

Your Company: Their Money

What tech founders need to know about financing

Strategic Exits Partners Presentation to



ANGEL CAPITAL ASSOCIATION

October 23, 2024

STRATEGIC EXITS PARTNERS

We work solely with technology entrepreneurs and their investors to structure and execute the optimal exit transaction.

- **Our team are technology industry veterans**
- **30+ years tech industry experience**
- **Robotics, AI, ecommerce, enterprise software, electronics, cleantech**
- **We have founded, scaled, and exited dozens of companies**





David W. Rowat

- B.A.Sc. – University of Waterloo
- M.A.Sc. – UBC
- MBA – Harvard Business School
- 35 years C-level experience with technology companies
- Worked with over 75 tech companies in Vancouver variously as CEO, CFO, COO, employee, consultant, etc.
- **Partner, Strategic Exits Partners**

Origins of “Your Company: Their Money”

- 2003: Basil Peters founded Strategic Exits to advise on M&A strategies and execution for tech companies.
- 2008: Basil wrote *Early Exits*.
- 2017: David Rowat and Len Zapalowski joined as Partners.
- 2022: Basil retired; Dave and Len continued as Strategic Exits Partners.
- 2024: Dave perceived that many first-time founders had minimal background on how the tech financing system worked.
- 2024: David wrote *Your Company: Their Money* as a sequel to *Early Exits* to give founders and angels some financial background prior to raising money.



"This book should have been written long ago. It gives founders the framework they need to manage the most important negotiations of their careers."
David Sutcliffe
Tech Industry CEO and Director

YOUR COMPANY: THEIR MONEY

What tech
founders need
to know about finance

DAVID W. ROWAT

“Your Company: Their Money”

Summary of Contents of the book

- Macroeconomic impacts on tech financing and capital markets.
- What does an early exit look like.
- Most exits are small.
- Stages of growth, types of funding methods.
- Keep the share cap table flat.
- Funding from the Family, Friends, Founders, Fools
- Characteristics of angels; how they operate.
- Evolution of venture capital, how it works.
- New types of investors.
- Early exit decision point: raise venture capital or seek an early exit.

Characteristics of Early Exits

- 2 – 5 years from founding
- Pre-Seed and Seed companies
- \$1 - \$10 million in valuation
- Lean operations
- Focusses on few milestones
- Minimal funding: 4Fs and angels only

The Myths of Exits

For a long time, tech founders were told that the proper path to exit was to grow a company to hundreds of millions with the help of Venture Capitalists and then exit by an IPO or sale to a larger company.

Early Exits dispelled those myths.

But the myths were never true. Most exits have always been small, private transactions without a VC.

Most Deals are Small

- 78% of exits are companies with fewer than 100 employees.
- Only 20% of exits are backed by VCs or other institutional investors.
- 91% of exits are for their strategic value, not for accretive revenue or profits.
- 86% of exits are for companies generating less than \$10 M in revenue.
- These numbers are consistent over several years.

