7 Steps To Monetize Your Shares In A Company

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Jun 19, 2014, 12:07pm EDT

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You've built a successful company, but it isn't a media darling. It takes seven years to take a company to an IPO or an acquisition, according to CBInsights, and you're ready to leave now to build your next company, or just take a break.

While your instinct might be to pivot and move on to your next gig, we'd argue that your focus should be on monetizing your options in your current company.

Turns out, this isn't easy unless you're Pinterest, Uber, Dropbox or Cloudera.

It's a pretty daunting task that'll take everyone of the 90 days you have to exercise your options. This will buy you time and lower the pressure from your spouse to look for a new job right away.

Keep in mind that the odds are that you will not able to monetize your shares in most private companies. Both of us founded Spoke – a company that pioneered the social network space. But 12 years later, it is unlikely that we will be able to liquidate our Spoke holdings – in direct contrast to the situation at our competitor LinkedIn before it went public.

1. Decide if you're going to sell your exercised options.

Assuming you've decided to exercise your options, there's the question of do you sell any of the exercised options. You should consider the following when deciding on this:

- **Generate cash to exercise.** If you don't have the cash on hand, you have to sell some of your exercised shares to pay for the rest.

- **Pay your taxes.** Exercising your options (assuming they are valued higher than your strike price) generates taxes – AMT if you are exercising and holding; ordinary income taxes if you exercising and selling.
- **Manage risk.** If the options represent a significant fraction of your net worth, you probably need to diversify your portfolio.
- **Fund your next startup.** Need we say more?
- **Move on.** Often, one does not want to be burdened by thinking about how the team in place is going to continue building value and increasing the value of your shares. You simply want the freedom to focus on the next opportunity.

2. Put on your best sales and marketing hat.

Prepare a short, yet compelling pitch that paints a picture of the market, tells the company's story, provides a financial snapshot and ends with a statement of your goals for the transaction. You'll use this document to get the initial meeting.

3. Get Your Documents Ready.

Prepare the following docs for when you have a follow-up meeting:

- A mutual Non-Disclosure Agreement that ensures that the company's information is protected and used by the potential buyer solely for the purposes of the transaction.
- A copy of the company's Certificate of Incorporation ("the articles"), most likely from the State of Delaware.
- A more detailed financial disclosure and/or investor presentation that provides insights into the market, the market opportunity, the company's go-to-market, growth in customers, customer and partner case studies, revenue and bookings history and projections with details on key drivers, and a financial summary showing revenue, gross profits and margins, operating expenses, EBITDA, net income and net margins. Be careful not to violate any nondisclosure agreements in place.
- Excerpts from the latest 409A report with the latest analysis of the company's fair market value per share (FMV).
- A statement from your company's CFO on how many shares there are on a fully diluted basis (the "FDS count").
- Your company's Stock Option Agreement/Equity Incentive Plan that, among other things, states what the Company's Right of First Refusal "ROFR") is.

4. Target your buyers. Match your wares with their interests.

When one of us called a friend to tell him that we had left the firm we worked with, his first question was "What are you doing with your shares?" followed by "Go and sell them on the secondary market!"

The secondary market is a group of buyers who buy shares – at a discount – ("illiquid assets") in private firms that they believe will give them handsome returns when the firm goes public via an IPO or gets bought. They are typically looking for two- to three-times returns on their investment and are willing to wait for an exit.

These buyers come in all colors – from institutional buyers, who have raised money from their Limited Partners (LPs, in finance speak) to wealthy individuals. And all sizes – from the smallest individual buyer to firms with $25 million in funding to the larger players with over $500 million in committed funds.

5. Figure out what you believe to be a fair price.

This is probably the hardest– the market is, after all, an illiquid one, and there isn't any history to guide you.

Valuation is a black art; if you want to understand it better, read Aswath Damodaran's book. Here are simplified reference points on determining valuation:

- The health and momentum of your company.
- A 409A report that your company might have commissioned. This should have a recommended value per share based on a couple different methods – the Fair Market Value ("FMV").
  - If you don't have a 409A, the FMV is most likely the price at which options were last issued.
  - Ensure that the 409A is an honest, recent, estimate from a reputable firm (e.g., Silicon Valley Bank). Note that companies are required by law to refresh their 409A at least every 12 months.
  - Other transactions that have been approved in the private market.

Depending on when the 409A was run, the performance of the company and the state of the market, you'll have to estimate two numbers and the latest FMV:

1. The value of each share today.
2. The value of each share at exit.

6. Negotiate your best deal. Pay attention to the deal structure and to the tax laws.

Assuming you can attract more than one buyer, you need to determine how the offer price compares with your expectations. While the buyer hates it and will try to constrain you with a no-shop clause in a letter of intent (LOI), you'll have to work to get the best possible deal.

One of the challenges you'll face is that each offer will present a different deal structure.

- Some will offer you a straight deal: we'll buy everything you have.
- Others will buy all you have and will let you participate in the upside once a certain threshold has been met ("you will get 25% after a price of $X has been met").
- Some others will move some of your unsold shares into escrow and hand them back to you once they have met their financial goal; else, they will sell some of your shares in the escrow account till they meet their financial goals.

You'll have to model the different offers assuming a range of plausible outcomes – ensure that you are running these numbers in consultation with your CPA. The deal structure and the associated tax implications can transform an apparently "lousy" deal into an amazing one – based on when and how much you have to pay in taxes.

Words of wisdom: A bird in hand is worth two in the bush; so, don't get too greedy and risk everything!

Warning: Ensure that all offers have committed capital behind them. Make sure that the manager making the offer can close the contract without having to go back to his/her LPs for approval or to draw down the money to transfer to you.

7. Close the deal. Be prepared for the inevitable delays.

The simplest deal results from the company exercising its ROFR and buying all of your shares. They can do a cashless exercise, using their lawyers to handle the paperwork. It's almost as simple if you exercise all and sell some to the company or to a buyer in a straight deal.

Be prepared for skittish investors in the last minute. They might ask for a call with management, or want to do some more due diligence. Run your process to close around day 75 (of the 90 available to you to exercise your options). If something goes wrong with your preferred buyer, you have time to turn around and close the deal with the next best buyer in 15 days. In the worst case, assuming you are confident about the risk you are taking on, be prepared to exercise your options and then close the deal.

Finally, whom do I call on to talk about monetizing my options?

The secondary market for options grew when early employees of Facebook and Twitter were looking to liquidate their shares and move on to other gigs. A number of funds and market places were created to trade in these illiquid shares. The market is still in flux. However, to get you going, here are some leaders in the space.

1. Akkadian Ventures
2. Atlas Peak Capital
3. Delta-v Capital
4. ESO Fund ESO
5. Founders Circle Capital
6. Harvest Growth Capital
7. Industry Ventures
8. MicroVentures
9. Millenium Technology Value Partners
10. NASDAQ Private Market/NPM
11. SharesPost
12. Skyline Advisors
13. Split Rock Partners
14. W Capital Partners
15. WedBush

In closing

You're taking on a non-trivial task – a small scale version of the process that a company goes through when it's going for an IPO or an M&A event – to reap the financial benefits that you've worked so hard for. Be prepared for the ups and downs. Be realistic, don't be greedyand keep your eye on the ball. And, most importantly, don't forget to celebrate after successfully executing on the transaction.

Cautionary note*: We are not tax consultants and urge you to consult your tax and financial advisor to get the best advice for your specific situation. We assume no responsibility for the tax and financial consequences of any transaction that the reader makes.*

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