

# Start at the End - Your Exit Strategy

New Ventures BC Seminar

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# Outline

- Congrats and Why Are You Doing This?
- Do You Even Want (or need) Investors?
- Why You Need an Exit Strategy First
- M&A Exits are Happening Earlier
- Companies Don't Need As Much Capital
- Differences Between Angels and VCs
- Optimum Strategies for Entrepreneurs

# Qualifiers on This Presentation

- I was a technology entrepreneur
- And now I am a technology investor
- My comments are from that perspective
- Financing and exit strategies are different for life science and energy companies
- I am not including 'public market' financial strategies until those markets recover

Why Are You Doing This?

# Congratulations on Being An Entrepreneur

- For those few among us that can,
- I think it is the best business-life choice.
- I'd like to start by having you ask yourself:
- Why are you doing this?
- Seriously.

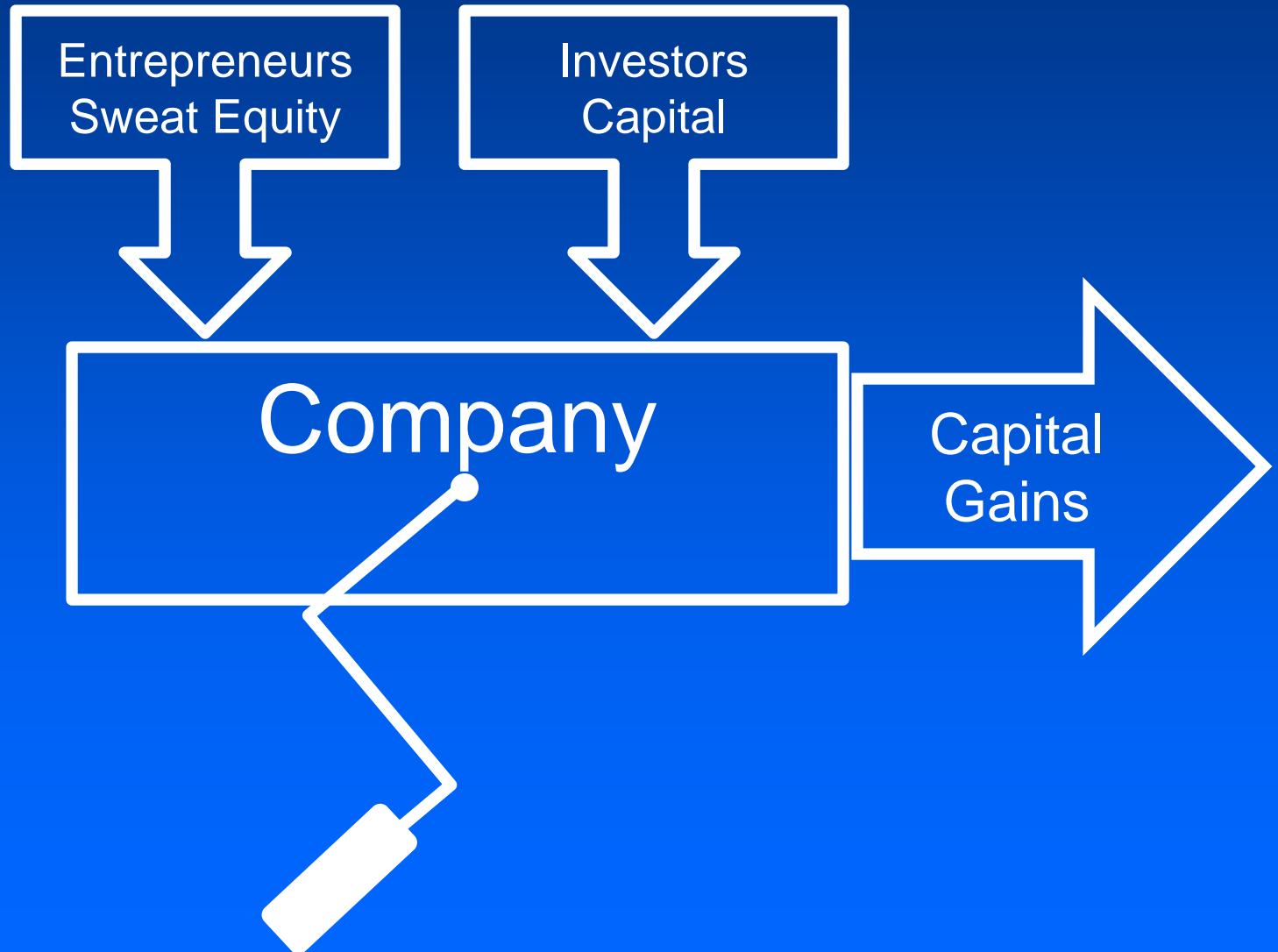
# Entrepreneurs Have Complex Motivations

- To what extent are you doing this because:
- You can't get a paying job?
- It's the most exciting thing you can think of?
- (that's legal)
- You like learning so fast it feels like your head might explode – most days?
- To make a truly huge amount of money?

# For Investors – It's Easy

- I am an investor
- Unlike you entrepreneurs, I just want one thing
- That makes it simple from my perspective
- This is what your company looks like to me
- And every other investor

# Simple Model of a Company





# 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

What's Happening in Exits Today?

# Two Types of Exits

- There are basically two types of exits:
  1. Going public (an IPO or RTO)
  2. Being acquired (an M&A transaction)
- Today, there is effectively no IPO market
- So I am only talking about M&A exits today

