PRAISE for **EARLY EXITS**

"Times have changed. VCs now invest $10s of millions in each new venture looking for home runs over a long investment cycle. Unfortunately, singles and doubles provide inadequate returns for huge VC firms, so VCs press for big winners at the risk of losing everything. Dr. Peters has a compelling new strategy for entrepreneurs and angels: improve your odds of lucrative returns using only angel money and focusing intensely from the outset on seeking Early Exits."

Bill Payne, Angel Investor
*Author of The Definitive Guide to Raising Money from Angels (www.billpayne.com)*

"Overall, excellent and timely ideas and I believe, a must read for all Angel investors."

Warren Himmelstein, Past President San Diego Tech Coast Angels and Past Vice Chairman Tech Coast Angels

"Early Exits is a ‘must-read’ book for serious entrepreneurs and individual investors.
It is the only book that I have seen in 12 years that focuses exclusively on Exit Strategies. An invaluable resource with a detailed contents section, it is easy to read with plain language, not too much jargon and good case studies examples. READ IT."

Bob Chaworth-Musters, founder of the Angel Forum - VCC

"Early Exits is a timely and intrepid assessment of Venture Capitalist’s changed fortunes in the investment world. Dr. Peters investigates how both Angel Investors and the boards with whom they are associated must respond to this new environment. Unique in its subject matter and full of real life experiences and advice, this book will captivate your attention from cover to cover."

Bruce MacCormack, Chairman, Bellingham Angel Group, LLC

"I really enjoyed reading Early Exits, and could not put it aside until I read it from cover to cover. It describes some very interesting concepts which I am sure will create controversy in the investment community. In my opinion, every entrepreneur should read this book at least twice: once when they start their venture and the second time when they are getting serious about their exit."

Alan Juristovski, Co-founder and CEO MetroLeap Media Inc.

"Early Exits is a must-read for all entrepreneurs wishing to attract angel investors. Peters nails it when he says that ‘exits are the best part of being an entrepreneur or investor’. This book will get entrepreneurs and investors to plan for earlier exits rather than waiting until it’s too late."

Mike Volker, Co-founder Venture Angels and CEO of the WUTIF Fund

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**THE FIRST BOOK ON EXITS FOR ENTREPRENEURS AND ANGEL INVESTORS**

**EARLY EXITS**

**Exit Strategies for Entrepreneurs and Angel Investors**

(But Maybe Not Venture Capitalists)

**BASIL PETERS**

**EXITS** are the least understood part of investing and entrepreneurship.

Very little has been written about exits—the emphasis is always on starting, financing and growing.

Most earlier books on exit strategies were written for owners who wanted to retire.

Recently, there have been several books written about exits for VCs. This is not surprising considering that most venture capital agreements give them the control on exit transactions.

This book is about the large number of other exits—the ones that are not driven by the VCC. Exit opportunities have changed dramatically in the past few years. Today, it’s more likely that a company will be sold without ever having an investment from a VC.

Exits are also happening much earlier than before. The largest number of exits today are in the under $30 million valuation range. These exits are often completed when companies are only two or three years from startup.

The goal of this book is to help entrepreneurs and angel investors have more successful, more frequent and more enjoyable exits.
Early Exits

Exit Strategies for Entrepreneurs and Angel Investors (But Maybe Not Venture Capitalists)

Basil Peters

Published by meteor|bytes
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For more on this book please visit www.Early-Exits.com.

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The 21st century economy needs entrepreneurs—those magic few among us who can conceive and create new high-growth, knowledge-based companies.
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-Gene Fowler
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Introduction

Exits are the least understood part of investing—as often by the investors themselves as by the entrepreneurs. This book is about the large number of other exits—the ones that are not driven by the VCs.
1.1 The End of the ‘Swing For The Fences’ Era

As I prepare this book in late 2008 the world’s financial systems are in turmoil. Huge investment banks have become extinct, governments have rushed in with bailouts, initial public offerings (IPOs) have all but disappeared, the venture capital industry is in crisis and investors are holding on to their cash more tightly than they have in decades.