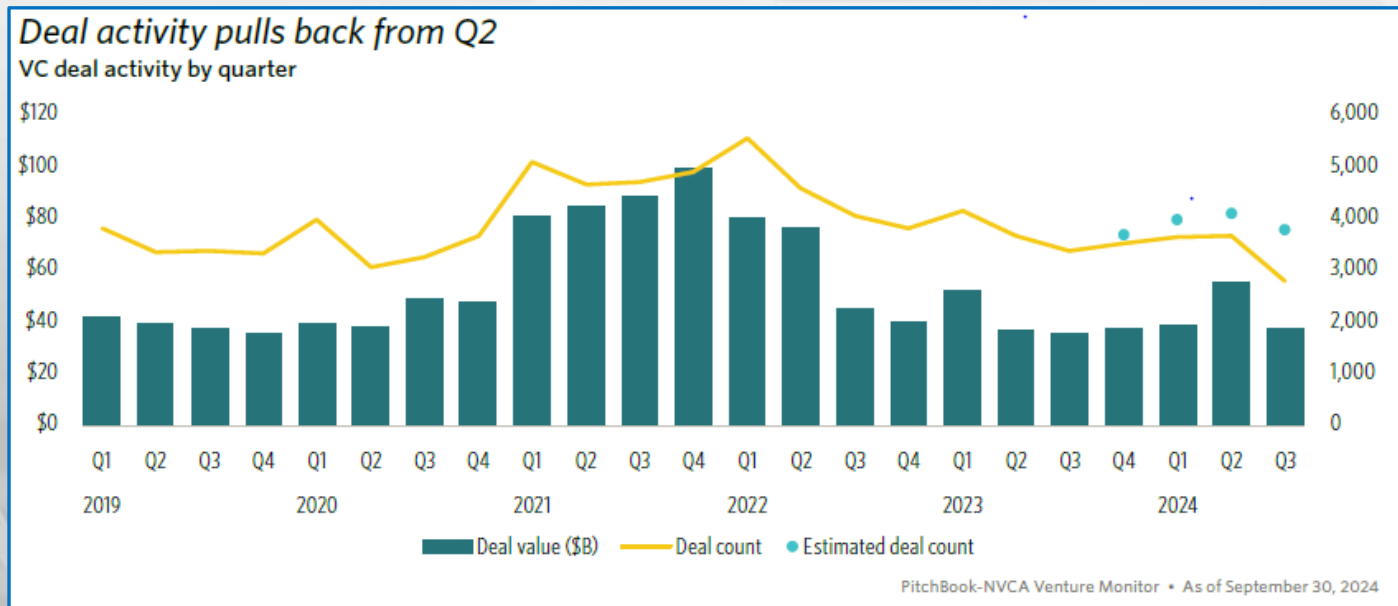
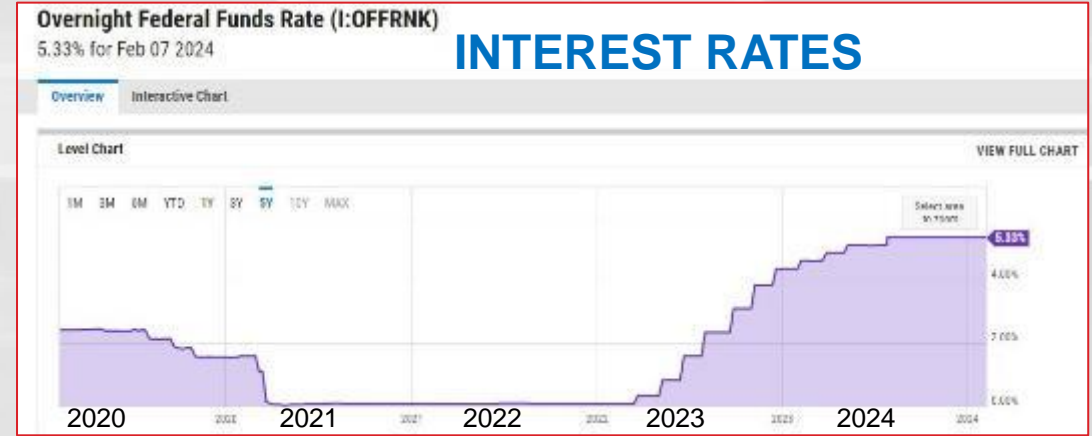
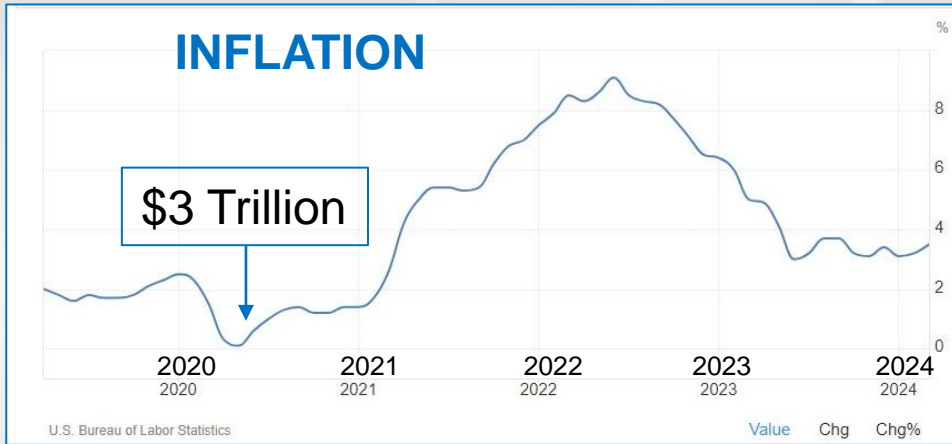
Take-Aways

- Early exits are highly prevalent, and always have been.
- Early exits are small companies.
- Most acquisitions are strategic, not financial.
- It is the unique capability of the company that prepares it for an exit, not the size or longevity.

Macro-Economics Affects the Capital Markets

- Having an excellent value proposition, an MVP, repeat customers, and a torrid growth rate may not be enough to get you financed.
- Macro-economics: interest rates, inflation, economic growth, etc. has an out-sized impact on the capital markets, either good or bad.