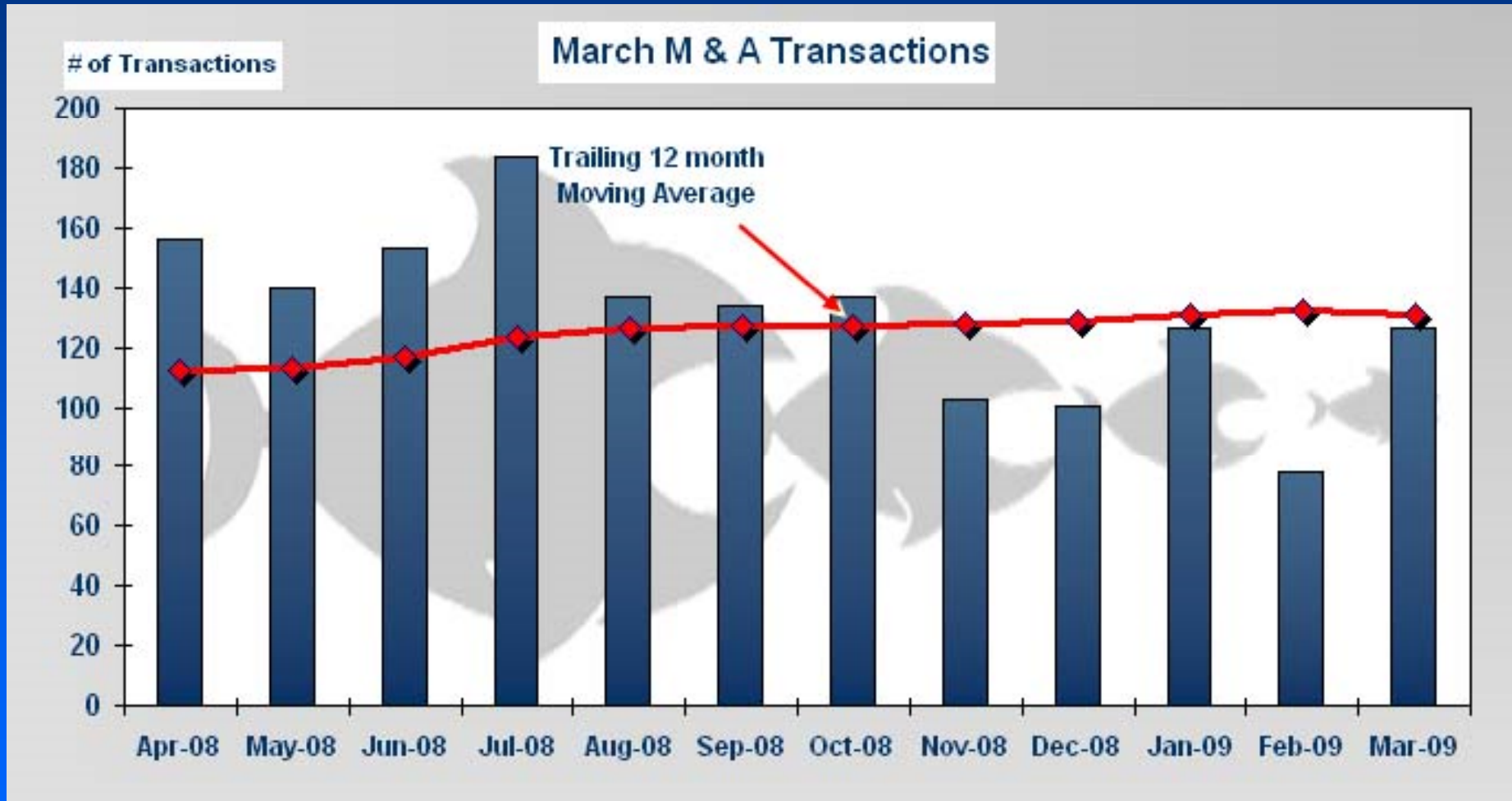
# Lots of Doom and Gloom in Exits

- Lots written recently in the mainstream press about the bad news in exits
- IPOs have almost disappeared
- Total M&A transaction dollar volume has fallen by at least a third
- That's true, but it's only part of the story

# We Always Hear About The Big Exits

- The media always reports the really big exits
- From my neighborhood, it's exits like Club Penguin's \$350 million sale to Disney or Bioware's \$800 million sale to EA
- Those exits aren't happening very often now
- The 'new' big story is the large number of smaller exits

# Small M&A Transactions



From: Current Environment for Exits by Brent Holliday, Capital West Partners

# Most Exits Are Under \$20 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
- I estimate the median price to be well under \$20 million
- And probably below \$15 million

# Examples of Under \$30 Million

- Google bought Adscape for \$23 million (now AdSense)
- Google bought Blogger for \$20 million (rumored)
- Google bought Picasa for \$5 million
- Yahoo bought Oddpost for \$20 million (rumored)
- Ask Jeeves bought LiveJournal for \$25 million
- Yahoo bought Flickr for \$30 million (rumored)
- AOL bought Weblogs Inc for \$25 million (rumored)
- Yahoo bought del.icio.us for \$30 – 35 million (rumored)
- Google bought Writely for \$10 million
- Google bought MeasureMap for less than \$5 million
- Yahoo bought WebJay for around \$1 million (rumored)
- Yahoo bought Jumpcut for \$15 million (rumored)



# 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 startups
  - 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
- \$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

# M&A Exits Are Happening Earlier

- Today it's not uncommon for companies to be acquired just a couple of years from startup
- Club Penguin, in Kelowna, is a website for 6 to 14 year olds
- It was sold for \$350 million cash just two years from startup

When Can You Sell?

# A Common Misunderstanding

- A common misunderstanding 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
- 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. Revenue per customer
  2. Gross margin per customer
  3. Customer lifetime (or churn)
  4. 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

# That's When You Can Sell

- There are often additional factors like competitors and market changes
- But the important threshold to determine when you can sell is when you have proven the model
- That's when you can have a reasonable negotiation on value
- And sell the business



# It's Often The Optimum Time

- As soon as you prove the model is often the best time to sell
- Always best 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 'ride it over the top'

Do You Even Need Investors?

# Do you even need investors?

- A hundred years from now, this will be recognized as a golden era for entrepreneurs
- Hey, why are you laughing. I am serious!
- Never before has there been so many huge opportunities
- That were so easy to capitalize on
- It's all because of the internet

# The Olden Days

- When I was a young entrepreneur,
- back in the 1980s (yeah, I know... wow... are you old)
- Companies cost tens of millions to build
- Didn't matter if it was a hardware company or a software company
- That created an enormous venture capital industry (more about this in a minute)

# You know what a mashup is 😊

- It's harder for me when I talk to groups of investors – they often don't get it
- The internet, open source and this huge, hungry global market means that
- Today, very valuable companies are being built on just tens of thousands of dollars
- Club Penguin, Plenty of Fish, MetroLyrics for example