This chaos is, in part, a result of the ‘swing for the fences’ thinking that has taken over much of the financial world in recent years. Everyone’s been looking for the ‘big score,’ the billion-dollar payout—the moon shot that would vault them into the ranks of big money.

That era is over. Sober thinking is now the rule of the day. The turmoil and this new way of thinking presents a new, and possibly even more exciting, opportunity for entrepreneurs and angel investors. The news may not be as good for traditional venture capitalists or the companies in which they invest.

This new reality extends trends that have been emerging for some time, but which have gone unnoticed amid all the noise about the big venture capital and private equity deals that were awash throughout North America.

A different financing landscape for entrepreneurs has been emerging over the past few years and will continue to evolve in this new financial climate. This new reality favors investments in promising young companies by angel investors, who will often achieve an exit within a few years instead of following the riskier, and much longer, funding patterns of the traditional venture capital industry.
The payoffs for this strategy are not as large as some of the earlier moon shots in the last few years of the 20th century, like Google, Skype or PayPal, but they come far more often—and with much less risk. Cumulatively, these early exits provide a very attractive investment return for both angel investors and entrepreneurs.

It’s similar to a baseball team concentrating on hitting consistent singles and doubles rather than hoping for the big grand slam home run to put them in the win category. It’s old time ball playing—and investing—and it’s the complete opposite of the swing for the fences mentality that emerged over the past couple of decades. In that scenario, a company starts up, raises big venture capital funding, and after a decade or more of hard work, and a great deal of luck, eventually completes a multi-hundred million initial public offering (IPO).

My premise is that startups and emerging companies should adopt this new, simple approach—start small, stay lean, raise only the funding you really need, grow the business judiciously and then execute an early exit.

As far as I can tell, this is the first book on exits written for entrepreneurs and angel investors.

1.2 The First Book About Exits For Angels and Entrepreneurs Instead of Venture Capitalists

Exits are the least understood part of investing—as often by the investors themselves as by the entrepreneurs. That’s because there has been very little said, or written, about them. The emphasis was always on starting, scaling and growing.
Most of the early books on exit strategies were written for business owners who wanted to retire. More recently, there have been a number of books written about exit transactions for venture capitalists. This is not surprising considering that most venture capital (VC) agreements give the VCs most, if not all, of the control in deciding when and how all shareholders benefit from an exit transaction.

This book is about the large number of other exits—the ones that are not driven by the VCs.

Exit opportunities have changed dramatically in the past few years. Today, it’s more likely that a company will be sold without ever having an investment from a venture capitalist.

Exits are also happening much earlier than before. The largest number of exit transactions today are in the under $30-million valuation range. These exits are often completed when companies are only two or three years from startup.

The second quarter of 2008 was the first time in history that there were no IPOs of venture-backed companies in the US. At the same time, the market for merger and acquisition (M&A) transactions of technology companies was extremely active.

These trends created a terrible time for VCs but a great one for entrepreneurs and angels.

Most of the strategies and exits described in this book don’t work for traditional VCs. In fact, I expect many VCs to react quite negatively to many of the observations and ideas presented. This is not surprising, as this is not good news for the traditional venture capital investment model.
In this era, the choices entrepreneurs and boards make between angel and VC investment will have profound effects on exit opportunities and probabilities of success.

This new exit reality has new rules and new opportunities—some of which include:

- Exits occurring in only two or three years.
- Most transactions under $30 million.
- Small M&A markets are much less efficient (often a very good thing).

The goal of this book is to help entrepreneurs and angel investors have more successful, more frequent and more enjoyable exits.
Exits are the Most Fun

Exits are the best part of being an entrepreneur or investor. It’s when we get financially rewarded for all of the creativity, hard work, investment and risk we put into our companies.
2.1 Why Exits Are Fun

There are many reasons we work. One of the obvious ones is to earn money, but money is not the most important reason. Money is often well down the list depending on the scale on which you measure. Most of us work to feel successful, to know we are useful, to have a sense of purpose and to have fun.

All work becomes boring eventually. After you’ve performed any business process well a few dozen times it can become numbing and routine. Your hundredth subordinate review, or sale of the same product to the same customer, can be worse than dental work.