Macro-Economics Chain of Events



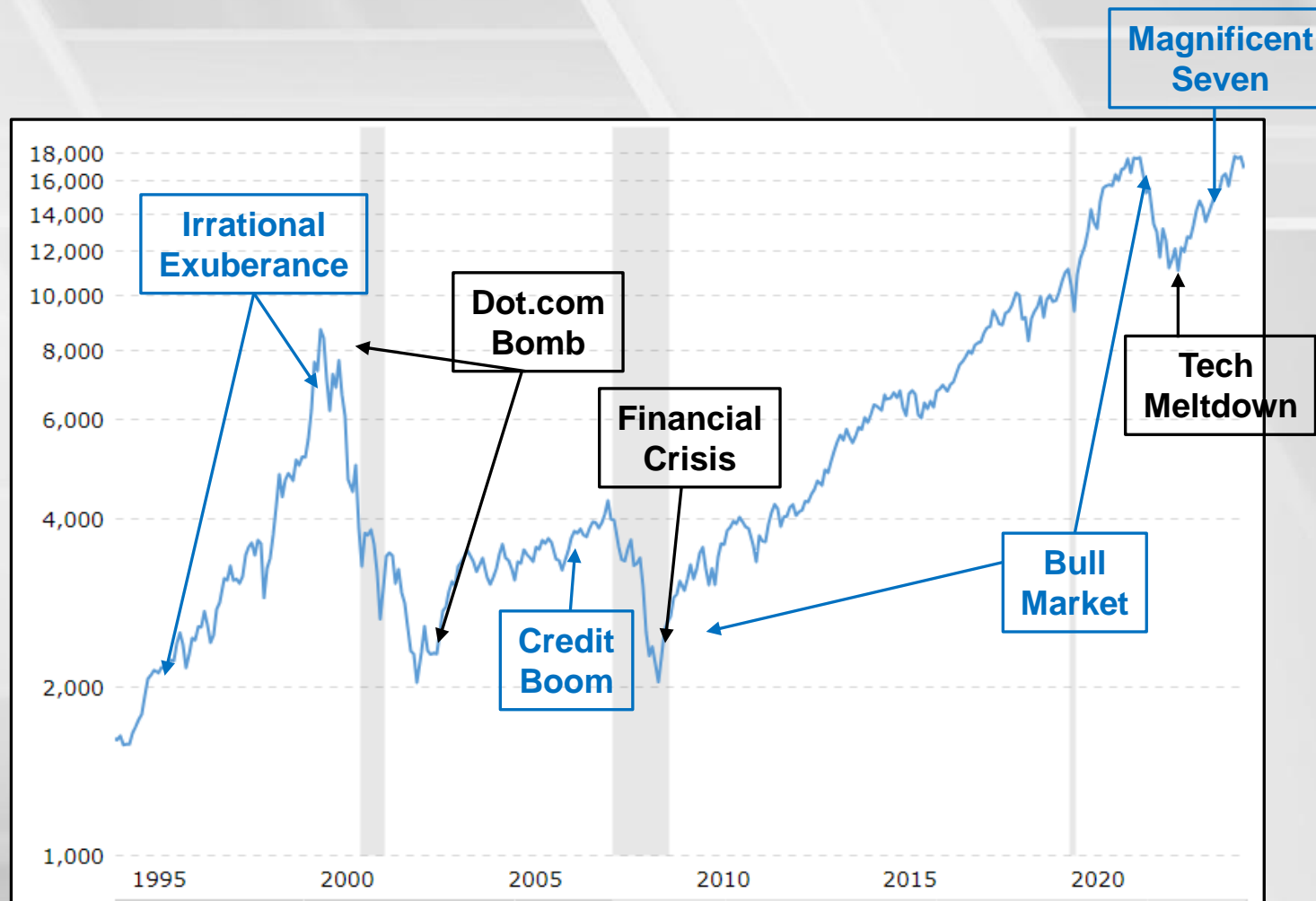
We Have Seen This Movie Before

3 Periods of major retrenchment:

- 2000 – 2002 Dot.com Bomb
- 2007 – 2008 Financial Crisis
- 2022 Tech Meltdown

3 periods of rapid growth in tech stocks:

- 1995 – 2000 Irrational Exuberance
 - 2002 – 2007 Credit boom
 - 2008 – 2022 Bull Market
-
- Tech stocks fall hard, but then rally to greater heights than before.



The State of the Tech Financial Markets

- Magnificent Seven continue to out-perform; 42% YTD.
- Early-stage tech deal flow remains stalled.
- Inflation is below 3%, the Fed target.
- US economy is not in recession.
- First 0.5% cut in interest rates, more cuts expected.
- \$1.5 Trillion in dry capital targeted to the tech industry.

All trends are positive:

Will there be a rebound soon?

Some pundits predict a slow recovery.

