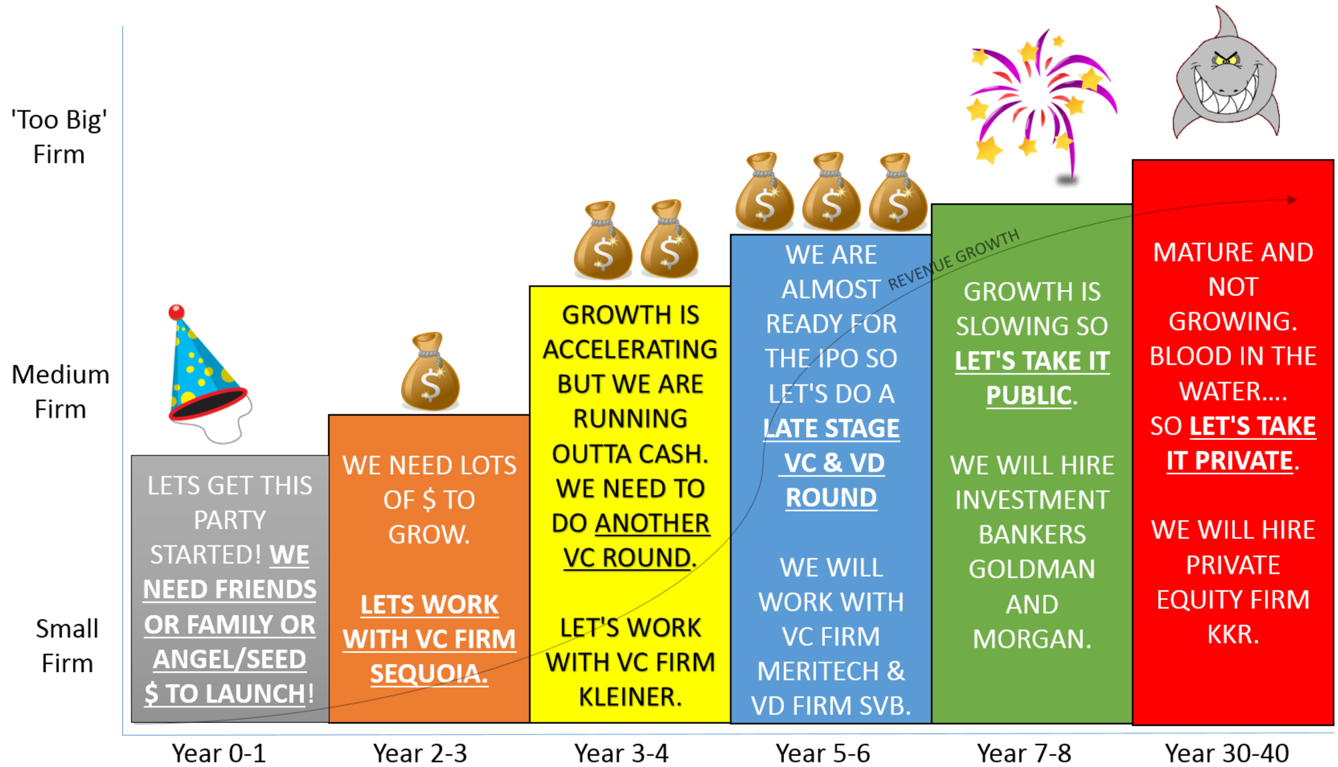
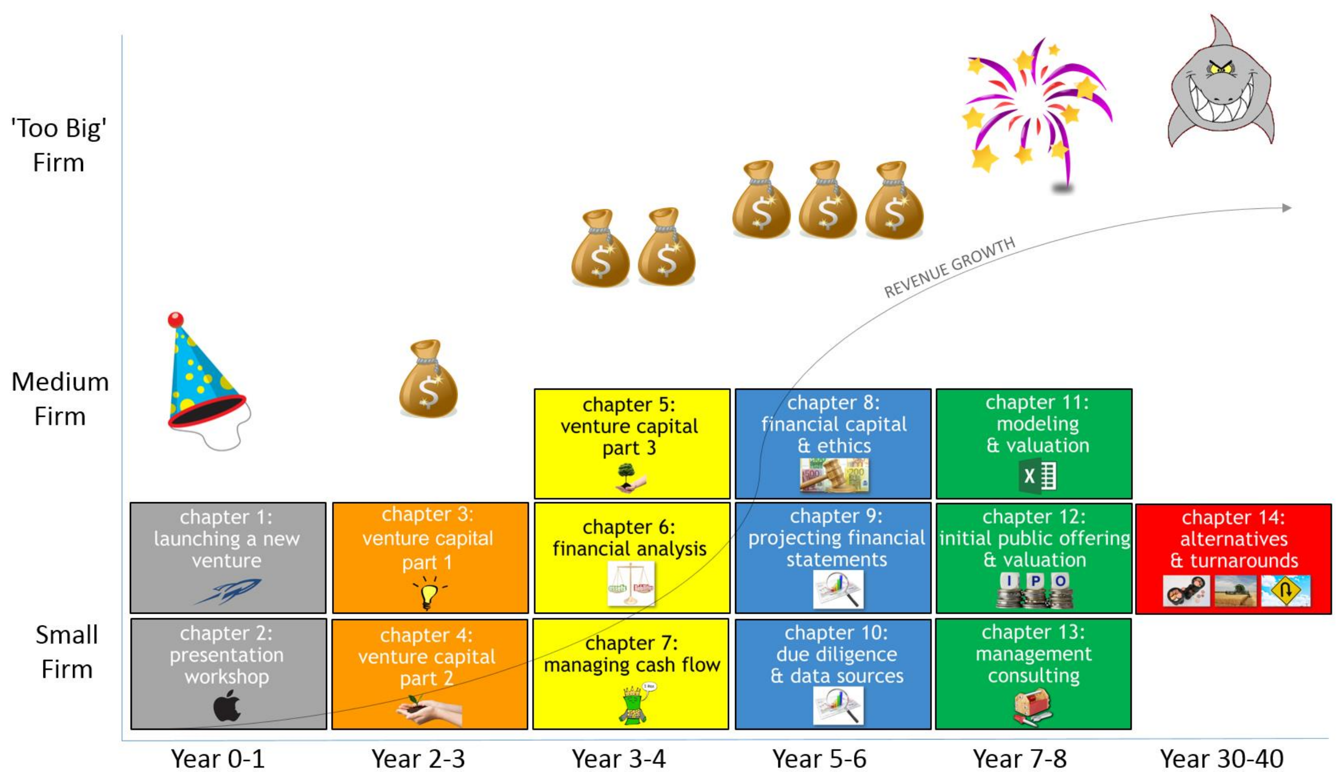
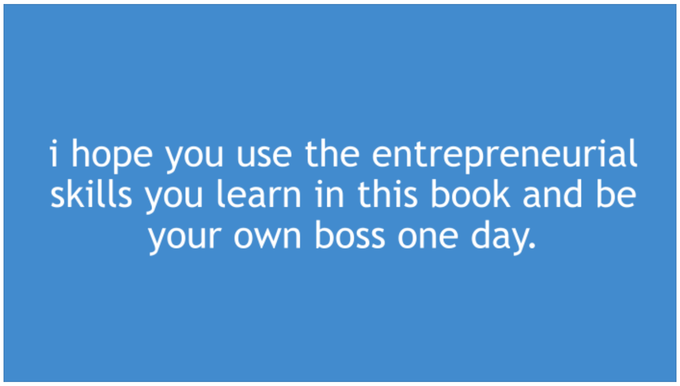
CHAPTER 14: ALTERNATIVES AND TURNAROUNDS

