance startups
- The actual data is that Angel Investors finance 27x more startups than VCs
- www.AngelBlog.net/Angels_Finance_27_Times_More_Start-ups_Than_VCs.html

The Really Big Money

- In America, each year Venture Capital Funds invest about \$20 billion
- Angel investors also invest about \$20 billion each year
- Even more surprising, Friends and Family investors invest about 5 to 10 times more than either VCs or Angels
- From “Fools Gold” by Scott Shane 2009

Financing Singular Software

- A key question for me during NVBC
- Bootstrapped (we dipped into the nest egg)
- But it didn't take much
- Software business: can pay as you go
- We quickly became and stayed profitable

Virtual Company

- Most of my career: traditional software shops
- With org charts, offices, department heads
- Singular was always a virtual company
- My philosophy: outsource everything that is not a core competence of the company
- My other philosophy: spend \$ to make \$

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

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
- It's easy to show that the median price is under \$20 million
- I think its probably below \$15 million
- That's seemed surprising to me the first time...

Ways to Exit

- There are basically only two ways to sell your company:
 1. An IPO (going public)
 2. An M&A transaction (private sale)
- These days it's almost entirely M&A

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
- 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

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

Our 21st Century Economy

- What works today:
 1. Small companies innovate and bootstrap
 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

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

A B.C. Really Early Exit

- This Vancouver company asked me to keep their details confidential – for now
- This startup wanted to test the idea for their first product, so they called on a medium 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

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

Singular's Exit Strategy

- First met Basil Peters at NVBC
- He emphasized importance of planning exit
- I took that to heart... for about two weeks
- Then I got busy
- Two years later, he reminded me