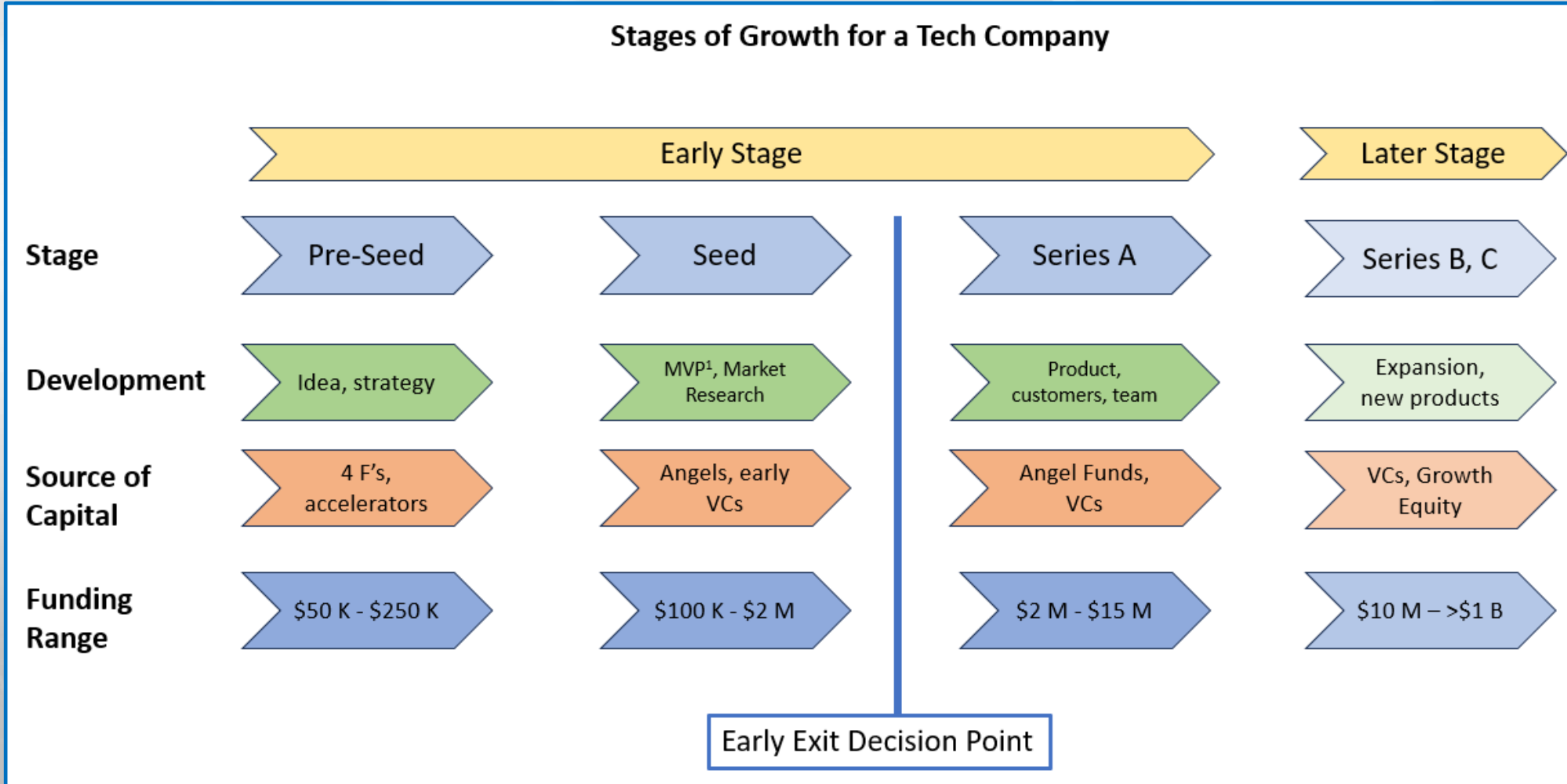
You Can Never Count Out US Tech

- In the middle of the tech collapse, out of nowhere the next BIG Innovation appears: GenAI.
- Fastest rate of adoption in history:
 - 1 M users in 5 days, 100 M in 2 months.
- Funding for GenAI soared in 2023 to \$25B.
- More funding but shifting to commercialization.
- But is it enough to pull the tech industry out of its doldrums?

Types of Investors

- Principal types:
 - 4Fs: Founders, Family, Friends, Fools
 - Angels – lots of variants
 - Venture Capitalists – money and experience