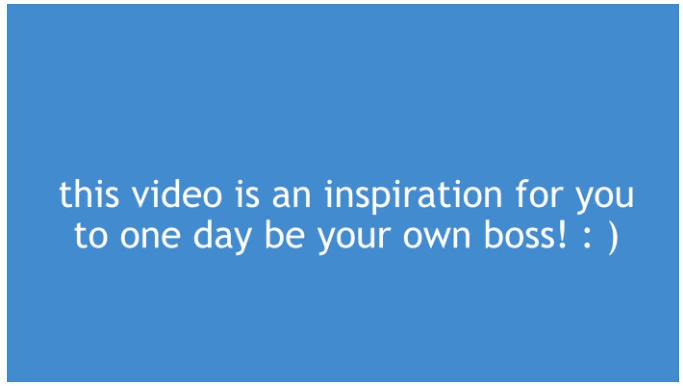
"We are all in. All the time. 24/7. 365 days a year.

100% heart. 1000% passion."


'Too Big' Firm
Medium Firm
Small Firm
LETS GET THIS PARTY STARTED! WE NEED FRIENDS OR FAMILY OR ANGEL/SEED $ TO LAUNCH!
WE NEED LOTS OF $ TO GROW.
LETS WORK WITH VC FIRM SEQUOIA.
GROWTH IS ACCELERATING BUT WE ARE RUNNING OUTTA CASH. WE NEED TO DO ANOTHER VC ROUND.
LET'S WORK WITH VC FIRM KLEINER.
WE ARE ALMOST READY FOR THE IPO SO LET'S DO A LATE STAGE VC & VD ROUND
WE WILL WORK WITH VC FIRM MERITECH & VD FIRM SVB.
REVENUE GROWTH
GROWTH IS SLOWING SO LET'S TAKE IT PUBLIC.
WE WILL HIRE INVESTMENT BANKERS GOLDMAN AND MORGAN.
MATURE AND NOT GROWING. BLOOD IN THE WATER.... SO LET'S TAKE IT PRIVATE.
WE WILL HIRE PRIVATE EQUITY FIRM KKR.
Year 0-1
Year 2-3
Year 3-4
Year 5-6
Year 7-8
Year 30-40


'Too Big' Firm
Medium Firm
Small Firm
REVENUE GROWTH
chapter 1: launching a new venture
chapter 2: presentation workshop
chapter 3: venture capital part 1
chapter 4: venture capital part 2
chapter 5: venture capital part 3
chapter 6: financial analysis
chapter 7: managing cash flow
chapter 8: financial capital & ethics
chapter 9: projecting financial statements
chapter 10: due diligence & data sources
chapter 11: modeling & valuation
chapter 12: initial public offering & valuation
I P O
chapter 13: management consulting
chapter 14: alternatives & turnarounds
Year 0-1
Year 2-3
Year 3-4
Year 5-6
Year 7-8
Year 30-40





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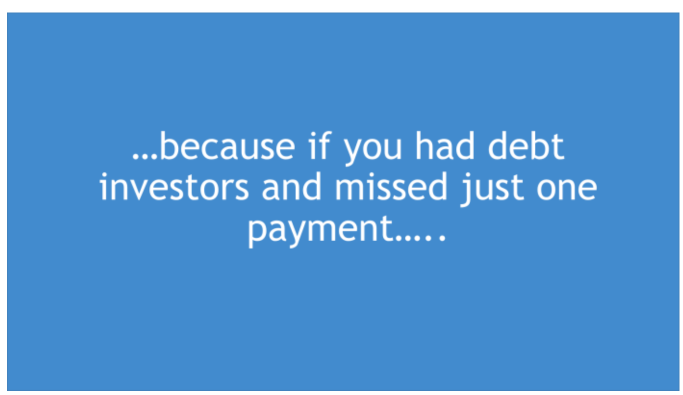
We have started a company in this book. We took the company public. Companies often get too big. When this happens they get too inefficient. Their stock price starts to fall. Investors get upset. Blood is now in the water and here come the sharks.....



….then your business dies.

ok. let's examine additional sources of financing.

raising money is tough. should you pay upfront fees to a consultant to raise you money?

