Alumni Ventures

Network-Powered Venture Capital

eGUIDE

The Anatomy of a Venture Exit

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There are currently over 110,000 venture capital-backed companies worldwide.[1] While the majority (67%) of these companies will fail to secure an exit or upround, those that do can earn significant value for stake-holders and investors when it comes time to exit.[2] In 2021, VC-backed companies generated a record $774.1 billion in exit value.[3]

Many factors impact the success (and failure) of a startup, including level of funding, speed of finding product-market fit, and a well-established business model.[4] Companies with the right talent, products, and timing may be able to successfully execute an exit. And the exit methods? Well, there are a few of them.

In this guide, we will explore four different exit strategies — initial public offerings (IPOs), mergers and acquisitions, special-purpose acquisition companies (SPACs), and liquidation — and share examples from our own portfolio.

1 "Venture Capital Database," *Pitchbook*.

2 "Venture Capital Funnel Shows Odds Of Becoming A Unicorn Are About 1%," *CBInsights*, September 6, 2018.

3 Sabrina Fang, "U.S. Venture Capital Activity Soars to New Highs in 2021," *NVCA*, January 14, 2022.

4 "The Top 12 Reasons Startups Fail," *CBInsights*, August 3, 2021.

What Is An Exit?

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An exit is an entrepreneur's plan to sell their company to investors or another company.[5] Hopefully this can be done profitably and at a healthy multiple to the amount originally invested in the business. But even if a business is unsuccessful, exiting wisely (and at the right time) can help reduce the entrepreneurs' — and investors' — losses.

Before beginning the exit process, many companies opt to reach critical milestones to solidify lasting value, resulting in the best return on investment. Those milestones often include boasting a solid customer base and possessing a clear plan for the future.[6]

Time is a factor too in planning for an exit. Different industries may take longer than others to reach full exit potential.[7] For example, SaaS companies on average take nine years to exit, while gaming and e-commerce companies can often take only four and five years.

Timing can also be dependent on market conditions, the company's finances, and the preferences of the team and major investors, among other factors.

5 Adam Hayes, "Business Exit Strategy," *Investopedia,* October 31, 2020.

6 "When Should I Start My Exit Planning?" *NAVIX Consultants.*

7 Sammy Abdullah, "How Long Does It Take a Startup to Exit?" *Crunchbase,* November 25, 2018.

Initial Public Offering (IPO)

One of the most common exit strategies is the Initial Public Offering or IPO. This exit sells ownership of the company through publicly-traded shares.[8]

A pre-IPO company is considered private and only raises capital from a limited number of shareholders, including venture capitalists.[9] However, after an IPO, a company can gain access to more capital and better publicity by listing their shares publicly on a stock exchange. Private investors can then exit their position — typically after a pre-determined lockup period — and sell their shares on the open market, hopefully turning their paper profits into realized gains.

So when does a company know they are ready to IPO? A company will typically begin discussing the idea of going public with key investors and advisors once they feel they are prepared to meet stringent regulatory requirements and the responsibilities to a broad set of stakeholders.[10] While companies can decide to IPO at varying valuations, most choose to delay the jump until they hit a private valuation of over $1 billion — also known as "unicorn status.[11]"

There were 951 IPOs in 2021[12] — more than twice as many as the prior year.

8 Stephen Titcombe, "Exit Strategy Selection: IPO vs M&A," *VCBay*, June 8, 2021.

9 Jason Fernando, "What Is an Initial Public Offering (IPO)?" *Investopedia*, November 30, 2021.

10,11 Ibid.

12 "Number of IPOs in the United States from 1999 to 2021," *Statista*.

Examples of Alumni Ventures portfolio companies that have IPO’d include:

- **Accolade** is an independent health and benefits solution designed to improve experience, outcomes, and cost of medical care. The company was listed publicly at $22 per share in July 2020, equating to a market cap of ~$1.2 billion.
- **Compass** is an end-to-end technology platform that reduces the friction and frustration associated with selling, buying, or renting a property. In April 2021, Compass priced its IPO at $18 per share, equating to a market cap of ~$6.96 billion.
- **Upstart** is a marketplace lending platform that more directly brings together lenders and borrowers. The company listed publicly at $20 per share, equating to a market cap of ~$1.5 billion in December 2020.

