

# Early Exits Overview

Angel Capital Association New England  
and  
The Angel Capital Education Foundation

Boston

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by Basil Peters



# Early Exits Overview

- A one hour overview of a half day workshop
- The half day version has more content on exit strategy, exit execution and exit valuation
- Bill Payne now delivering the half day Early Exits workshop – New York Angels last week
- Hoping to make this an ACEF program
- Big topic - we'll move fairly quickly today
- Please hold your questions to the end

# Qualifiers On This Presentation

- I'm an Electrical and Computer Engineer
- I was a technology entrepreneur
- And now I'm a technology investor
- My comments are from my tech background
- Some aspects of investing in, and exiting, life science and energy companies are different

# Definitions

- I think we'd agree on the definition of "angel investor"
- "Venture Capital" used to have a clear meaning
- For this talk, I will use "traditional" Venture Capital or "old" VC to mean the multi-hundred million, or billion, dollar funds of the last decade
- "New" VC funds, micro-VC, VC 2.0 and angel funds are new models we are still figuring out
- M&A advisor also often called 'i-banker'

# 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 talk and the Early Exits workshop is about what actually works today

# How I Got Started on Early Exits

- I became fascinated by early exits in 2002
- When co-founding a seed / early stage VC fund
- Our local government provides a 30% tax credit to investors in qualified VC funds
- Under this legislation, investors can get their money back in just five years
- Less than half the time for typical VC funds

# Building a “5 Year” VC Fund

- As a fund manager, I had to focus intently on exits during screening and post investment
- To have any hope of liquidity in just 5 years
- I managed the BC Tech Fund for 3 years
- During that period, I made 9 investments
- Had three exits – 2 acquisitions and an IPO
- #1 Canadian VC tech fund of that vintage

# Successful Investing

- I've learned (expensively) that successful investing requires two things:
  1. Investing Right:
    - In the right companies
    - At the right valuation
    - With the right terms
  2. Exiting Well
    - At a good price
    - In a reasonable time

# More \$ and More 😊

- We spend a lot of time on the investing part
- I believe angel investors and entrepreneurs
- Would have:
  1. More Fun, and
  2. Make More Money
- If we focused more on our exits

# Angel Investing Is Still New

- Organized angel investing is still quite new
- The early angel groups started around 1994 - 97
- Angel investing today is where traditional Venture Capital was in the early 1980s
- We are still discovering the best practices
- Still don't have anywhere near enough hard data
- That's why meetings like this, and organizations like the ACA and ACEF, are so important

# What Angels Used To Think

- In the past, most angel investors would:
  1. Find a company
  2. Write a check
  3. Hope an old style VC fund followed
  4. Wait 10 to 15 years for an exit
- That may have worked in the 90's
- But it certainly doesn't work anymore

# The Economy Has Changed

- Part of the reason that doesn't work anymore in tech is because
- Traditional Venture Capital doesn't work
- When I wrote "Early Exits" in 2009, that was a controversial statement
- It's not anymore
- When old VCs invest they set the terms, so our returns suffer with theirs - or worse

# More on the old VC Model

- If you are interested in reading more on why the traditional VC model doesn't work anymore:

[http://www.angelblog.net/  
The\\_VC\\_Model\\_is\\_Broken.html](http://www.angelblog.net/The_VC_Model_is_Broken.html)

What happens to Angels when traditional VCs invest in our companies?

# Angels or VCs But Not Both

- Three fascinating new university research studies since 2008 on angels and traditional VCs investing together in the same companies
- Angels alone “as likely as the VC-backed firms to have successful liquidity events”
- “Angel funded firms are also more likely to show improved venture performance and growth”
- “outcomes are inferior when angels and VCs co-invest relative to when VCs invest alone”