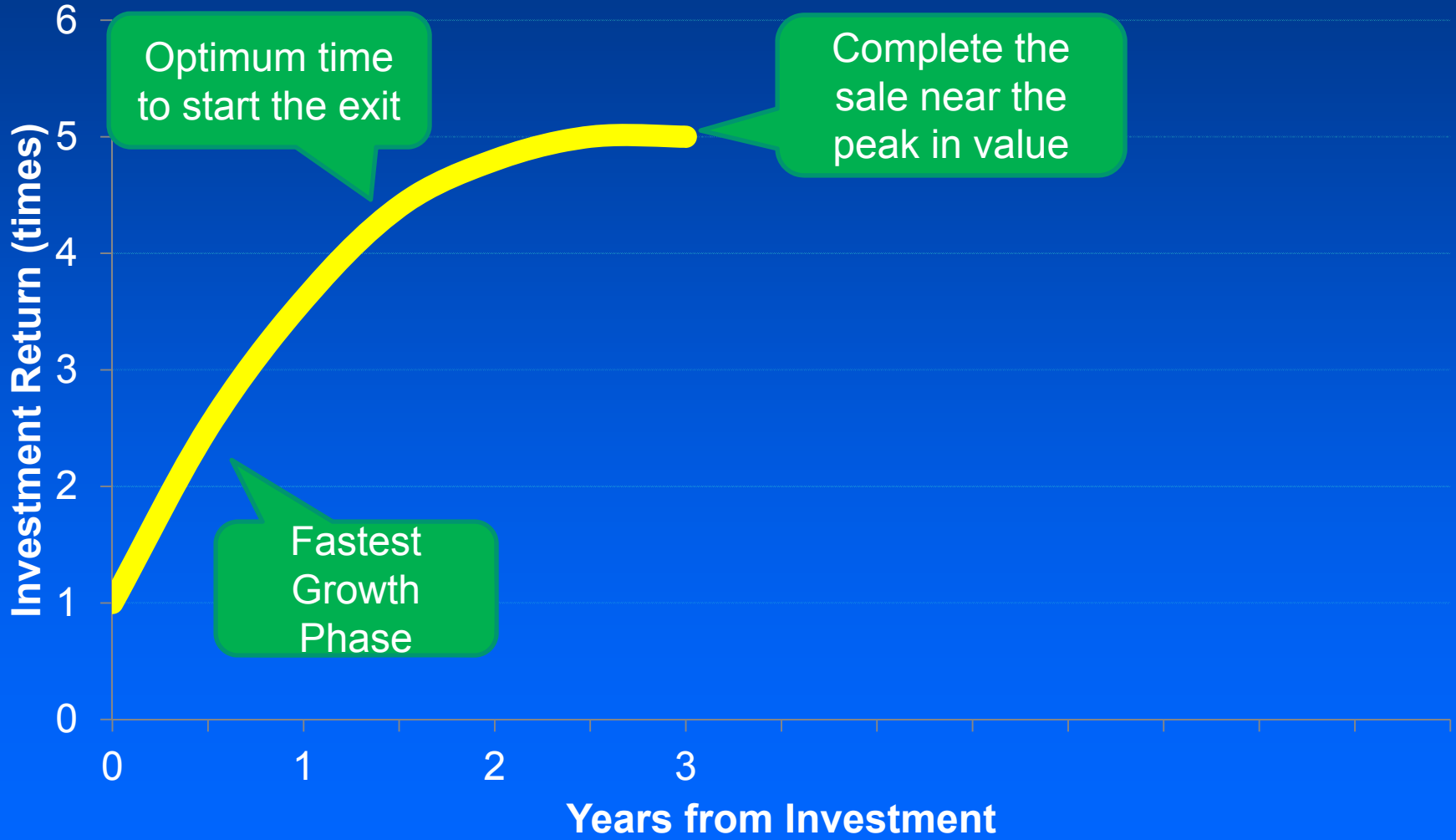
Exit Strategy Evolves

- I immediately knew it was time to act
- That was my gut, my head took longer
- We met several times
- Basil provided names of other M&A advisors
- I shopped around and came back
- Engaged Basil's company in March 2011