# What are your options – really?

- 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

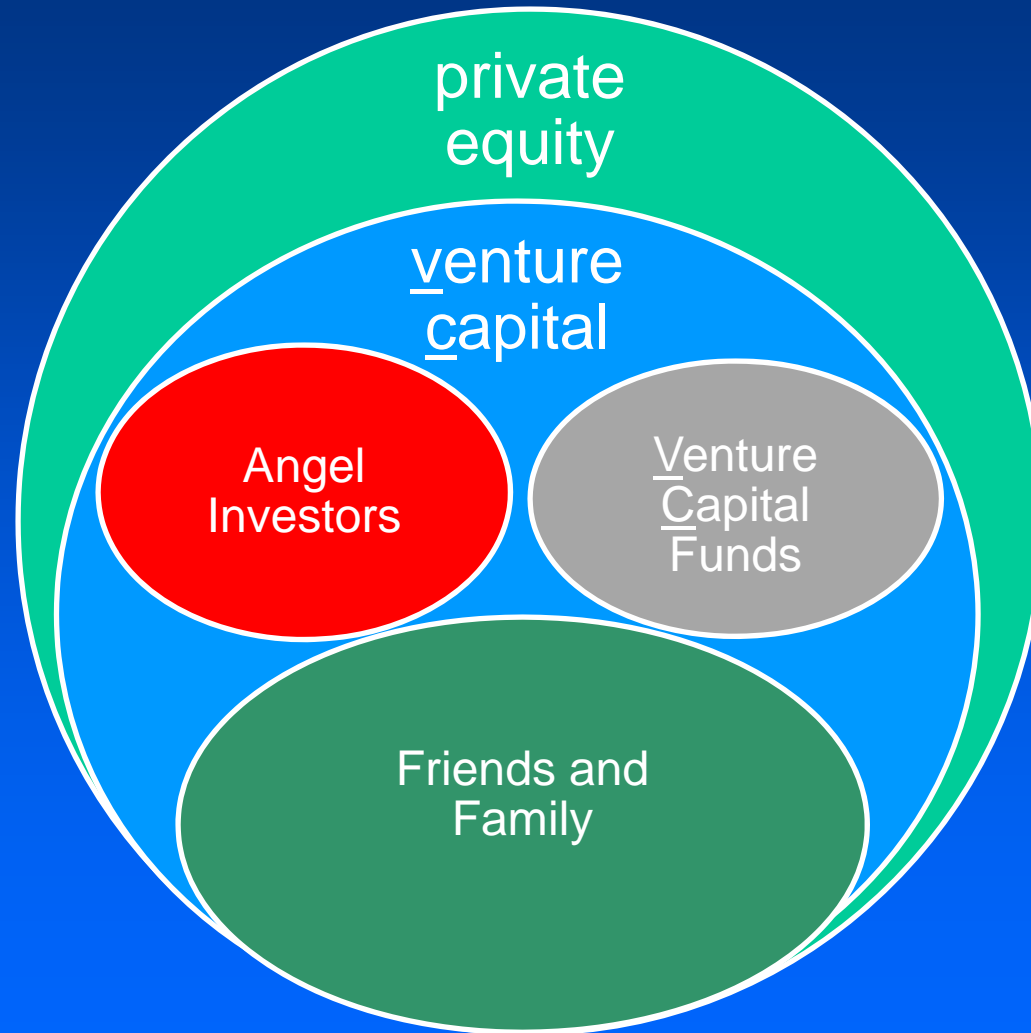
# If you really do need investors

- If you really can't bootstrap,
- Then what are your options to raise private capital for your startup?
- How many of you are planning to go to a venture capital fund to raise your startup capital?
- How many are planning on angel investors?
- Before I tell you – we need some definitions

What is venture capital –really?

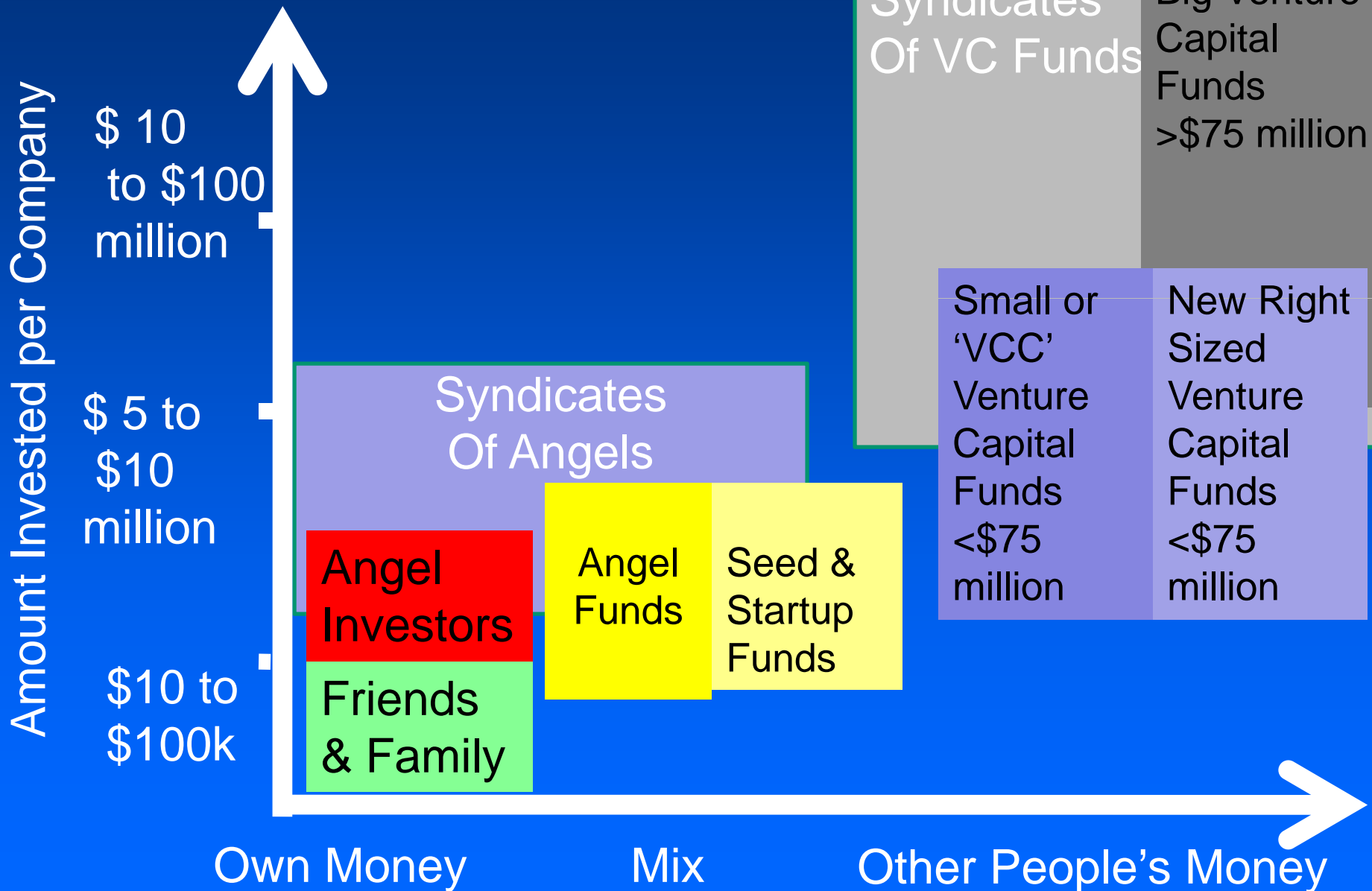


# What is venture capital?



It used to be that simple

# What It Looks Like Now



# Who Actually Finances Startups?

- I asked how many of you were planning to raise your startup capital from VC funds
- Don't feel bad, most entrepreneurs 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](http://www.AngelBlog.net/Angels_Finance_27_Times_More_Start-ups_Than_VCs.html)

# Some Surprising Data

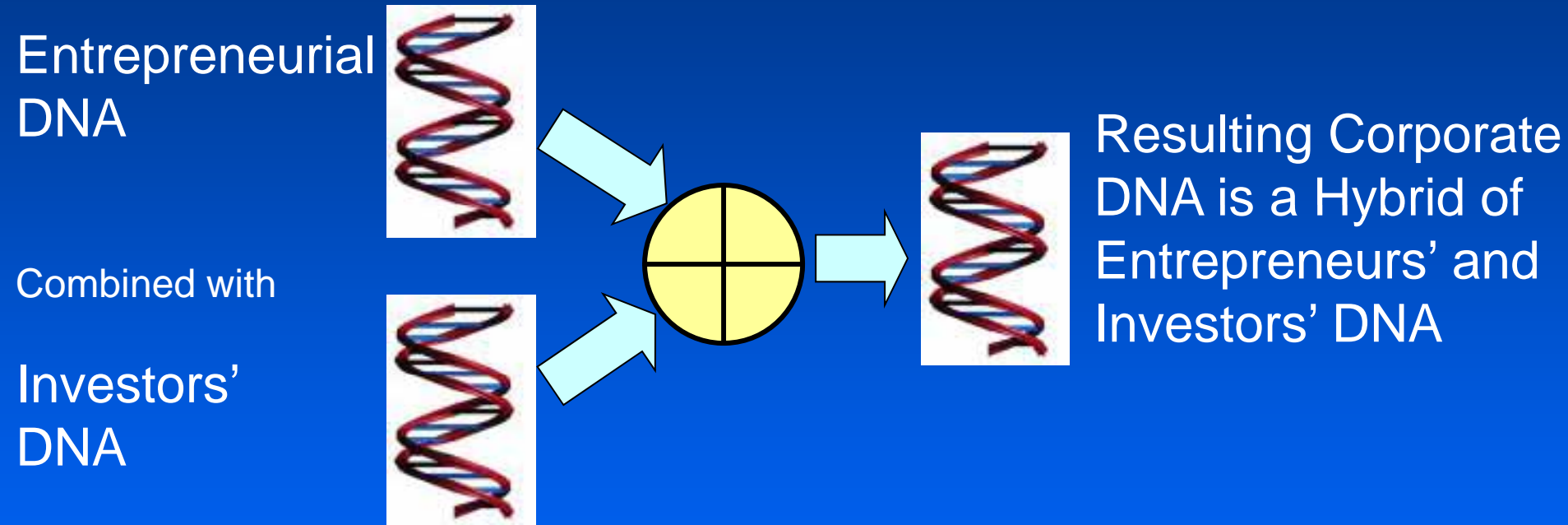
- In America, each year Venture Capital Funds invest about \$20 billion
- Angel investors also invest about \$20 billion each year
- Even more surprising, Friends and Family investors invest about 5 to 10 times more than either VCs or Angels
- From “Fools Gold” by Scott Shane 2009