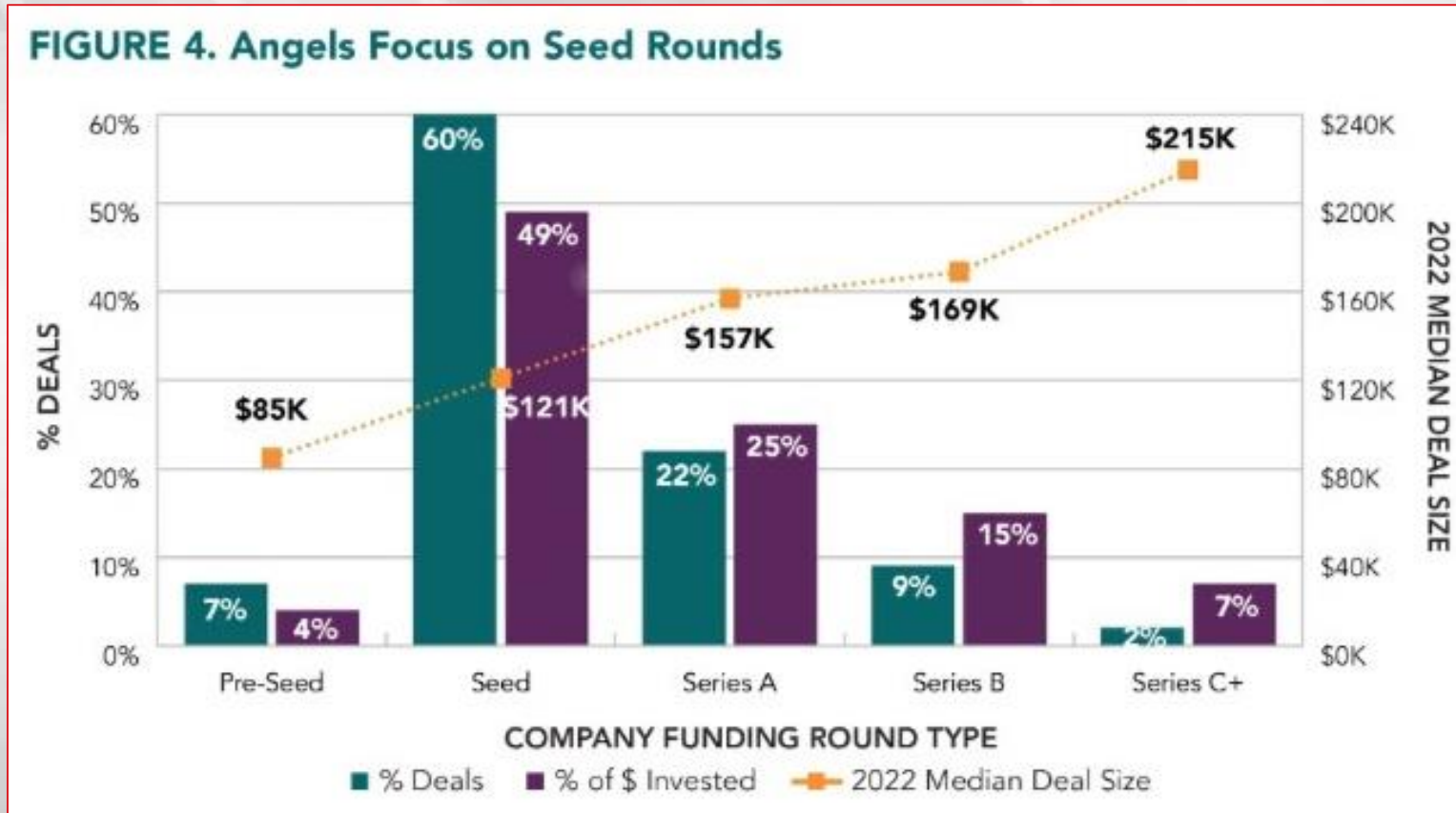
Stages of Growth



Founders, Family, Friends, Fools – 4Fs

- Easiest and maybe only source for start-ups.
- Reasons for investing: love or money?
 - 3Fs: Personal relationship with founder.
 - 4th F: starry-eyed view of potential.
 - If can't manage total loss, *don't take the money.*
- Cost of capital: most scarce resource: Founder's time
- Downsides:
 - No advice.
 - No follow-on investment.
 - Complicates cap table.