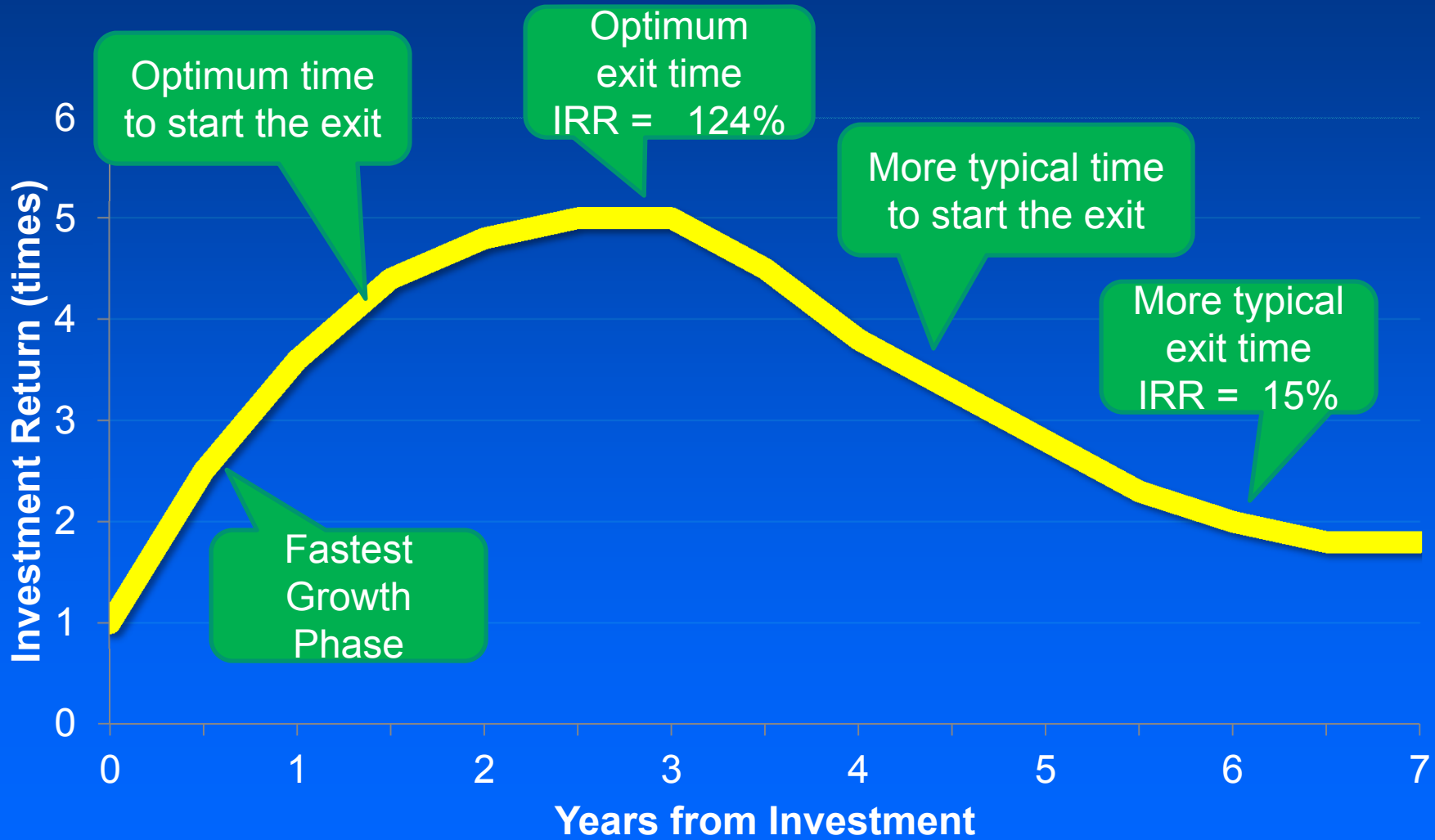
Ideal Exit Timing

- It usually takes 6 to 18 months to sell a company
- In an ideal situation, the company would incorporate this 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