99% of the time it is fraudulent or doesn't work!

fees after trumps fees before.

in real estate, commissions come after a sale and never before!

you will meet many dishonest people in business. keep your guard up!

commercial
&
venture bank lending

commercial loans are possible with a few years of operating history.

commercial lenders want to see cash flow projections based on a few years of history.

they care a bit less about the value of your assets unless they are uber liquid.

lenders hate giving money to earlier stage companies as the government harasses them about NPLs.

vc firms love risk.

debt firms hate risk.

wait! there is a bank that has a brand that implies that they lend to venture startups!

svb

Silicon Valley Bank

svb lends to vc backed startups...

...in return they get interest and more importantly warrants.

for vc firms, equity is the main course.

for vd firms, equity is the sweetener.

entrepreneurs partner with vc

before

entrepreneurs partner with vd

all of the hard work and due diligence was already done by the vc

the vd jumps on the bandwagon.

why u might not get debt financing

- ✓ if you don't have 2+ years financials
- ✓ if you have few tangible assets.
- ✓ if you have low revenue (tech…)
- ✓ 1-2 employees are too valuable

credit cards

- ✓ 50% of startups use credit cards for debt
- ✓ don't get romanced by teaser rates
- ✓ if your cr rating sucks, you can't raise d.

foreign investor funding sources

- ✓ the us government lets you buy lawful permanent resident status if you invest $1mn in a startup and create or preserve 10+ jobs
- ✓ the minimum drops to $500k if it is in a rural or high unemployment region.
- ✓ wow…many people buy the american dream
- ✓ even easier if foreigner invests in a turnaround!

additional government loans

- ✓ for native americans
- ✓ for hawaiians
- ✓ for women
- ✓ for veterans etc

vendor financing

- ✓ 'payable in 2, 10 net 30'…
- ✓ …means you get a 2% discount if you pay in 10 days or else it is due in 30 days.
- ✓ dumb idea though….
- ✓ …as that 2% discount for 10 days = an annual compound rate of over 40%!

vendor leasing

- ✓ kind of like what svb does for loans
- ✓ …except you lease equipment and….
- ✓ …part of payment is in warrants

other financing examples

- ✓ mortgage if the company owns the business
- ✓ 'direct public offerings'….
- ✓ ….means you get a loan of up to $1mn through a syndicate of many investors
- ✓ this is basically crowdsourcing [lending club]

bootstrapping

- ✓ this means you pay for the start up yourself
- ✓ but I advise <u>always</u> advise using O.P.M. …
- ✓ other people's money [unless you are loaded]
- ✓ and set up that LLC so your family is protected.

<u>PLEASE</u> don't ever finance an early stage company with a loan… www.tiny.cc/chris100

topic 2 of 3:

harvesting

harvesting an investment

- ✓ assets can be transferred to investors
- ✓ company can be sold and cash is distributed to investors
- ✓ company goes public and shares are distributed 6 months post IPO lockup

planning an exit strategy

- ✓ you need to explain liquidity targets to investors when you are raising capital
- ✓ otherwise trauma occurs as investors have their own personal liquidity needs
- ✓ easy way to value them is using relative multiples [we covered valuation already]

buyouts.

- ✓ leveraged buyout (lbo)….
- ✓ …financed using debt
- ✓ must have great cash flows to secure loans

buyouts.

- ✓ firms like KKR or TPG can help
- ✓ many public companies partner with these private equity firms and go private….
- ✓ …with the goal of going public again at some point.

buyouts.

- ✓ if management drives the buyout then..
- ✓ …it's called a management buyout (mbo)
- ✓ this took place with nabisco in the 80s with KKR's help (henry kravis)

KKR (Henry Kravis)

and

LBOs in action

Henry Kravis from KKR created the private equity business, which do LBOs (leveraged buyouts) and can take a public company private, which is the opposite of what IPO investment bankers do! www.tiny.cc/chris101

ESOPs.