Mergers & Acquisitions

Mergers and Acquisitions (M&A) are another common exit strategy. In the U.S. alone, 676 large M&A transactions took place in 2021 ("large" in this case defined as having a deal value in excess of $1 billion).[13]

An acquisition is when one company purchases another company, ultimately granting the acquirer a majority stake in the business.[14] Acquisitions typically occur through a mutual agreement between two firms. However, there are circumstances where a company will forcefully take over another by buying more than 50% of its shares.[15]

While there are different approaches, the acquired firm's shares are usually bought for more than their current market value — generating profit for the existing stakeholders. An example of a well-known acquisition is when Amazon acquired Whole Foods in 2017 for approximately $13.7 billion.[16]

Mergers involve combining two companies to form one.[17] There are two different financing methods for mergers: purchase and consolidation. A purchase merger is similar to an acquisition, in that one company purchases another outright and merges the acquired company's assets into its business. A consolidation merger occurs when firms of the same size decide to join together as one entity through mutual agreement.[18] The merging of Exxon and Mobil in 1998 is one such successful example.[19]

13 "Number of Merger and Acquistion Transactions in the United States in 2020 and 2021," *Statista*.

14 Adam Hayes, "What Are Mergers and Acquisitions (M&A)?" *Investopedia,* May 16, 2022.

15 Brandon Renfro, "What Is an Acquisition?" *The Balance,* April 17, 2022.

16, 17 Ibid.

18 Adam Hayes, "What Are Mergers and Acquisitions (M&A)?" *Investopedia,* May 16, 2022.

19 "The 7 Largest Mergers and Acqusitions," *Global Expansion,* December 6, 2020.

At Alumni Ventures, some of the mergers and acquisitions in our portfolio include:

- **Freshly** delivers healthy, gourmet, ready-to-eat meals to your door. The company was acquired by Nestlé on October 20, 2020, for $950 million — with the potential for future earnouts.
- **Humio's** time-series logging and aggregation platform facilitates real-time observability through log data management. The company was acquired by Crowdstrike in February 2021 for $400 million in an all-cash transaction.
- **JUMP Bikes** offers affordable and scalable bikeshare technology. Uber acquired the company in April 2018 for ~$200 million.

Special-Purpose Acquisition Companies (SPACs)

Special-Purpose Acquisition Companies, or SPACs, are one of the most unique strategies to take a startup public. Unlike traditional methods where investors deploy capital in an established business, a SPAC first raises cash through an IPO (which is held in a trust) and then looks for a private company to merge with or acquire with that cash, thereby turning the private company into one whose shares are publicly traded.

SPACs offer many benefits for private companies. For one, the timeline for a SPAC merger is often two to four months shorter than the six to nine month timeline of a traditional IPO.[20] SPACs also allow companies to negotiate the terms of their public offering and are often combined with an experienced team or board of directors to help guide the company.

Alumni Ventures portfolio company Wheels Up — an innovative membership-based private aviation company — listed publicly via a SPAC merger in July 2021, raising ~$650 million through the process. It is now listed publicly on the NYSE under the ticker UP.

20 Chris Metinko, "SPAC vs Traditional IPO: Investors See Benefits of Blank-check Companies," *Crunchbase News*, December 3, 2020.

Liquidation

Not all exits are positive or within the entrepreneur's plans. As noted in the beginning, only a small percentage of startups survive. The remaining ones often liquidate (ending company operations) due to the inability to pay obligations.[21]

When a company liquidates, any remaining assets are typically sold — often at a discount — to help pay off outstanding debts; the residual value, if any, after all debts are paid is typically divided among shareholders, according to a predetermined "waterfall," or hierarchy of payments (e.g., preferred shareholders before common, etc.). Unlike bankruptcy, where a company has the opportunity to gain a fresh start, liquidation requires the company to terminate the business immediately.[22] Once the process is completed, the company will cease to exist.

Venture is a high-risk, high-reward asset class, and Alumni Ventures has certainly seen some of our portfolio companies liquidate also. One example is Lumiata, an AI platform company optimizing healthcare delivery to individuals. The company launched in 2013 and raised about $50 million before losing its footing, ultimately selling strategic assets to kidney care company Somatus in 2022.

Even well-positioned companies can fold due to unforeseen market risks. AV portfolio company Freebird was a mobile rebooking tool that allowed disrupted travelers to secure a new ticket on any airline instantly. While Freebird saw sustained growth through early 2020, the COVID-19 pandemic resulted in a drastic deterioration of all travel, bringing the company's volume down to almost zero, with no definitive timing on a return to normalcy. In August 2020, Freebird liquidated and sold certain assets to Capital One.

21 Will Kenton, "Liquidation," *Investopedia,* June 5, 2022.

22 MasterClass Staff, "What Is Liquidation? Guide to Business Liquidation," *MasterClass,* February 25, 2022.

Final Thoughts

Not all startups will IPO or sign a lucrative Merger & Acquisition agreement. However, those that do can potentially repay the team's and syndicate's commitment (sometimes significantly). The variety of possible options for an exit give entrepreneurs and investors more avenues to recoup some, all, or — in the best cases — many times the value of that commitment.

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