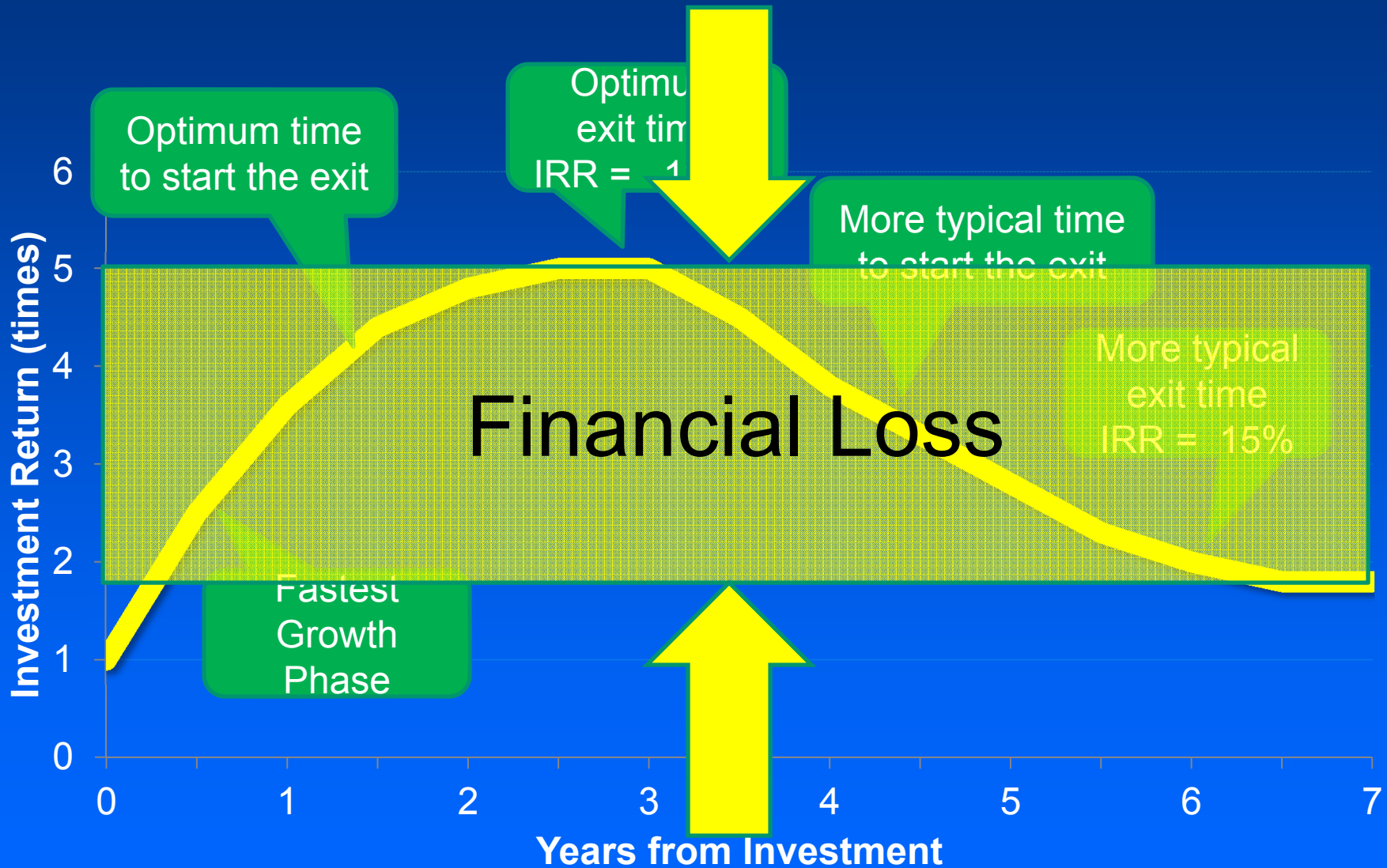
Ideal Exit Timing



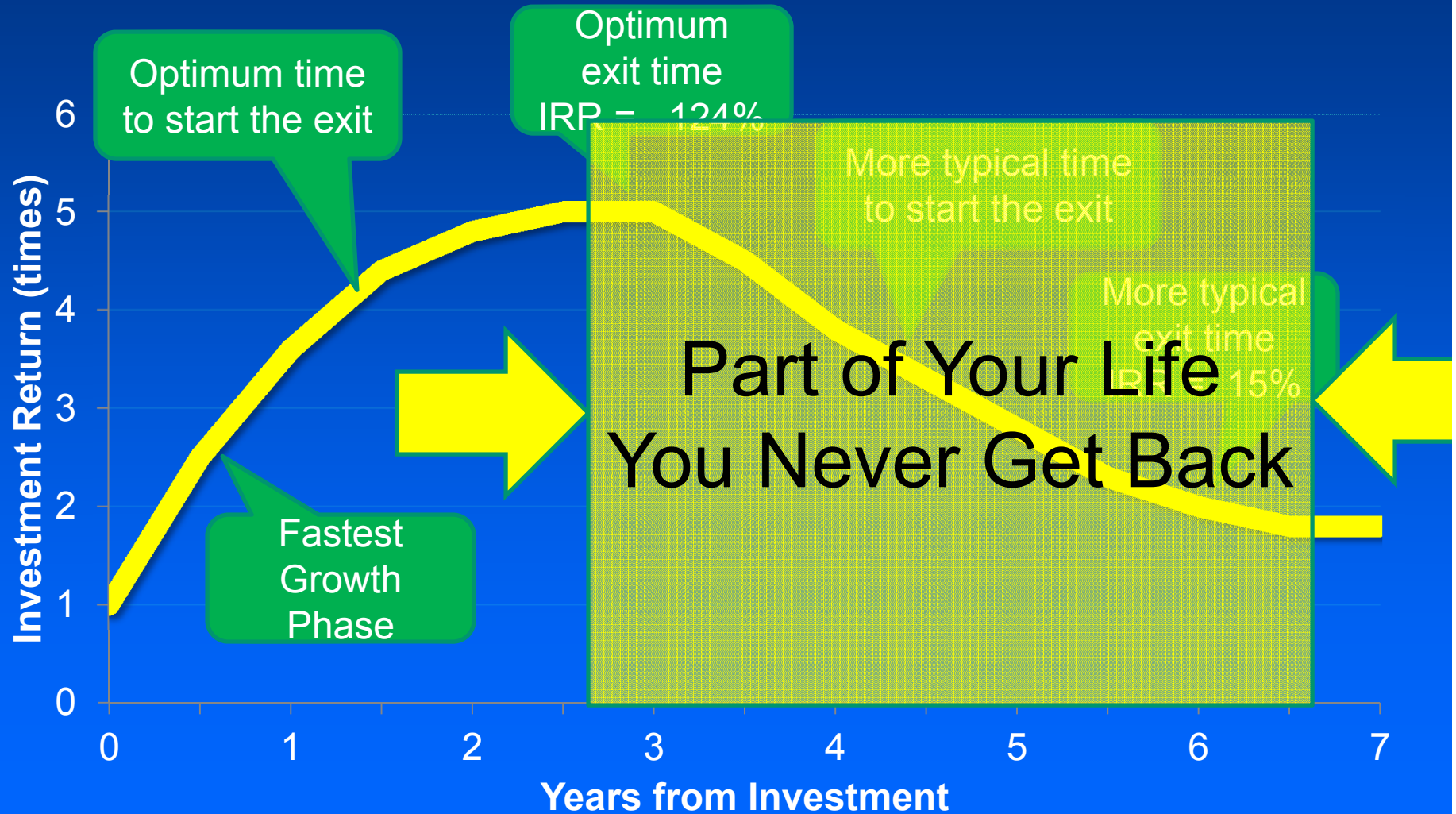
“Riding It Over the Top”