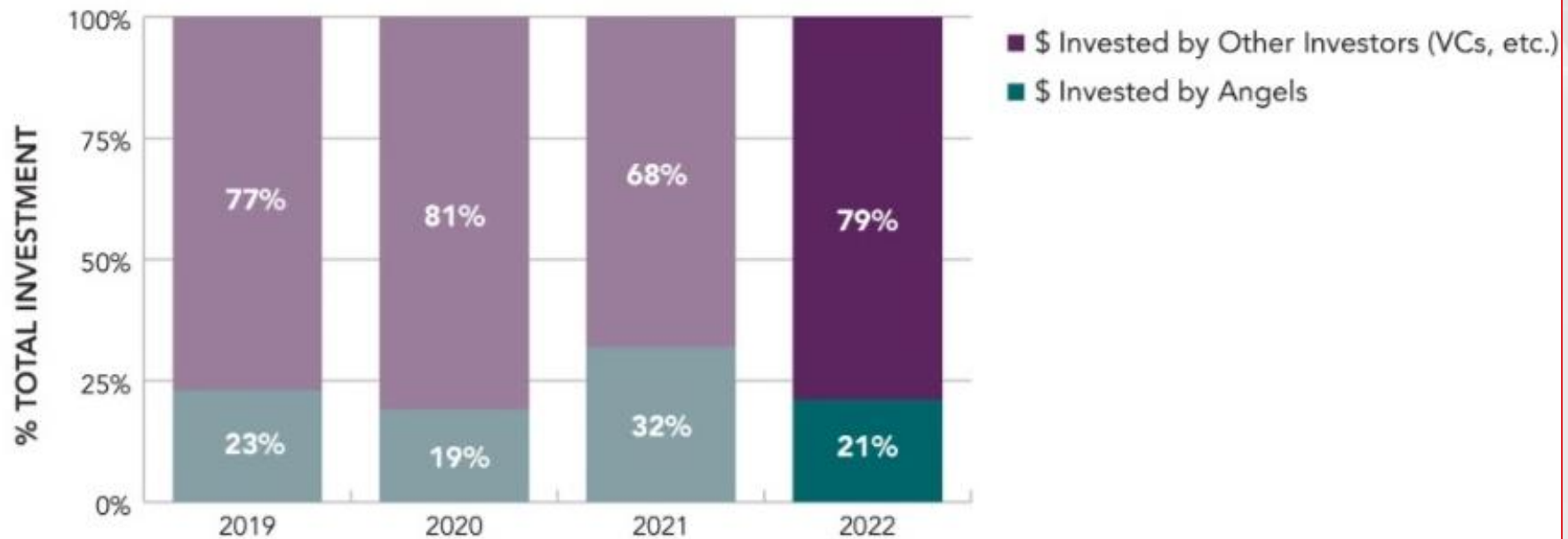
At What Stage do Angels Invest?



- Most angels invest at Seed stage, not Pre-Seed
- But 47% of dollars invested post Seed – follow-on investments significant

ACA Angels Only Invest 20%

FIGURE 5. Angel Impact on Funding Rounds



- Significant co-operation between angels, VCs, and other investors

Investment by Individual ACA Members



- 72% of investments are less than \$50K; many small angels can participate

Angel Take-Aways

- Large number of angels.
- Most angel investments are small.
- Angels collaborate.
- Follow-on investments represent half of all angel investments.
- Diversity of angel investment processes.
- Angels are looking for different things – do your diligence.

Venture Capital has Defined the Economy

- Venture Capital started after WWII, grew slowly until tech companies started to hit home runs in 1980s.
- Success spurred more investment, VC funds, tech companies.
- VCs allocated funds, creating winners.
- VCs funded virtually all the major tech companies.
- VC Assets Under Management exploded to reach \$1.2 Trillion.
- Big tech companies now drive the economy.
- VCs are the engine of growth.

Venture Capital is Very Different

- VCs raise capital from institutional investors and form a fund; not their own money.
- VCs invest the fund proceeds in early-stage tech companies.
- Formal processes for diligence, review potential investments.
- Running a VC fund is a full-time job.
- VCs earn 2% of the Assets Under Management + 20% of the profits.
- VCs expect to remain invested for 10 years or more / save ~50% for follow on investments

Why Do VCs Swing for the Fences?

- VCs target rate of return is 30%.
- If only one or two investments out-perform they will meet their target.
- VCs don't know which investments will be the winner.
- So all investments are encouraged to swing for the fences, even if many strike out in the process.
- Many of the companies that swing and strike out could have taken a smaller exit earlier and earned an acceptable return.
- VCs may block an exit if it does not meet their target return.

How Do VCs Control the Company?