After about my tenth exit, I figured out why I like working on them so much—exits are the most fun. Exits are the best part of being an entrepreneur or investor. It’s when we get financially rewarded for all of the creativity, hard work, investment and risk we put into our companies.

2.1.1 There Is Always a Great Party

One of the other benefits is the big closing party.

It’s not so much that I need more rich food or expensive beverages, it’s just great to look around the table and bask in that feeling of excitement, accomplishment and celebration.

Exits are also exciting. The numbers are big—often really big. It’s always more exciting to be strategizing and negotiating when the differences are millions of dollars instead of tens or hundreds of thousands.

2.1.2 The People Are Interesting

The people involved in exits are also the most interesting. When you work on exits you always work with founders, directors and
C-level executives, sometimes from the biggest companies in the world. These people are always smart, challenging and interesting. This contributes to the challenge, and the fun.

2.1.3 It’s Psychologically Rewarding
Leading up to an exit, founders and CEOs have a lot of anxiety about whether they really want to sell their ‘baby’ and what will happen afterward. There are usually several sleepless nights devoted to fretting about when and if the transaction will be completed.

Fortunately, after being involved in a few dozen transactions, you begin to realize how normal these emotional and psychological effects are. It’s gotten to the point where I can almost predict the emotional implications of the next phase of the process. The good news is these are all just a normal part of the exit experience. It’s rewarding to have the perspective to be able to help the participants through these challenging phases of the exit process.

Possibly the best thing about exits is that they almost always make everyone happier and more excited about the future—and that’s contagious.

Some of the most heartfelt thank you emails I have ever received were after exit transactions. A few of those are included in the case studies in the appendix.
The Current Environment for Exits

Nobody can predict the future. We may be near the peak of the tech M&A market or the trend may last several more years. If you have been thinking about selling your business, now looks like a very good time.
3.1 It’s a Great Time To Sell a Technology Business

The years preceding the publication of this book, in the later part of 2008, have been a very good time to sell a technology business.

There is an interesting article in the April 7, 2008, issue of Business Week titled ‘Ravenous for Small Tech.’ The article reports that while the change in value of mergers and acquisitions (M&A) in all sectors is down 51% in 2008, compared to the previous year, the value of high technology M&A is actually up 132%.

In a May 2008 article in Mergers & Acquisitions, Tom Stein looks back and says, “2007 will be hailed as the biggest year for acquisitions of venture-backed technology since the dot.com days.”

Why is this happening now and how should this affect your exit strategy?

3.2 Big Companies Are Growing By Acquisition

The main reason the M&A market is so active is because acquiring companies is now the best way for large companies to grow. This is summed up nicely in a quote from Vivek Mehra, general partner at the venture capital fund August Capital in Silicon Valley: “Big companies stink at innovation, and they know it.”

Acquisition works so well that many big companies are now spending more on company acquisitions than research and development (R&D). Take Microsoft for example. According to Tom Stein, “Microsoft is seeking 20 companies, worth $50 million to $1 billion, and will spend more on acquisitions in fiscal 2008 than on R&D for the first time in its history.”
Cisco also prefers to ‘buy rather than build.’ The company has acquired 125 businesses since 1993. These big companies have large internal divisions completely devoted to buying companies.

It’s also a great time to sell a business because large companies are sitting on loads of cash. This situation presents a problem for company management because shareholders want them to either invest the capital to create growth or distribute it to the shareholders as dividends. Distributing cash is considered an admission of defeat for tech company management because it shows they don’t have any ideas about how to invest cash to increase shareholder value.

Big companies are also trying desperately to re-energize the entrepreneurial cultures that got them started in the first place. This phenomenon is well articulated in a December 2005 article in Business 2.0, ‘The Flickrization of Yahoo!’ The story describes how Bradley Horowitz, the head of Yahoo's developer network, decided to offer the founders of the photo sharing website, Flickr, $30 million for their startup. Horowitz invited Stewart Butterfield and Caterina Fake to Silicon Valley in late 2004. They had lunch in the Yahoo cafeteria and immediately hit it off. “I met Stewart and Caterina and fell in love,” Horowitz recalls. “It was beyond Flickr. I saw them as kindred spirits, entrepreneurs who could infect Yahoo with that small-company focus.”