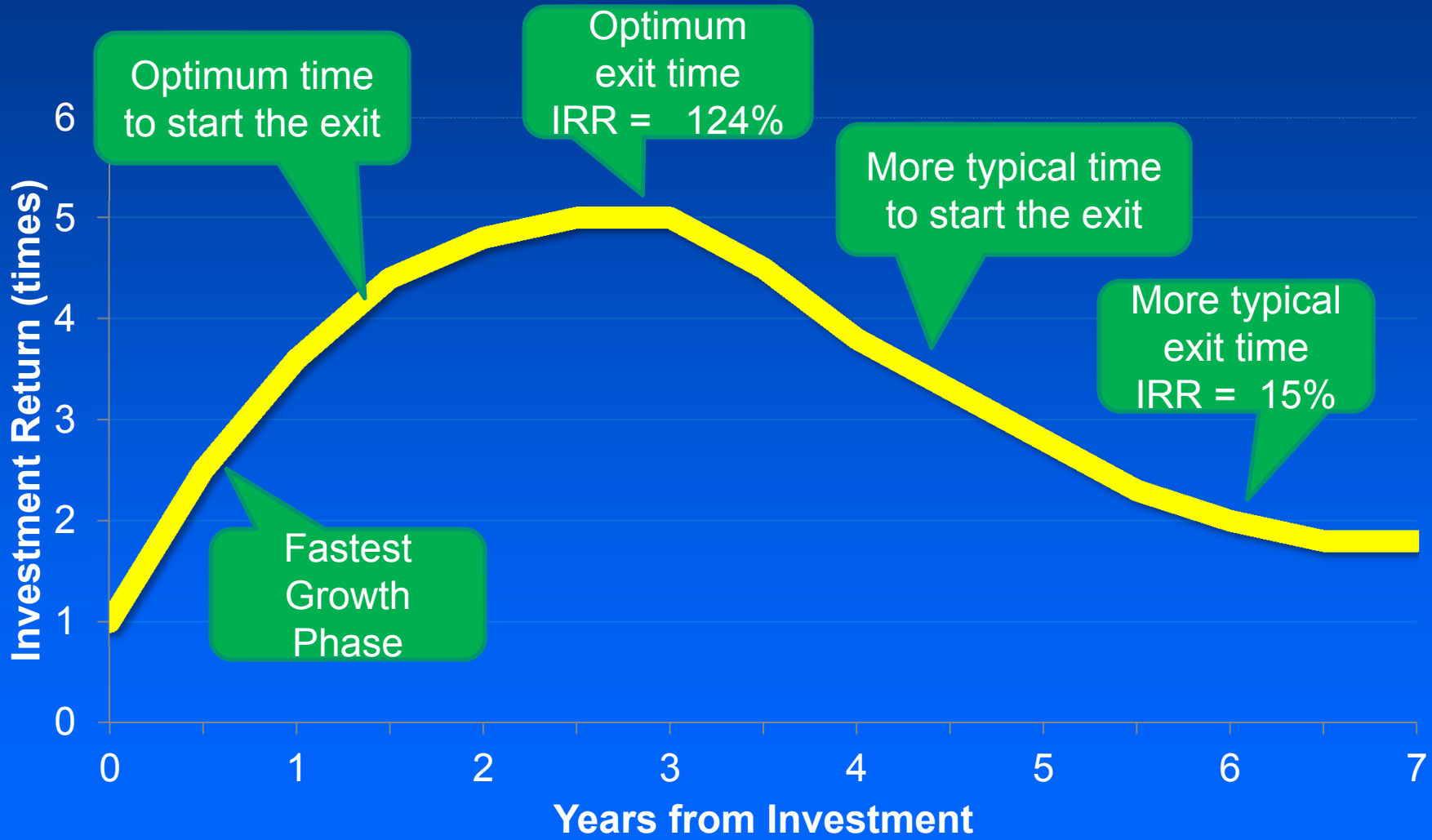
The Financial Loss



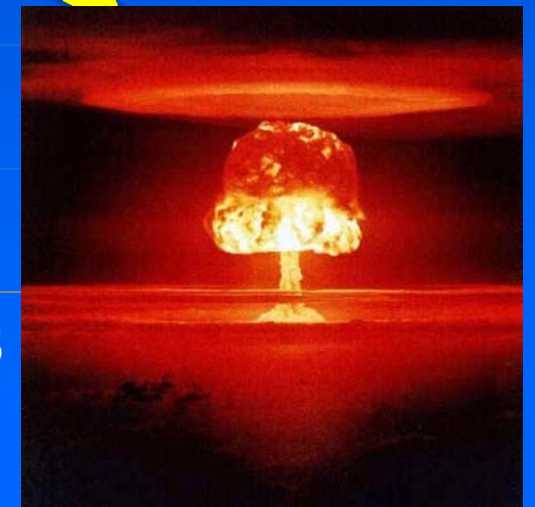