- ✓ employee stock ownership plans…
- ✓ …employees buy the company using leverage
- ✓ owned by all employees and not just management

IPO

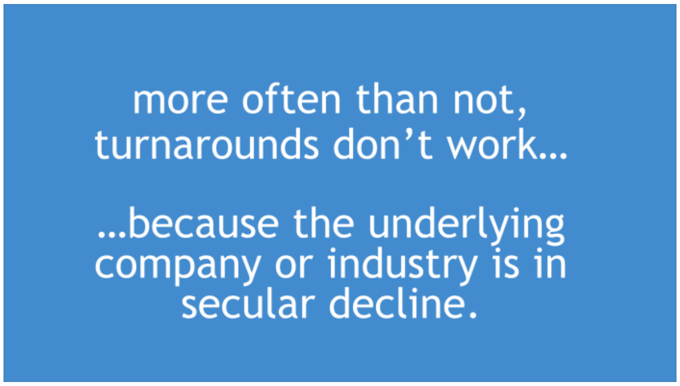
- ✓ we covered this…let's just over a few terms…
- ✓ …primary shares in an ipo means new shares (so the firm gets $)
- ✓ …secondary shares in an ipo means existing shares are sold (for the vc or for employees that want to cash out).

IPO

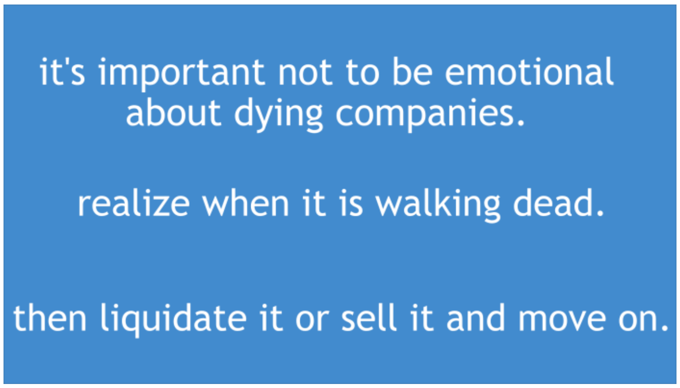
- ✓ 'underwriting spread' is the fee the investment bank gets (usually up to 7%)
- ✓ to list on NASDAQ you need to price at $4+, have over 1mn shares, been in business for a few years, BOD, etc.

topic 3 of 3:

troubled ventures & turnarounds



Corporate raiders restructure companies in the hope of turning them around (even though I don’t believe that turnarounds work in tech, per my article on this topic in the last chapter of this book). www.tiny.cc/chris102



Learn when to shut down a company. Don’t be emotional. Just move on and live to fight another day.

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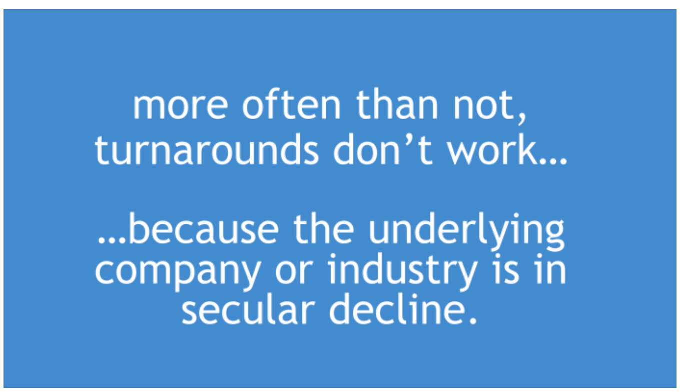