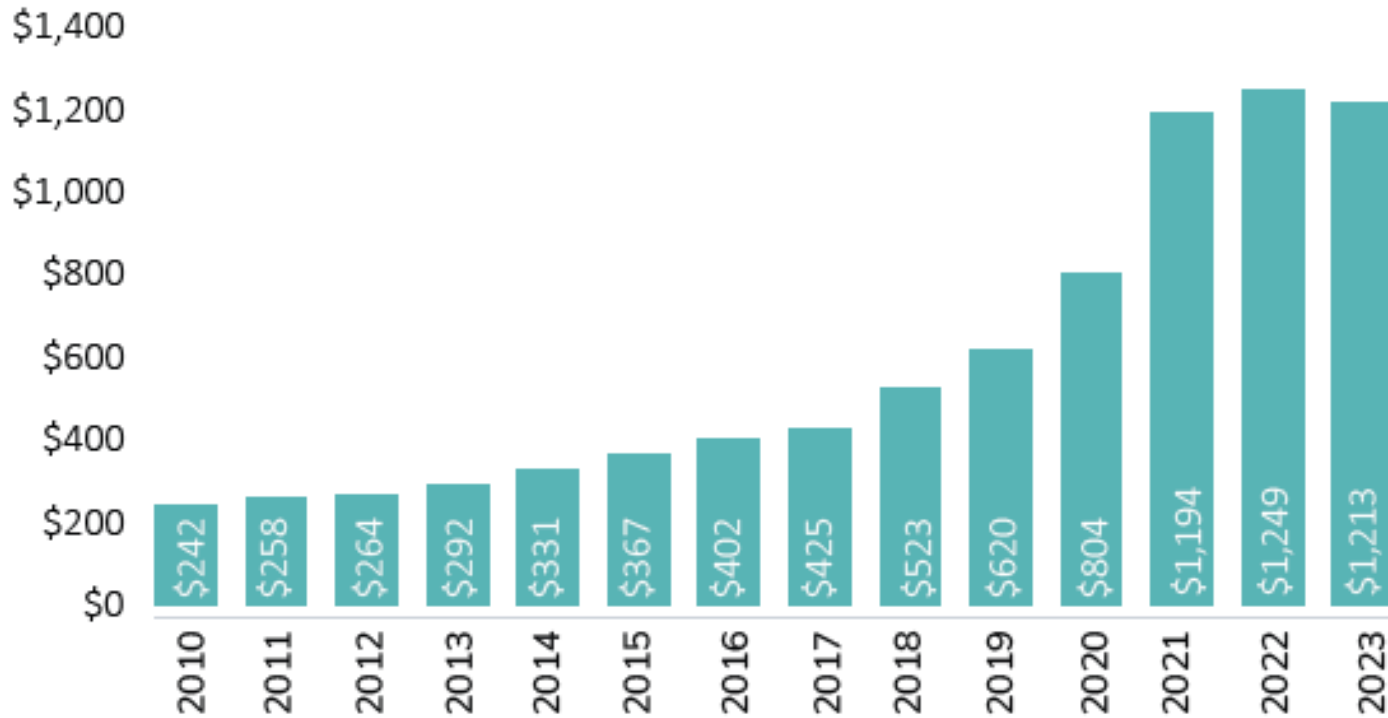
- VCs own separate class of preferred shares.
- Change to incorporation documents: all share series must agree on major items.
- VCs can control: financings, exits, CEO, Board seats, etc.
- Redemption Rights

How Do VCs Earn More than Their Pro-Rata Share?

- Various Form of Liquidation Preference:
 - Non-participating preferred share: VCs can take back their investment, or, convert to common shares and share pro-rata with founders.
 - Fully-participating preferred share: VCs get their investment back *and* share pro-rata of remaining proceeds.
 - Multiple on Liquidation Preference: VCs get back 2x, 3x, or more of their investment and then share pro-rata
- The seduction of warrants

VCs are Drowning with Too Much Cash

US Venture Capital AUM by Year \$(billions)