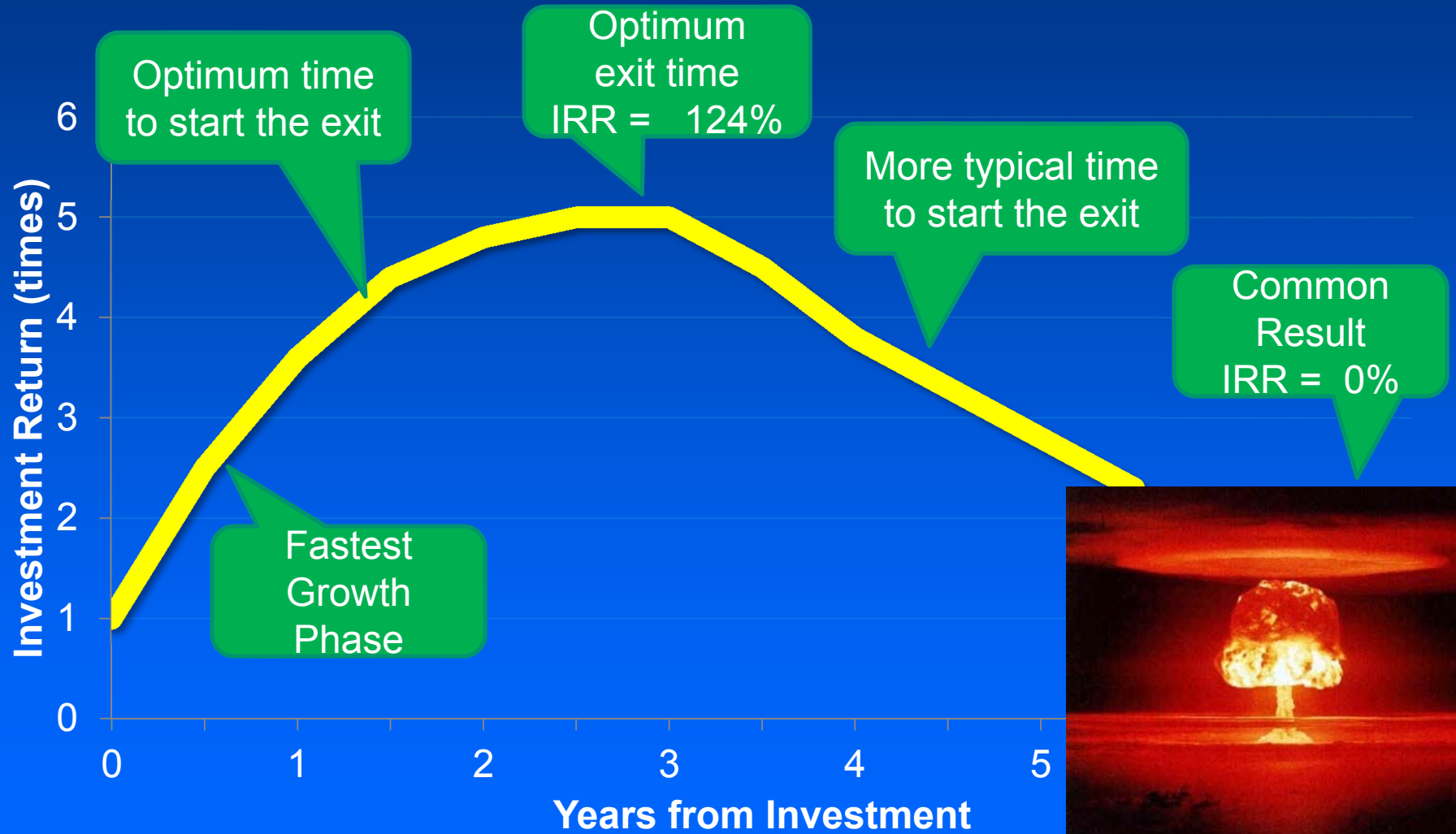
Part of Your Life You Never Get Back