Nobody can predict the future. We may be near the peak of the tech M&A market or the trend may last several more years. If you have been thinking about selling your business, now looks like a very good time.
3.3 Most Exits Are Under $30 Million

These days, the really interesting story about tech exits is not the small number of really big company acquisitions—it’s the big number of smaller exits. For the typical entrepreneur and angel investor, these smaller transactions are an excellent way to make several million dollars in capital gains and should be part of every company's exit strategy.

The financial media and most bloggers write about the really big startup exits like Club Penguin, YouTube, Skype and MySpace. Those are certainly exciting company acquisitions and great startup stories.

But for the other 99.9% of entrepreneurs and investors, the really exciting news is the large number of tech company acquisitions for under $30 million. Many of these acquisitions are so small they aren’t even press released. In my own funds, where I have been generating some regular early exits, recent transactions have been in the range of $15 to 30 million.

Several smart venture capital bloggers have also been writing about this trend over the past few years. The best reference I found was an article by Om Malik, titled ‘The New Road to Riches,’ which was in Business 2.0 a couple of years ago. He reports that the Mergerstat database, which includes about 5,000 tech company acquisitions per year, showed an average selling price of $12 million.

3.4 Examples of Early Exits Under $30 Million

I spent some time on Google searching for recent tech company acquisitions and quickly pasted this list together (while the sales
can be confirmed, some of the prices cannot be verified). Most of these companies are big success stories and millions of us use their services every day. They are also great companies acquired for $30 million or less:

- 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).

### 3.5 Who Is Buying?

#### 3.5.1 Fortune 500s Are Buying

One of my friends from a Fortune 500 company explained it to me this way: “We 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. It’s a different skill set than starting things. If we see a company acquisition priced at $100 million, we regard it as already out of our sweet spot for adding value. But at $20 million, it’s really easy for me to get an acquisition approved.”
3.5.2 **Medium-Sized Companies Are Also Buying**

It’s not just big companies that are growing through acquisition. For every big company, there are probably tens of medium-sized companies that are also potential acquirers for any company looking for an early exit. In some situations, companies with strong management teams will acquire other businesses that are larger than the one they were operating. A good example is the Parasun exit in the case studies section. That company was acquired by a public company that had larger revenues, but a lower enterprise value, than Parasun.

These medium-sized companies are also active purchasers of companies valued under $30 million.

3.5.3 **Private Equity Funds Are Also Strong Buyers**

There has also been a remarkable growth in private equity buyout funds in the past several years. These funds are similar to what used to be called ‘merchant banks’ 20 years ago. These funds often buy companies for cash, operate them for a few years and then resell them, hopefully for a significant gain.

Often private equity funds will purchase a number of companies in an industry and increase their value by consolidating and realizing operating synergies and efficiencies.

These funds are very active acquirers of companies in the under $30-million range.

3.5.4 **Even Individuals Can Be Buyers**

Another increasingly common buyer for companies under $30 million is previously successful entrepreneurs or executives. These individuals, having been successful in an earlier business, have exited with a substantial amount of money, but not enough to
The Current Environment for Exits

...retire. Even if they did make enough to retire, they often just aren’t ready to. They will often use some of their own capital, augmented by capital from private equity funds and subordinated debt, to purchase a company. Often this practice enables them to acquire a business that is worth several times the amount of money they can invest themselves.

This type of transaction also works most often when the purchase price is under $30 million.

3.6 Optimum Exit Strategies For Entrepreneurs and Angel Investors

It seems pretty clear that the optimum strategy for tech startups today is to design the company, and its corporate DNA, so everyone is aligned around the idea of a company acquisition in the under $30-million range. The good news is that these exits can often be completed in just a few years from startup. They also have a much higher probability of success than swinging for the fences and hoping for a big NASDAQ initial public offering.

This exit strategy is nicely summarized in ‘The New Homerun’ by Tom Stein in Mergers & Acquisitions magazine, May 2008. He said, “Startups must be content with hitting singles or doubles, that is, a buyout of $50 million.”
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