# What Happens When VCs Invest

## New insights from Wiltbank Data

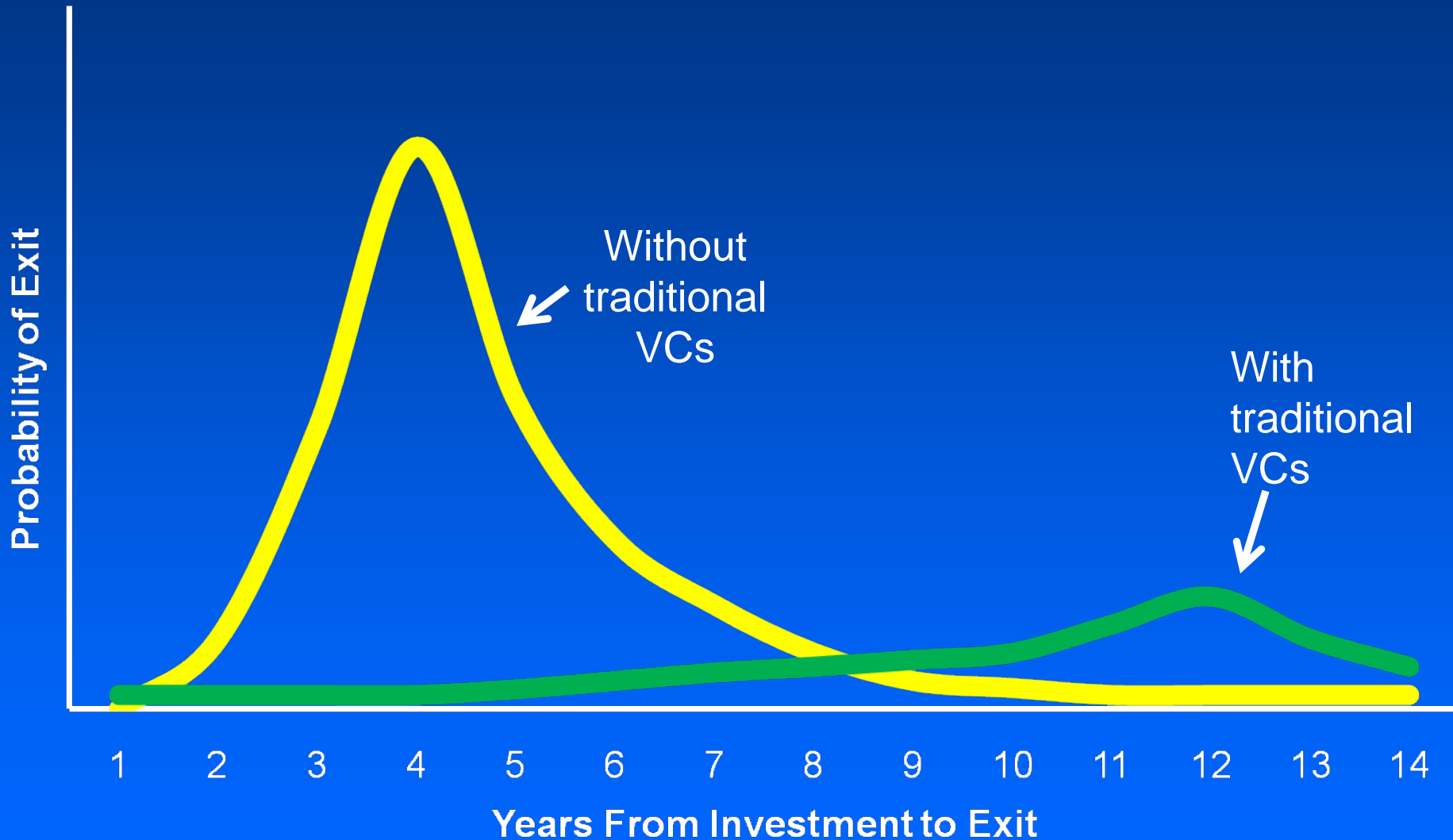


Source: Robert Wiltbank, PhD Willamette University with Funding from the Kauffman Foundation

# The Bottom Line

- 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 lower average returns 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

Most M&A Exits are under  
\$20 million

# 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 Google's purchase of YouTube for \$1.6 billion
- Or the Google – Groupon rumors last week
- Those exits are very rare occurrences
- The 'new' big story is the large number of smaller exits

# 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 These Exits

- Google bought Adscape for \$23 million (now AdSense)
- Google bought Blogger for \$20 million (rumored)
- 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 start-ups
  - We basically suck at building businesses 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

# Big Companies = VC Competitors

- Another fascinating new development
- Big company corporate development and M&A teams now consider VCs their competitors
- Big companies have lots of cash
- And don't see old VCs as adding a lot of value
- They know old VCs will hold on for huge exits
- So they plan to acquire the good companies before the traditional VCs can invest

# 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](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
- All combining to create a very healthy market for exits under \$30 million

# Startup Economics Have Changed

- Another big change 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 traditional VC funds
- Today, entrepreneurs can build companies for \$100,000s
- And in some cases \$10,000s

# Why It Costs So Little Today

- The Internet
- The most disruptive innovation of our times
- Instant access to the entire global market
- Fundamentally changing how we work
- One example - open source software
- More importantly - virtual companies