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 missed the ideal time to exit
- There was a good probability it would not just exit for less,
- But end up never exiting

Reasons This Happens

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

(More on this in my other talks on Exit Timing and The Wave at www.Exits.com/blog)

Missing the Wave

- Missing the Wave of Consolidation is a particularly heartbreaking error
- Many of the companies that missed it were quite profitable and very valuable
- The wave destroys both
- For CEOs that have built successful businesses
- Not missing the wave might be their most important job

Singular's Exit Timeline

- Engaged Basil's company in March 2011
- Had the financial model and Information Memorandum drafted by May 2011
- Closed the transaction in July 2012
- About 16 months after signing the engagement

The Acquirer: Red Giant

- Basil contacted about 50 companies
- We received more than one written offer
- Red Giant approached us before we approached them
- Same market, complementary products, a leader in the category, similar culture
- I liked the founders right away
- My gut said it would be a good fit and it was

The M&A Advisor's Contribution

- The negotiation phase is where the advisor really helps
- At several critical points in the process, Basil introduced ideas I would never have thought of
- These:
 - Helped to ensure the deal actually closed
 - Ensure the terms met my goals
- “Basil that was [expletive deleted] amazing!”

The Joys of Cross Border

- I'd been part of the senior team in four previous transactions
- So, some experience but I wasn't a principal
- A cross-border acquisition has lots of wrinkles
- Basil's experience here really helped

Tax Complexities & Innovations

- Taxes are always mind-numbingly complex
- In a cross border deal, the tax complexity multiplies
- Basil introduced me to Don Furney of PWC
- Don did some very insightful tax work that helped both me and the buyer

Summary on the Exit Environment

- Most acquisitions are under \$15 million
- Modern companies don't need much capital
- Bootstrap if you possibly can
- Angels can finance up to \$5 to 10 million
- The optimum exit strategy is to target an exit for under \$30 million
- To maximize success - Start at The End

Summary on Singular's Exit

- I had a number in mind and reasons for exiting
- Basil brought a lot of experience and innovation to the process
- I leaned on him a lot
- I got what I wanted, couldn't have done it without him

Singular In Retrospect

- Bruce, it's been about a year since you sold Singular to Red Giant
- How does it feel to you now?
- What would you have done differently?
- What would you most like to share with this generation of New Ventures grads?

Resources

- www.AngelBlog.net – blog for entrepreneurs and angel investors
- www.Exits.com/Blog - blog on exits
- www.Early-Exits.com – book on exit strategies for entrepreneurs
- www.BasilPeters.com – for this PowerPoint and videos of previous talks