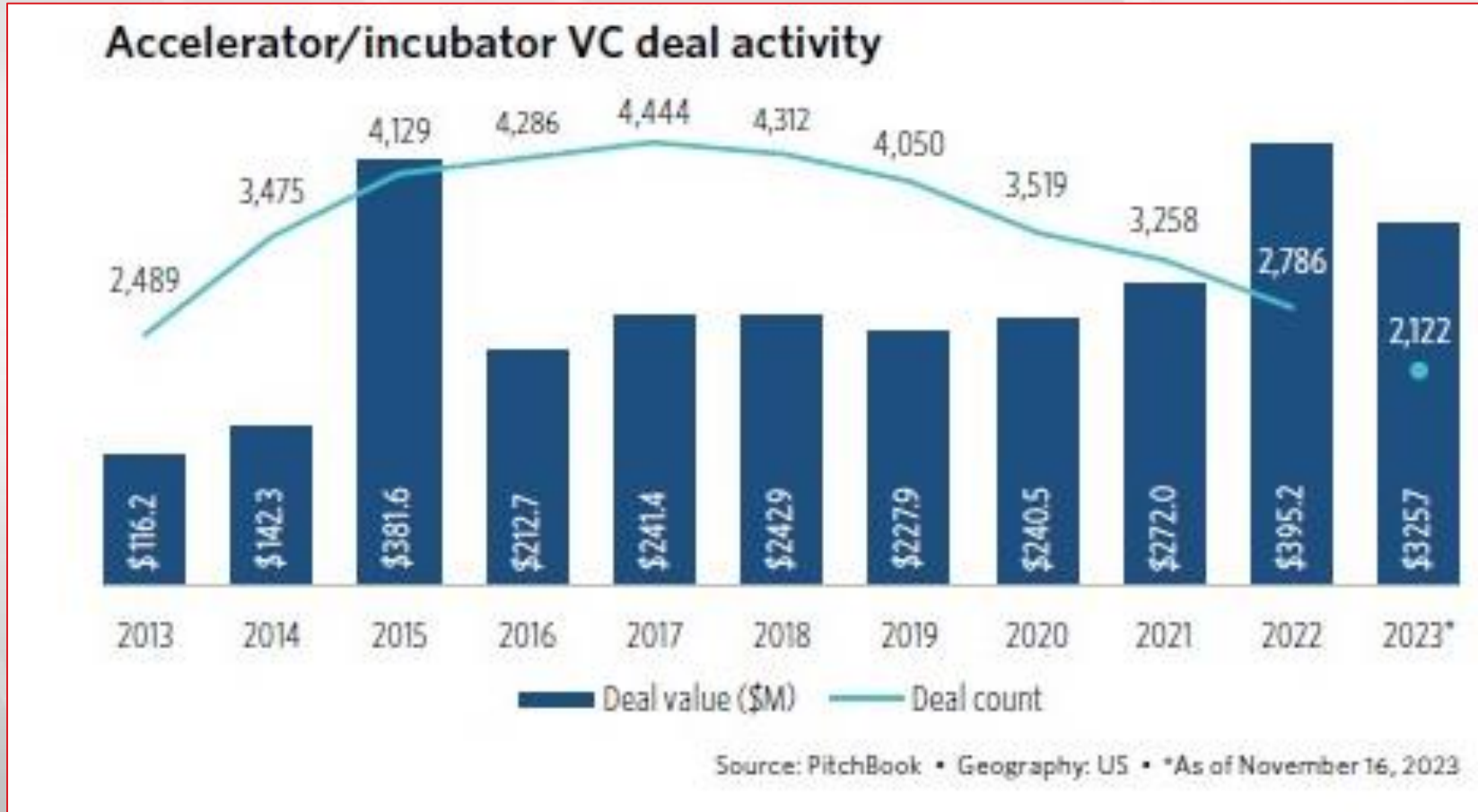
Source: NVCA 2024 Yearbook; Data provided by PitchBook

* Return data through 6/30/2023

Proliferation of New Financing Types

- VCs, angel funds and large corporations are introducing new financing vehicles.
- New angel fund types: VC angel arm, Scouts, Family Offices, Super Angels.
- Angel / VC arms of large tech companies.
- VCs are also introducing new early-stage financing vehicles: Venture Studios.
- Financing ideas at company birth: incubators and accelerators.
- Crowdfunding:
 - AngelList funded 6,017 startups in 2023.

Incubators and Accelerator Deals



The Early Exits Decision Point



Raise Venture Capital

Exit

- Many companies succeed in developing and launching a product, but they need Venture Capital if they want to grow.
- Should they raise Venture Capital to grow, or seek an Early Exit now?

Venture Capital – a Deep Commitment



Raise Venture Capital

- If they choose to raise venture capital, their lives have changed completely, and there is no going back.
- Founders may spend 10 years or more building the company to the valuation that satisfies the VC.
- They may get fabulously rich, or they may struggle, and many companies will die.

Take the Money and Run



Exit

- If the company choose to exit now, they can take some money off the table sooner.

The Early Exits Decision Point



Raise Venture Capital

Exit

- There are Pro's and Con's with each option.

Raise Venture Capital

Exit

Advantages	Disadvantages	Advantages	Disadvantages
Financing may be critical to company's growth.	New financing may be hard to find in cold markets (like now).	Founders control the timing of the exit and may opt to exit early.	Company is sold before it reaches its maximum commercial potential.
New Board of Directors can improve company performance significantly.	Founders could be working for 10 years or more to achieve the VC's target valuation.	Founders receive financial return years sooner.	Company is sold before it reaches its maximum valuation.
	Founders are no longer in control of major decisions.	Founders avoid execution errors common with fast growth and increasing complexity.	An early exit may not provide an exciting financial reward.
	VCs may, and often do, replace the CEO.		

Raise Venture Capital

Exit

Operations	Operations
Large investment in fixed assets	Minimal investments in fixed assets
Build out Sales and Marketing	Sell to a few reference customers
Continued investment in R&D	Develop technology with strategic value
Raise venture capital	Don't raise external capital
Growth trumps all	Stay lean and mean, highly focused
	Proactively look for an early exit

Raise Venture Capital

Exit



Early-stage tech entrepreneurs must weigh the benefits of a smaller, early, more certain exit against the chance of a “Big Win” with a higher risk of failure.

Take Aways

- Tech founders need to learn the basics of tech finance.
- The impact of the macro-economy on the capital markets.
- 4Fs, Angels, Venture Capital; what distinguishes them.
- How VCs control your company with <50% of the stock.
- Angel and VC investment by stage of growth.
- Proliferation of new financing fund types.
- The Early Exits decision point.

THANK YOU

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