# Investing 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](http://www.24hour-startup.com) ← great video
- Not an isolated example, see [www.Flippa.com](http://www.Flippa.com)

# Big 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 Early Can You Sell?

- 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'
- For example, prove what a customer is worth and what they cost to acquire

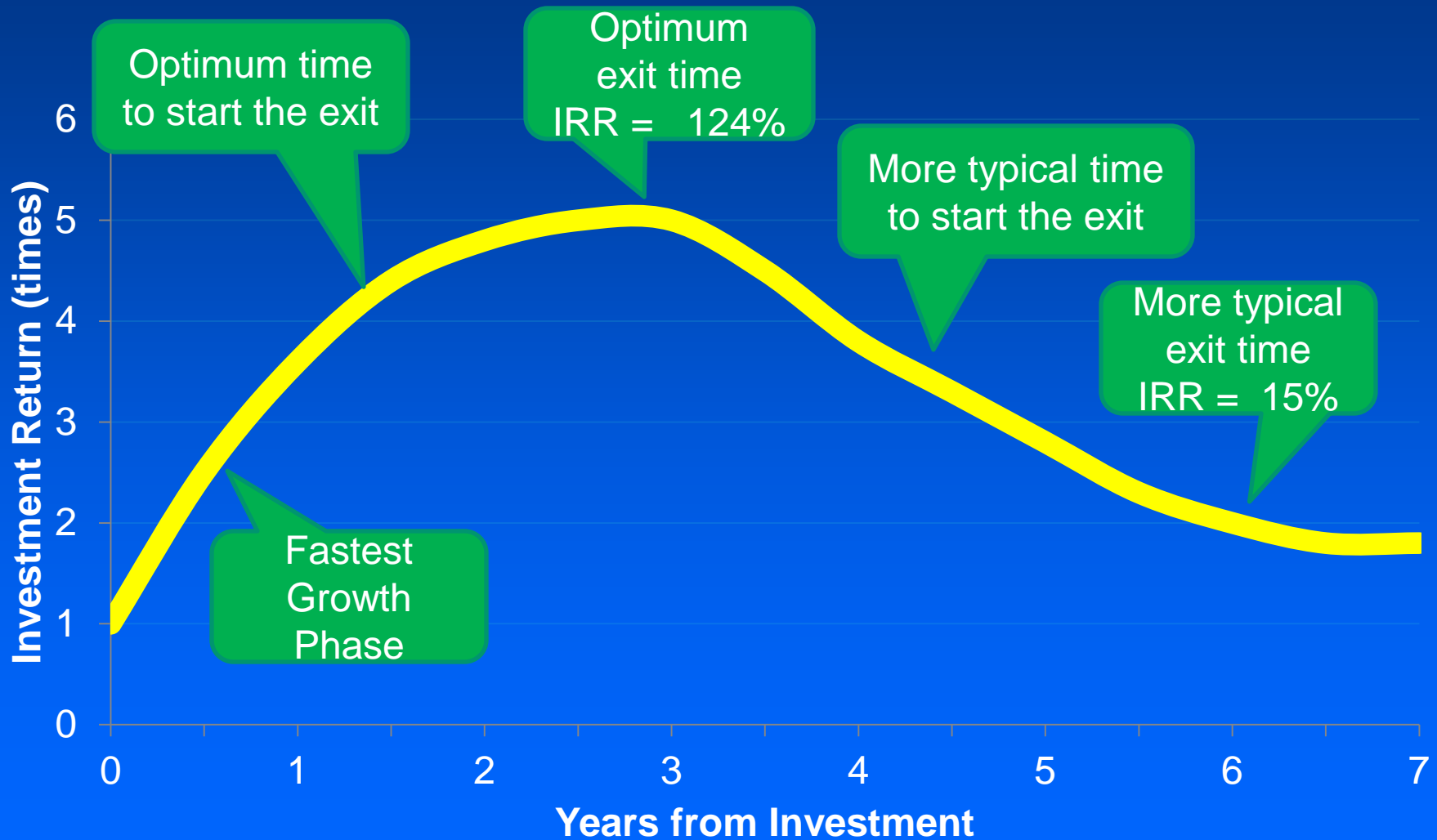
# It's Often The Optimum Time

- As soon as you prove the model is often the best time to sell
- 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

# 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 fund 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 end up never 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](http://www.angelblog.net/Timing_Your_Exit_-_Dont_Ride_It_Over_the_Top.html)