# Angel Co-Investment

- Just a couple of years ago, the conventional wisdom was that angel investment topped out at around \$2 million per company
- Kauffman and ACA started talking about co-investment just a couple of years ago
- Now I regularly see groups of angels investing \$5 million to \$10 million
- More than enough for today's companies

# Why You Need an Exit Strategy First

# Check Financial DNA Before



Check the compatibility first

# 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:
- [www.angelblog.net/Dont\\_Blow\\_the\\_Biggest\\_Deal\\_of\\_Your\\_Life.html](http://www.angelblog.net/Dont_Blow_the_Biggest_Deal_of_Your_Life.html)

# Developing an Exit Strategy

# 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 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

# 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
- Even after, check alignment annually

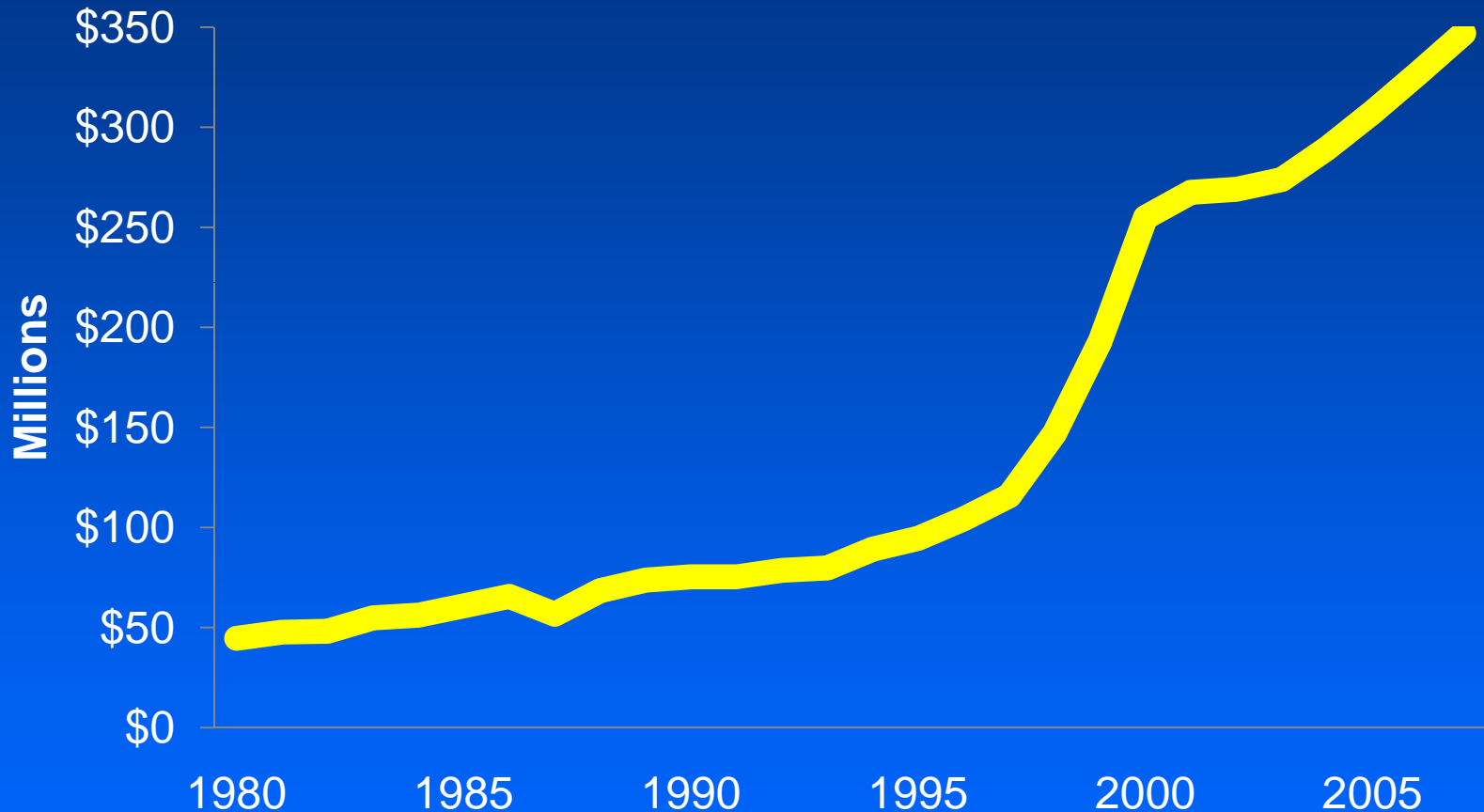
# The Differences Between Angels and Traditional (Big) Venture Capital Funds