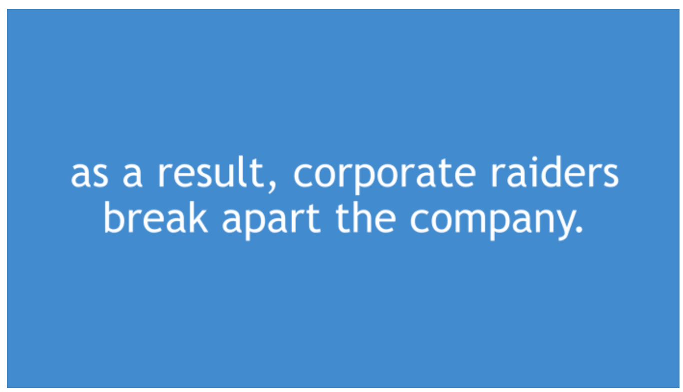

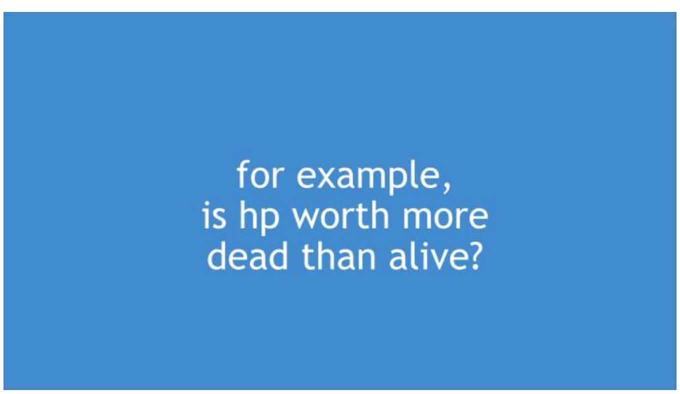

The primary reasons that companies die is that they run out of cash. Cash is king.

financial distress

when cash on hand is insufficient to pay for current liabilities

loan default

miss one payment and it's over.

acceleration provision

when a firm defaults on just one payment then all future payments are due immediately.

cross default provision

one late payment on one loan causes <u>all</u> loans to go into default

foreclosure

the legal process where lenders collect and take stuff from you

LLC protects your family.
equity rules.

This is the house I grew up in in Mississauga, Canada. On the left is a picture of my friend's house. A wonderful family lived there that owned a few amazing Portuguese delis. Unfortunately my friend's father didn't set up an LLC. The restaurants were in his name. As a result, when he missed just ONE payment, the bank took his house and everything in it. Bastards. They even changed the lock on the door. PLEASE protect your family and hire a lawyer when you start a company. She/he will register your company for you so that your family is protected.

insolvent

negative book equity

25% of companies go belly up within 2 years of being founded.

>50% of companies shut down within 4 years of being founded.

WHAT IS 'CHAPTER 11': WHAT IS THIS AND WHY IS IT IMPORTANT TO YOU?

what is all this "chapter this"

and

"chapter that"

stuff in bankruptcy law?

bankruptcy laws is a legal code that has many chapters. i.e.,:

- ❑ chapter 7 is how people/firms liquidate stuff
- ❑ chapter 9 is how cities deal w/ bankruptcy
- ❑ chapter 11 is how firms deal w/ bankruptcy
- ❑ chapter 12 is how farms deal w/ bankruptcy

"chris not only is this session incredibly boring but please show me what my life might be like if i don't follow my dreams and be my own boss one day."

www.tiny.cc/chris104

what about the other chapters?

- chapter 1,3 & 5 are general bankruptcy rules
- chapter 15 = the trustees that help banks
- chapter 13 restructuring personal debt
- most important=7(liquidate),11(restructure)

chapter 7 liquidation

after a person/company files for bankruptcy then a court supervises the liquidation process

chapter 11 bankruptcy example…

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chapter 11 bankruptcy filing

this temporarily protects a distressed firm so they can restructure or pay off debt

buys you time

operations restructuring

increase revenue
or
cut expenses

asset restructuring

selling assets
or
improving ratios like d/e

asset restructuring

you can also improve ratios like:

days sales outstanding

or

inventory conversion period

financial restructuring

changing terms on debt
(i.e., gimme more time)

chris this session is depressing me

can you share a little positive stuff?

YES!

chapter 11 works!

65% reorganize
28% liquidate
and
7% merge with another firm

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chris this session is so interesting now!

can you walk me through ch 11 steps?

HECK YAH!

1: file for chapter 11 with one of 300 bankruptcy courts

2: a bankruptcy judge accepts or doesn't accept petition

3: if no fraud, the company has 120 days to make a plan

4: 60 days is then given to creditors to accept the plan

5: investors then vote

debt sucks early on.

banks don't give a damn.

vc firms care (more)

raise as much $ as you can when you can from equity investors.