# Planning for Successful Exits

1. Company selection (by type)
2. Understand the exit strategy
3. Test the exit alignment
4. Design the term sheet to facilitate the exit
5. Especially the vesting
6. Good boards make a huge difference
7. Don't let old VCs change the exit strategy
8. Help maintain focus and execute the exit

# 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

# 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 help with this

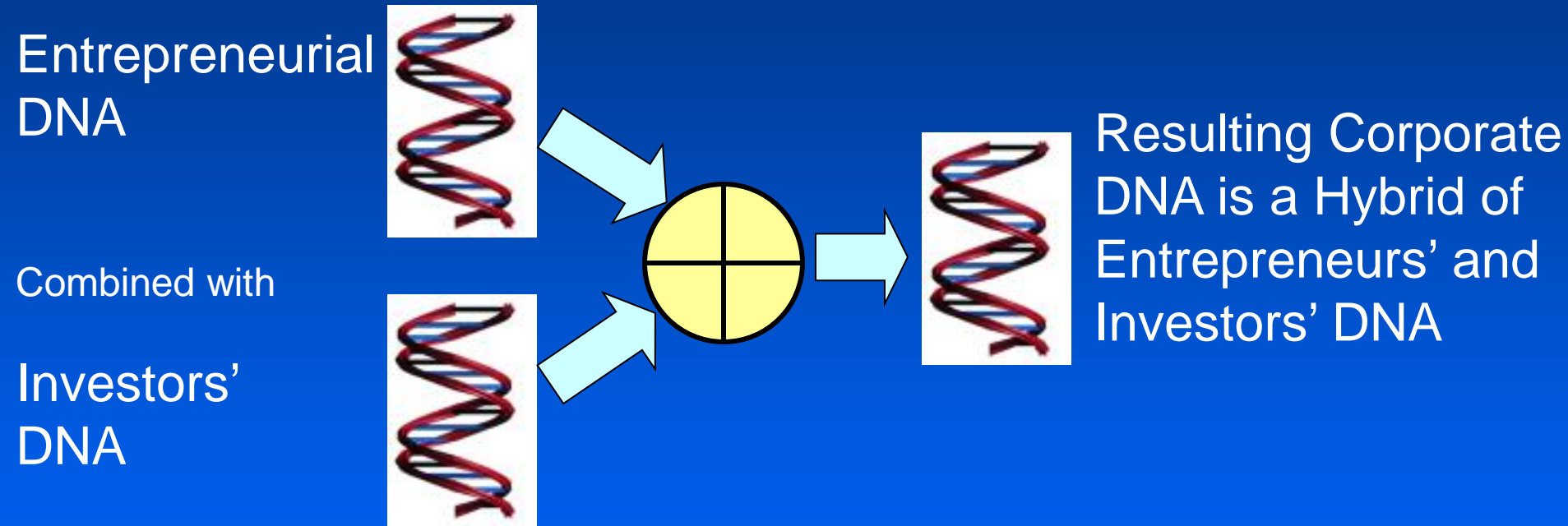
# Check The Alignment

- It's surprising how often there is a serious 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

# 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

# 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

# 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

# Before You Start Selling

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

# Building The Sales Funnel

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

# The Bidding Process

- The third phase is the most exciting and most intense
- Ideally three buyers will be in due diligence
- And actively negotiating, simultaneously
- The CEO will 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

# 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

- Often called an ‘investment banker’
- 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’

# The Exit Coach – A New Idea

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

# The Exit Coach

- 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' (\$2k to 8k /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](http://www.Angelblog.net/The_Exit_Coach.html)