# Angels and VCs - More Different

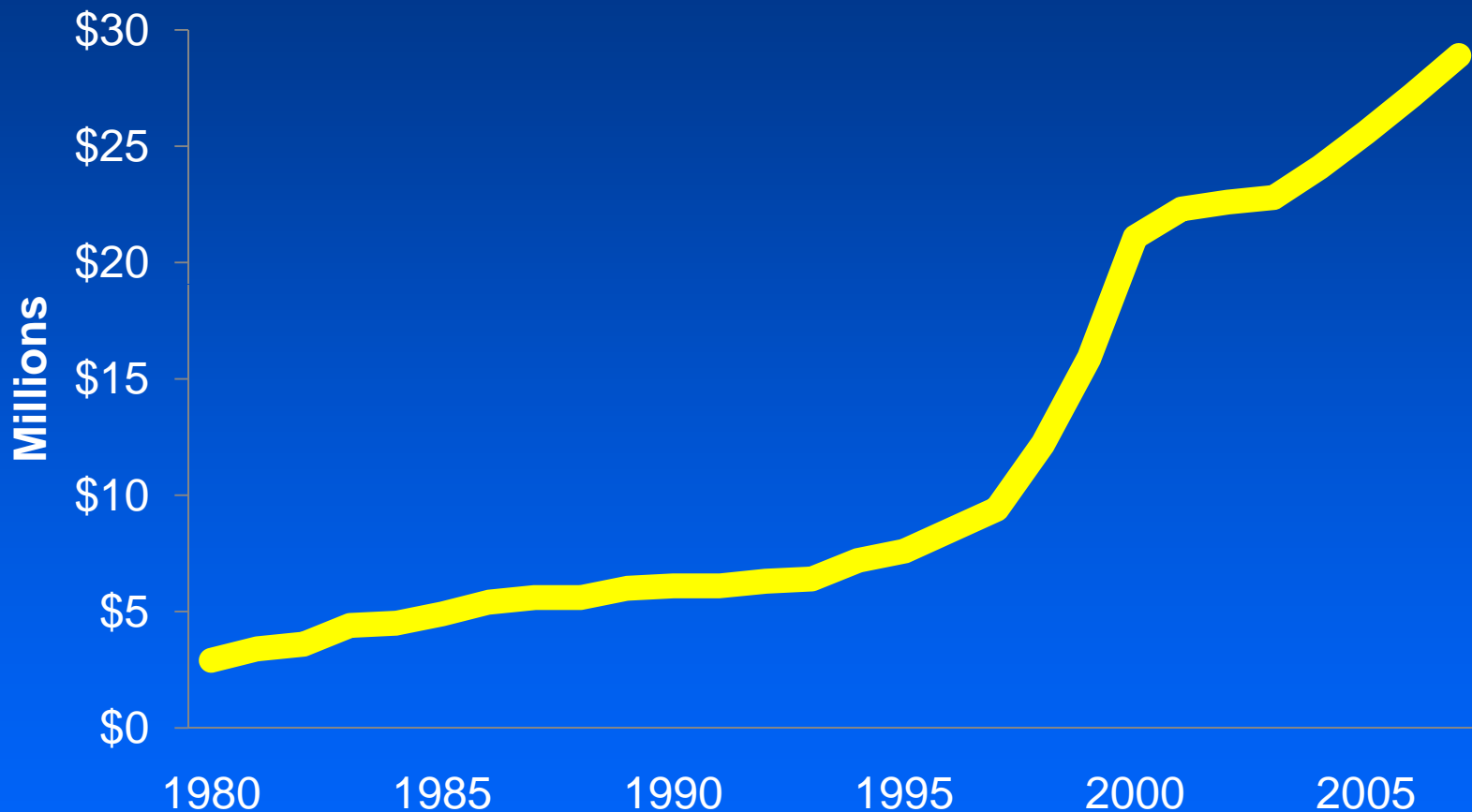
- This new environment is creating a clearer understanding of how different angels and traditional VCs really are
- From an exit perspective, there are three important differences:
  1. Minimum investment size
  2. Minimum return required
  3. Acceptable time to exit

# Size of Average VC Firms



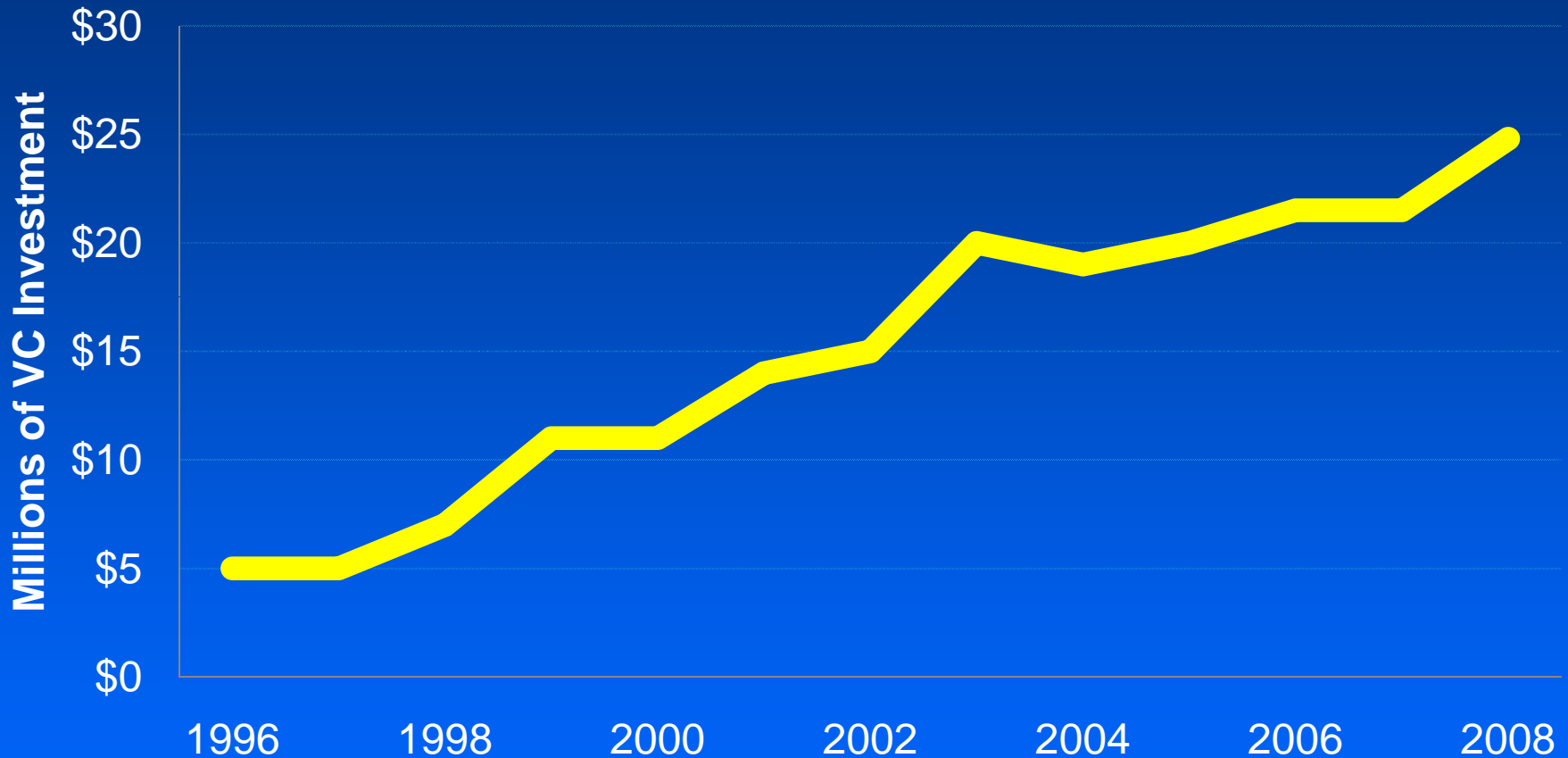
Source: US National Venture Capital Association, Thomson Financial