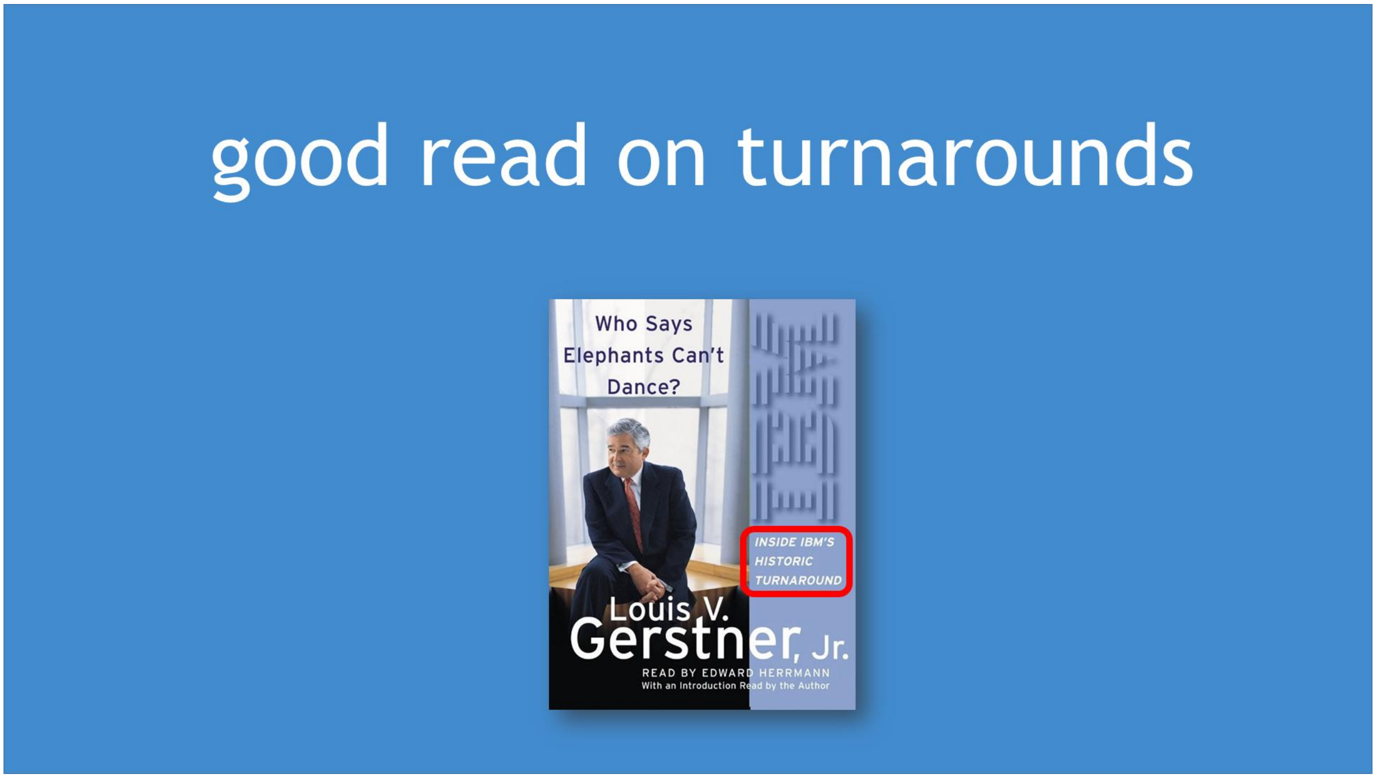
it's almost impossible raising money in a recession.

A butterfly effect can rip through the global economy causing a damn domino effect….which is what happened to many given the Madoff scandal. Heck his name was 'Made Off' so we should known better eh! :)

with all investors, offer near full transparency for 2 reasons (among others)…

…all you have in business is your reputation/integrity.

…and often the same investors will back you again (even if you were not successful! yes it is true)



Questions Based on Chapter 14:

1: Most companies that are not fraudulent that declare Chapter 11 status end up benefitting by restructuring.

True or False

2: Most people and entities that claim that they can help you raise money are not legitimate.

True or False

3: Entrepreneurs usually partner with venture debt firms before venture capital firms.

True or False

CHAPTER SUMMARY