CEOs >

4 Ways CEOs Kid Themselves About an Exit

Giff Constable Axial | June 13, 2018

SHARE

This is the last part of the 3-part op-ed series on the self-deceptions of our industry (i.e. lower middle market M&A and investing). Part 1 focused on private equity, part 2 on investment bankers, and today I turn the spotlight on CEOs.

It's not easy being a CEO, let alone surviving an exit process while in the hot seat. I've been through three, most recently selling Neo to Pivotal (PVTL). While there are many classic mistakes to avoid, this series is really about the ways we deceive ourselves. Here are four:

Self-deception #1: "My buddy Joe got 10x for his business, so I can too."

One of the most dispiriting things for a good banker, all of whom are trying to help their clients achieve their best outcome (I promise), is to meet a CEO or owner with crazy valuation expectations.

A surprising number of people fall prey to fantastical "what if" thinking. The way to keep yourself grounded is to be realistic about your own context, by which I mean the industry, size, growth rate, and overall health of your business.

First of all, get free advice from relevant bankers. Filter out the ones who just tell you what you want to hear. If they have done relevant deals in your industry, they likely will know "comparables" for how companies like yours are exiting. Bankers know that they have to build trust with potential clients — use that to your advantage to get market intel and market knowledge.

Second, be realistic about whether you have strength or weakness in terms of supply and demand in your market. In the real world, valuation isn't set by financial theory, but rather by what someone is willing to pay. I don't believe in super-broad auctions, but I do believe in competition and leverage.

Of course, when you have the right leverage, you can often beat the comparables. For example, in 2005, my colleagues and I advised Tax Partners on their sale to Thomson Reuters. Thomson is an infamously tough negotiator, but because we had two motivated parties AND we managed to keep either from walking too early, we basically doubled the expected price.

Self-deception #2: "I might be worth X today, so I'll be worth much more tomorrow"

Have you ever thought to yourself, "I think my business is pretty valuable today, but if I can hit my goals for the next two years, it's going to be amazing!" That might be true, but just be very clear-eyed about two things:

The first is execution risk. At Broadview/Jefferies, we sold a fintech company called OIS to SS&C. OIS had extremely rosy projections. They were *convinced* of their plans and had a lot of data to back it up. I ran into the founder/CEO a year after they were bought. It turned out that market conditions changed and they totally missed their numbers. I think that he was pretty glad he exited when he did.

The second concern is macro risk. The American economy has had a pretty good run for almost a decade now, and human memories are short. But anyone who remembers trying to sell or raise money in 2007/8, or 2002/3, or 1990/1, or even 1981/2 (you get the picture), remembers how hard it was. Buyers and capital froze up. I hope that this run continues for a good long while, but I do believe that we are in the latter innings of this particular economic cycle.

It might sound like I'm saying "sell now!" but I'm really just saying, "stay clear-eyed about your goals, your timing, and the possibilities."

Self-deception #3: "I know how to sell — why do I need a banker?"

The most critical advisor to have during an exit is a great lawyer. That said, I also am a firm believer in having a banker involved. Not a lot of people talk about this, but when push comes to shove, the most valuable thing a banker brings to the table is acting as a *skilled* buffer between the two sides. So is that really worth the fee?

When I sold my first startup, Ithority, I didn't use a banker but the buyer did. His involvement saved the deal. When I was a banker, I and my colleagues also saved deals on behalf of our clients. The reason why is very simple and very human. In deal negotiations, emotions run high, and your banker can prevent things from overheating past the point of no return.

Yes, there are other elements of value add, not least wisdom around negotiation and process, freeing you up to keep a hand on the wheel of the business, and maybe even keeping you and your family sane through the process, but if I'm honest, just by being a skilled and experienced buffer, bankers keep good deals from blowing up. A fee on a good deal is better than no fee on no deal.

Self-deception #4: "I'll talk to buyers when it's time to sell"

The famous tech investor, Paul Graham, once wrote an entire essay *Don't Talk to Corp Dev*, laying out all the dangers of wasting time with corp dev types. I completely disagree. Yes, be aware of possible shenanigans, but here's the thing:

> *It's harder to get a process moving from a standing start.*

Remember how I wrote about supply and demand up top? Regardless of how narrowly you want to run your process, you *will* want competition. Unquestionably, Axial can help you and your banker by connecting you with relevant, active counter-parties, but you should also build informal relationships with potential acquirers. You want to be on each other's radar. It will make it easier to get momentum if you ever do decide that the time has come to seek an exit.

About the author: Giff Constable is the VP of Product at Axial. Previously, he sold 3 lower-middle-market software and tech services companies as CEO, and was an investment banker at Broadview/Jefferies.