# Average Capital per VC Principle



Source: US National Venture Capital Association, Thomson Financial

# VC Investment Prior to M&A Exit

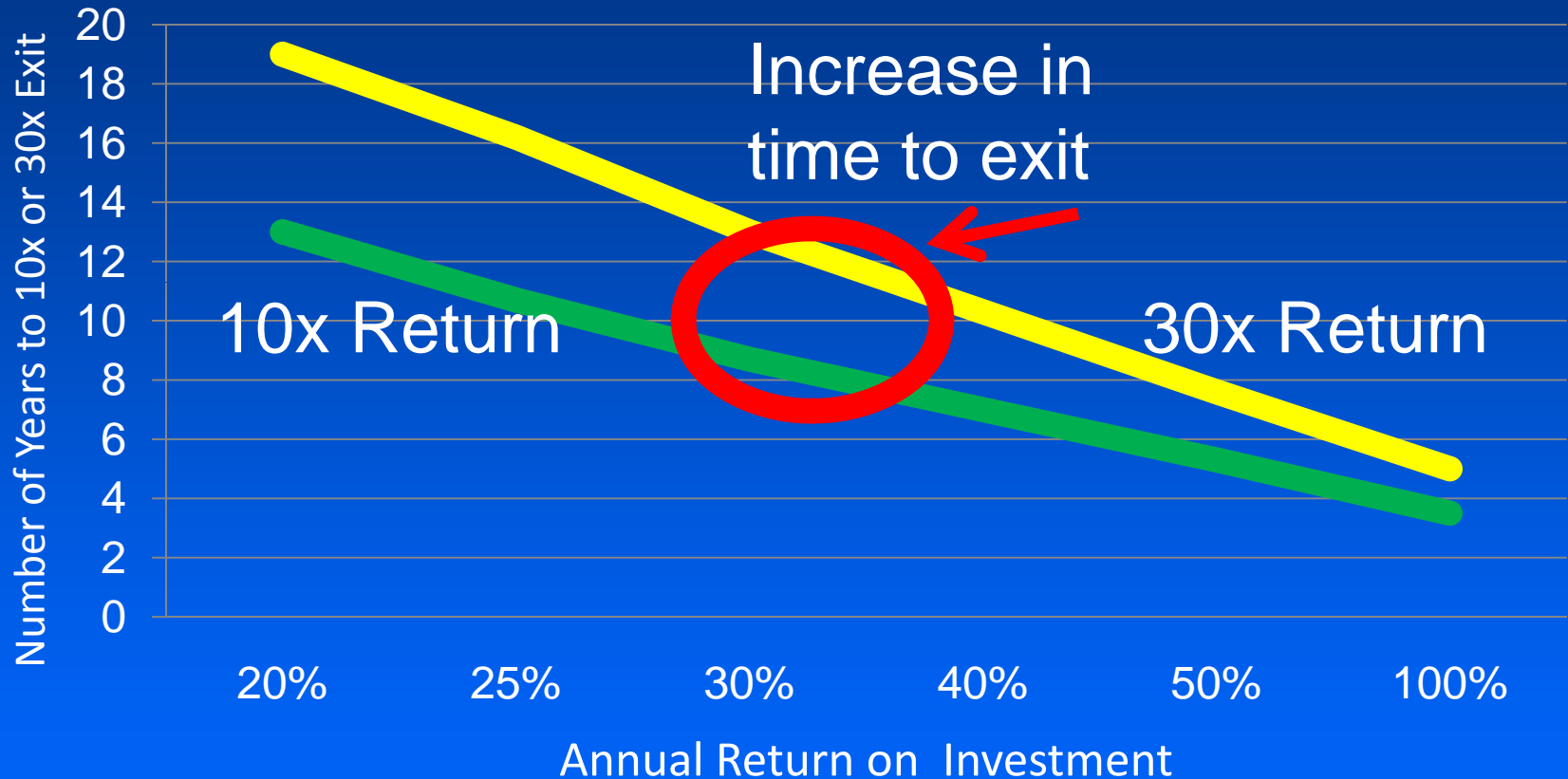


Amount of VC investment prior to M&A exit in millions. 2008 data for Q1  
Source: Jeffries Broadview, Dow Jones VentureSource

# VC Fund Math

- VC funds have gotten larger and larger
- Can't write a cheque for under \$5 million
- Traditional funds only invest money once
- All fund returns come from 20% of deals
- A VC fund needs a 20% annual return
- Simple math shows that the winners have to produce an average 30x return

# Additional Years to VC Exit



To achieve a minimally acceptable VC fund return of 20% per year and assuming all of the returns are from 20% of investments

# Unwritten Contracts with Investors

- Bloggers have helped entrepreneurs, angels and VCs understand each other better
- Entrepreneurs used to think it was simple
- Just increase the value of the shares
- But now realize that investors also need to get their money back
- Achieving an exit is part of the contract

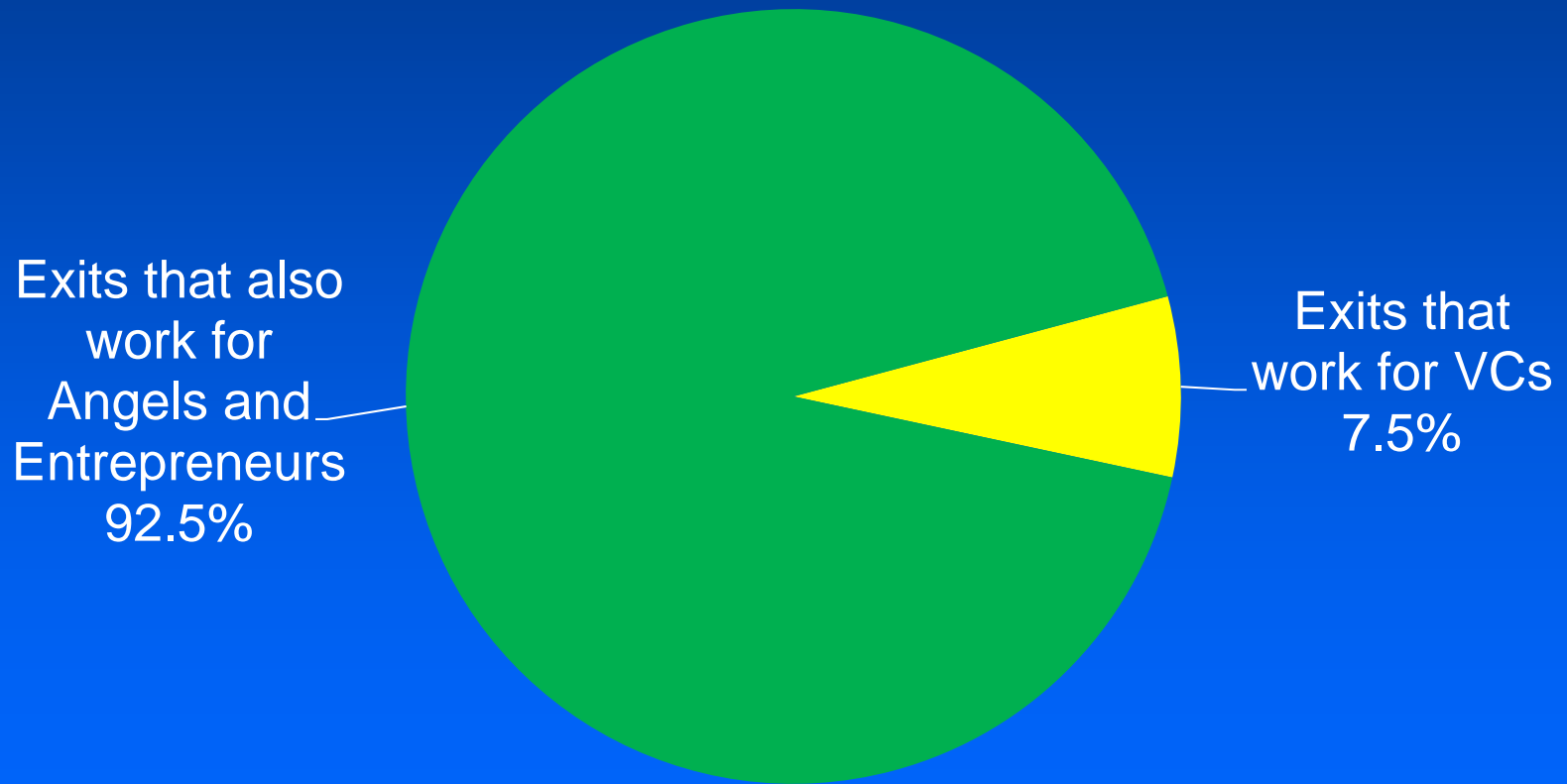
# Unwritten Contracts with VCs

- ‘Unintentional Moonshot’ by Josh Kopelman
- Simple rule of thumb for minimum multiples:
  - Series A – 10x
  - Series B – 4 to 7X
  - Series C – 2 to 4X
- So, once you sign a Series B term sheet at \$50M post-money [which might be only \$30 million pre-money] you’ve basically signed up for at least a \$200M exit target