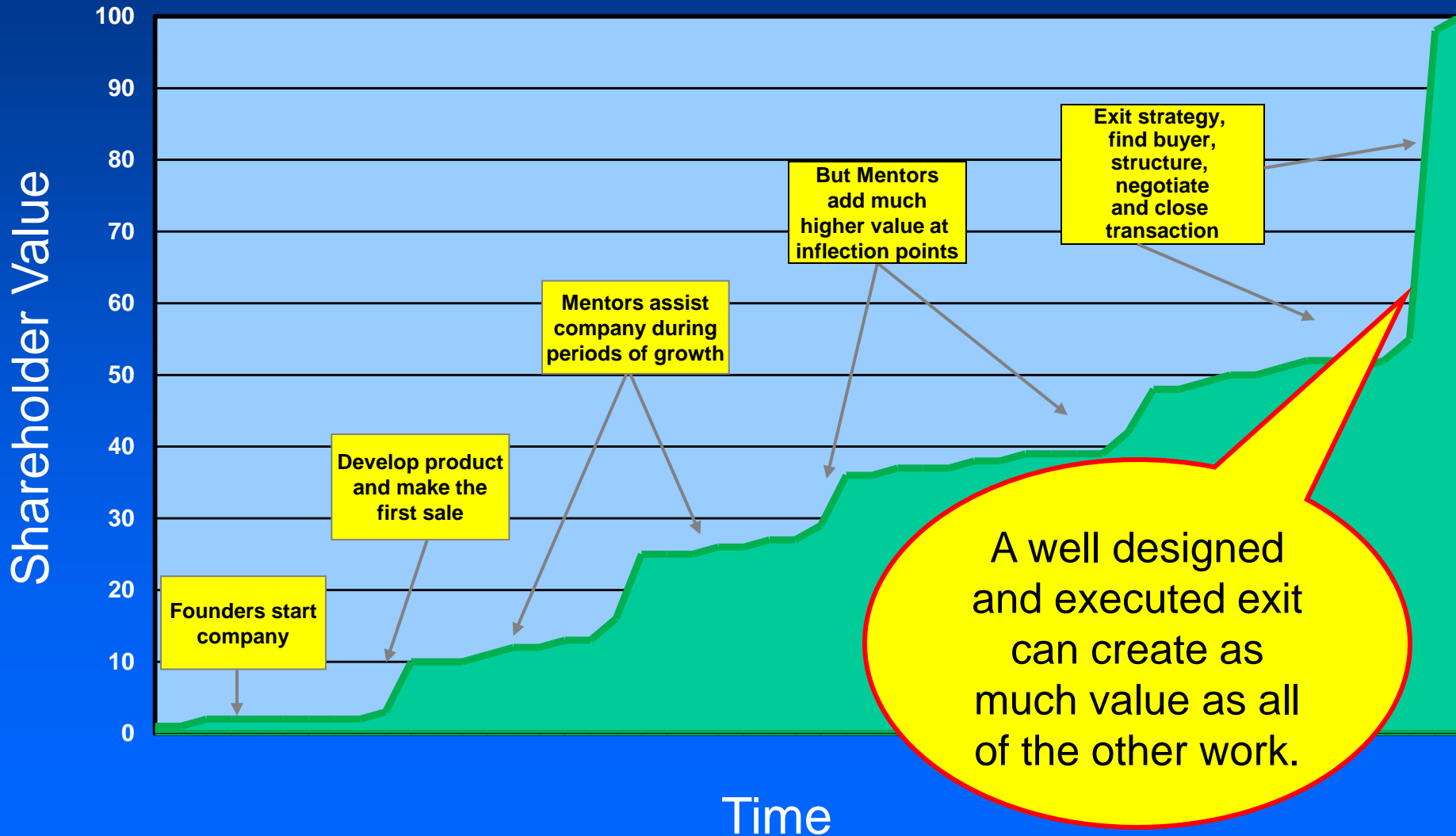
# Selecting The M&A Advisor

- There is almost nothing written about selecting M&A advisors
- The majority make sub-optimum choices
- The most important criteria are:
  - Transaction completion rate
  - Track record of maximizing price
  - Knowledge and compatibility
  - They should be local for < \$100 million

# 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](http://www.angelblog.net/M&A_Advisor_Fees.html)

# Building Shareholder Value



# Maximizing Exit Value

- There are many 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
- This one topic could be a multi-day workshop

# Our 21<sup>st</sup> Century Economy

- What works today:
  1. Startups innovate
  2. Angels, friends and family and maybe new, micro VCs, or angel funds, finance them
  3. Big companies, and others, buy them early
  4. The buyers then grow the business
  5. Entrepreneurs and angels recycle the gains

# 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

# Summary - 'New' Angel Model

- Find promising companies, do due diligence
- Check the founders alignment on the exit
- Term sheet designed to facilitate the exit
- Possibly syndicate with other angel groups
- Ensure they don't accidentally take 'VC money'
- Work with the company as a financial partner
- Exit in 3 to 5 years

# Videos on Early Exits

- [Selling a Company – Guide for Angels](#)  
National Angel Capital Organization, Toronto
- [How Not To Sell a Business](#)  
Entrepreneurs Organization, Vancouver
- [Early Exits Workshop](#)  
ACA Summit, San Francisco
- All available from [www.AngelBlog.net](http://www.AngelBlog.net)

# Resources on Exits

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

# Discussion