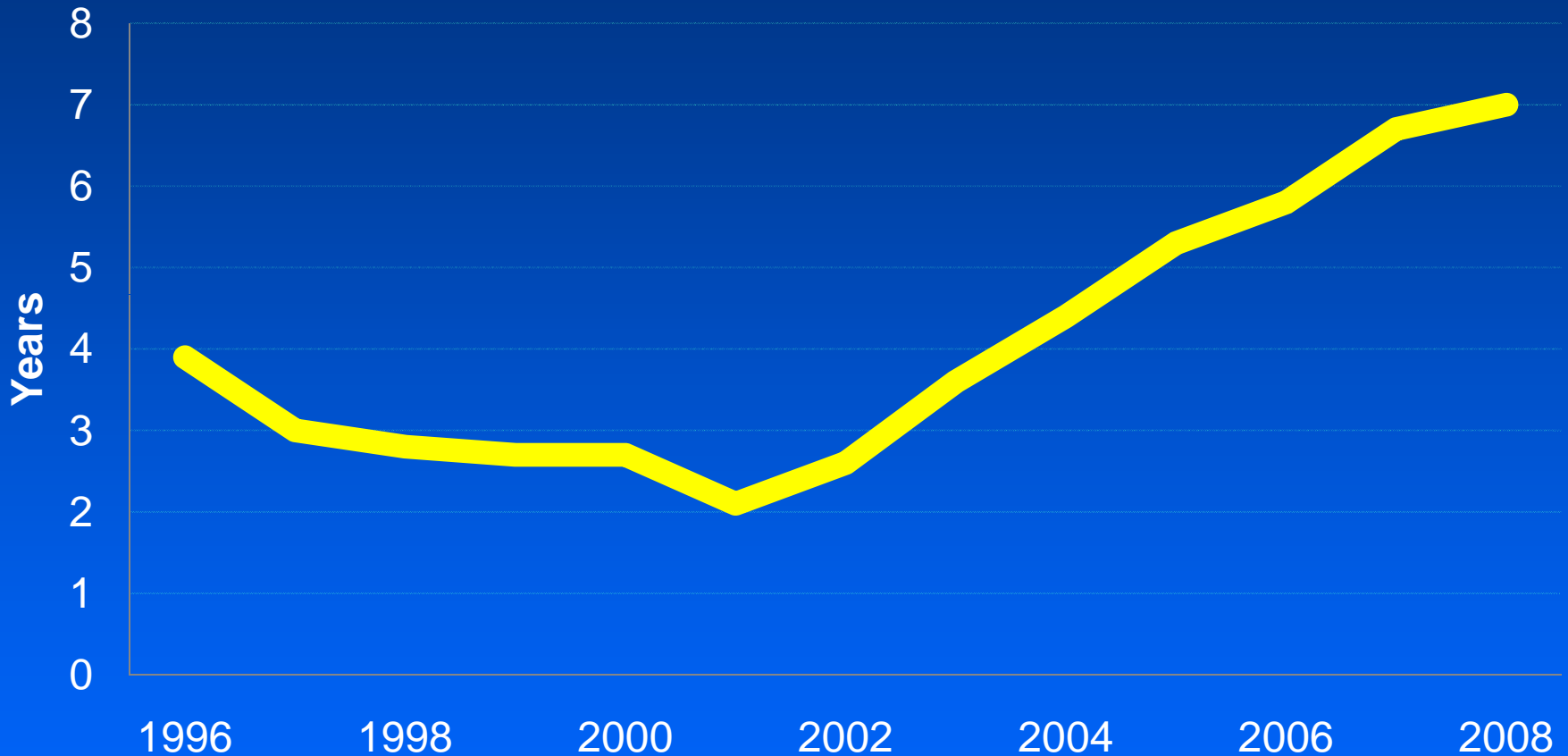
# 92% of Exits Don't Work for VCs

VCs Need Exits over \$100 million



Data from Mergerstat

# Time from VC Financing to M&A Exit

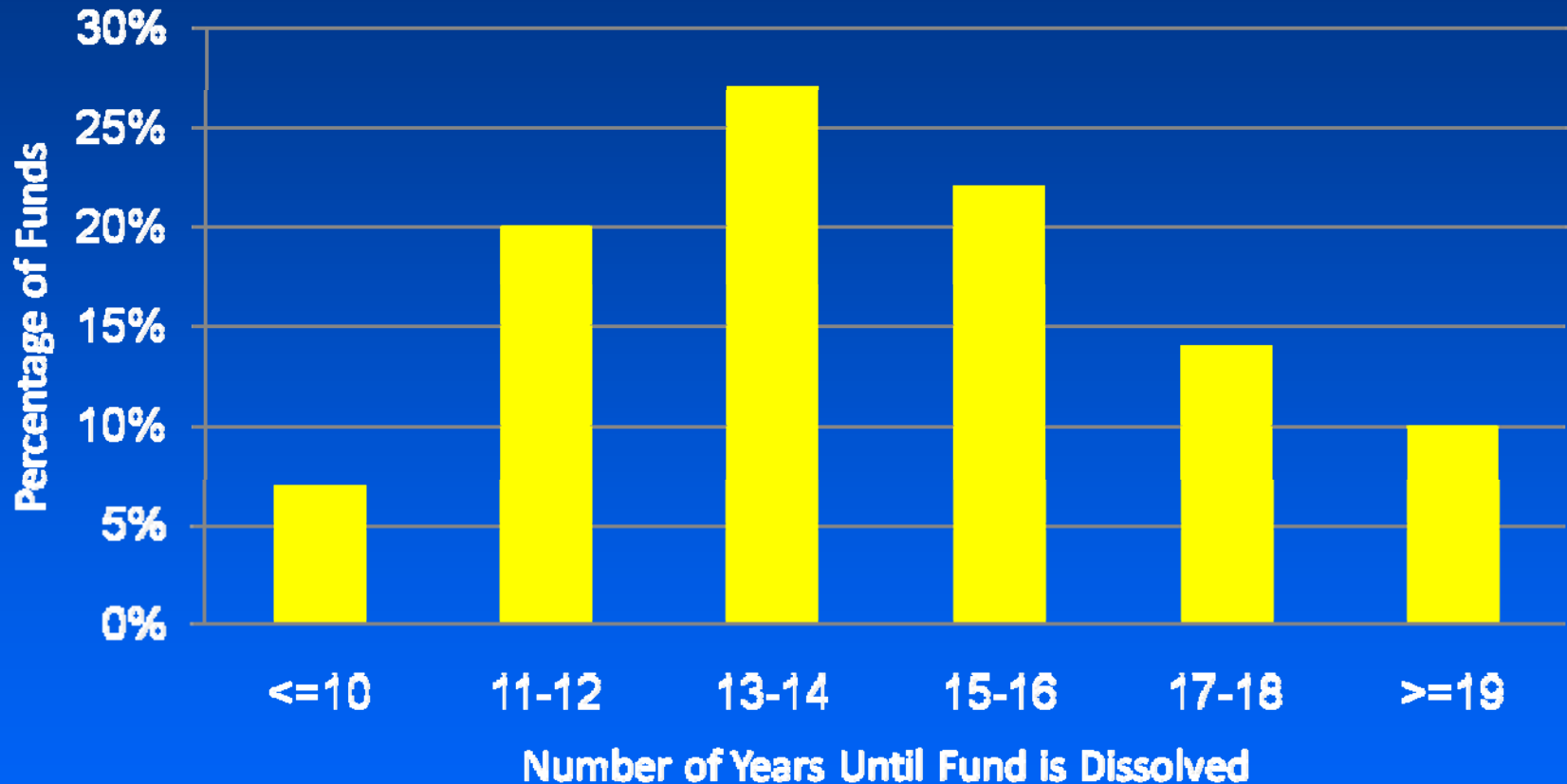


Median Time from initial VC financing to exit in years. 2008 data for Q1.  
Source: Jeffries Broadview, Dow Jones VentureSource

# What That Means for Entrepreneurs

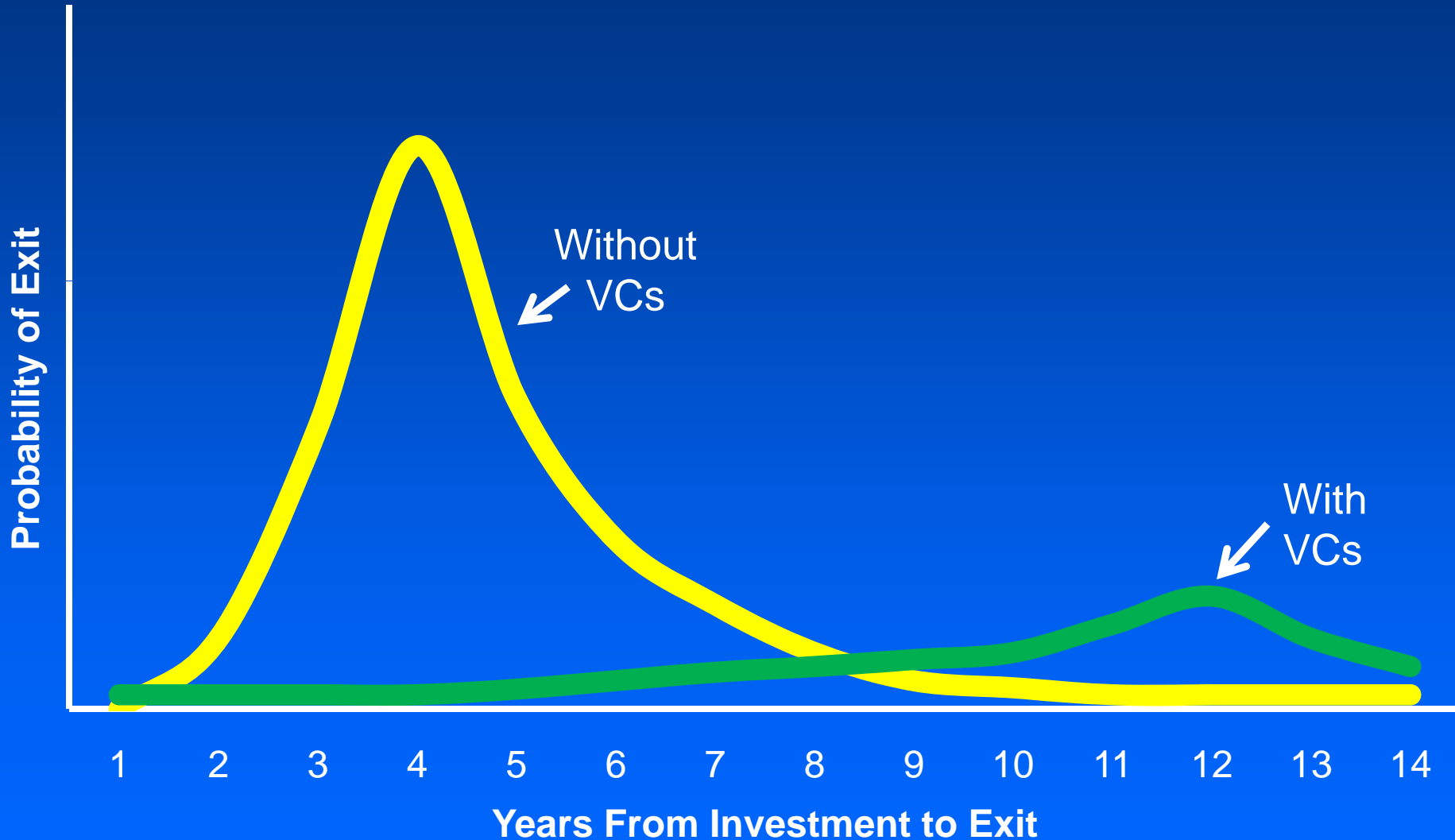
- A median of 7 years doesn't sound so bad
- But the reality is quite a bit worse
- It's 7 years across, A, B and C rounds
- A simple model suggests that equates to about 12 years longer for the entrepreneurs
- At first glance that doesn't seem possible
- Aren't most VC funds 10 years?

# Lifetime of IT VC Funds



Source: Adams Street Partners 2006 analysis of funds then dissolved. The chart shows the year a 10 year fund was actually dissolved.

# Exits Without and With VCs



# How VCs Block Good Exits

- Call from an entrepreneur asking for help in understanding why the VCs were blocking a great exit opportunity – he had no idea
- VCs have multiple mechanisms to block
- Board control, investment agreements, pref shares and votes
- Happens much more often than people think
- Dramatically increases risk of failure

# Angel Investor Math

- Investments as small as \$25,000 can make sense
- Returns as low as 300% over a few years are attractive
- Can easily reinvest the gains
- Exit objectives much more aligned with entrepreneurs than traditional VCs

# Investor Time Horizons

- VCs can wait a decade or more - and often need to for their math to work
- Angels today increasingly want an exit in 3 to 5 years
- Especially in today's unstable economy
- Is a fundamental incompatibility between angels and VCs in today's exit environment



# What happens when VCs invest

## New insights from Wiltbank Data



Source: Robert Wiltbank, Ph.D Willamette University with Funding from the Kauffman Foundation

# Angels or VCs But Not Both

- Fascinating new research May 2008
- Unique historical database of 182 Series A deals
- “outcomes are inferior when angels and VCs co-invest relative to when VCs invest alone.”
- Angels alone “as likely as the VC-backed firms to have successful liquidity events”
- Optimum is ‘Angels or VCs but not both’

# Angel or VC Checklist

	Angels	VCs
Amount of capital required to prove the business model	Under \$3 to 5 million	Over \$3 to 5 million
Years before being able to exit	2 to 5 years	10 to 12 years
Most likely value of the company at the time of the optimum exit	Under \$50 million	Over \$100 million
Willingness to relinquish control of important financial decisions	Not always required	Almost always required

# Summary

- Most acquisitions are under \$20 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

# Resources

- [www.Early-Exits.com](http://www.Early-Exits.com) – book on exit strategies for entrepreneurs
- [www.AngelBlog.net](http://www.AngelBlog.net) – blog for entrepreneurs and angel investors
- [www.BasilPeters.com](http://www.BasilPeters.com) – for this PowerPoint and videos of previous talks