THE KEY TO A SUCCESSFUL EXIT

By Frank Lonardelli

One of the biggest mistakes that investors make and certainly, I myself would be included in my early days of investing - is to *not* ask the fundamental question: "How do I get out?"

It's interesting, because as human beings we spend a large majority of our time focusing on how to 'get in,' to fit in; to be a part of something. Not what happens once we 'are' in – and "when should I and how do I get out?"

If you think about it, this thesis applies to our friends, our family, and especially marriage. Though the thought of a good exit strategy does not sound very romantic; before you enter into marriage, one ought to reconcile what the ramifications of 'getting out' are. And this is no different in investing.

Every great investment, and every investor ought to start with: "How do I get out?" as their first question if everything goes well and as planned, and secondly "How do I get out?" if everything does *not* go well and as planned. Are you starting to see the pattern here?

Given the limitations of this article, I will try to condense the answer to this question to a couple of pages, focusing on several key fundamentals that must be considered when planning your exit strategy.

1 Regardless if you are investing into equity or debt, ensure the *intrinsic* value of what you have invested into is worth at least the value of the capital placed into it. This means that no matter what we buy, and regardless of market conditions, if the original development expectations are impeded in any way and/or do not come to fruition in their entirety, the capital we invested into the property will be worth more on a 'going in' basis. This means investors are not exposed to the downside risk because the 'going in' investment value is based on 'placing a sign' on the property the following day and getting more then what you put in, or worst case - the same amount, as a down side assumption.

Every asset class in private equity has a reference-able market valuation which the investor needs to know given that is the standard of intrinsic value to that specific industry. In simple terms, any sub class of real estate has an intrinsic value; be it an apartment, a commercial building, or a parcel of land. You do not make money when you sell your property; you make money when you purchase it. Pay close attention to the upside, but be fundamentally focused on the measures in place to protect your downside when contemplating your exit strategy.

2 Having security through debt, or a registration of security on a hard asset, is a bare minimum for a successful exit. But this, of course, considers that #1 is in place.

> **"The greatest risk an investor takes is to pay into an investment against the promise of 'tomorrow's value' at today's pricing."**

3 It is important to focus on investment companies that are remunerated on performance and do not make a significant portion, if not all of their money, on the promotion. The greatest risk an investor takes is to pay into an investment against the promise of 'tomorrow's value' at today's pricing. In the Private Equity space, there always has, and always will be, deals that come along where the Issuers and product manufacturers make more money on the syndication of the investments than on the actual successful execution of their business plan. Stay away from those companies.

4 Though we have always been taught that the return on invested equity is in direct proportion to its exposure to risk, you do not need to expose yourself to massive risk to create significant gains. To increase the probability of being successful, the asset classes and locations you select should historically outperform all other classes of real estate. But beyond this, there are two other key elements that support the asset class and geography. First, how you purchase the asset. Never buy 'on market' properties. The second element is how the

capitalization is structured, being conscious of the use of leverage in projects.

5 Just like a marriage, know that when going into an investment, it is rarely ever a straight line to success, therefore buy the management team, not the business model. This is probably table stakes for most of you, but invest into a company that knows what they are doing, and not because they are ambitious, optimistic and have a friendly disposition. Look for a team of professionals with strong track records and proven performance. Stick with management teams that are focused, experienced, engaged, and most importantly: specialized. Look for management teams that have not only weathered, but conquered, in volatile markets.

6 Never buy if there is an opportunity to co-invest. Investors can be co-investors in 'institutional grade private market investments.' These investments have already been analyzed, under written, scrutinized and stress tested months in advance of issuing any private offering by major institutions. This can be viewed as providing an extra layer of security for investors.

Contrary to the beliefs of many that investing is solely about making tons of dough, your investment strategy should instead be about making reasonable returns while being fundamentally focused on the mitigation of risk.

Many people invest into private companies that may purport to have a 'value proposition' of investing. So they will invest their capital into companies that have a good or reasonable price to earnings ratio with a long track record of success, and a strong management team. This is a reasonable model. The question is, how reasonably will that model react when the widgets of the companies that the private equity group has invested into are no longer needed, and/or the demand side of the equation has contracted aggressively because of a protracted lull in the economic cycle?

For example, if a private equity company put money into a: fishing business, wireline company, directional drilling company, or a mud supplier (all energy services suppliers) and production decreases by 60%, that investment from an intrinsic value perspective will dovetail the market corrections. In other words, it will decrease by 60%. And though this is a market reality, when investing, especially in Alberta, the questions you want to ask are: "Can I handle a significant pull back on the face value of my investment?" If so, " How do I ensure that the face value does not go to zero?"

The idea of a successful exit actually needs to be benchmarked on the downside risk of exiting at least at breakeven. If you believe that the goal of investing is capital preservation and if you study the creation of wealth you will realize that a realistic exit strategy is the most important aspect of investing. Why is that? Because if you protect your downside, then your upside is usually a foregone conclusion. It is also almost impossible to overcome significant losses regardless of how good your long-term gains are, so protect your capital.

Consider intrinsic value as your starting principal, buy into a team of seasoned professionals that are remunerated on performance and not promotion, and ensure that when investing the company you are investing with has the same interests you do so that you can have a happy 'marriage' with your private equity investments.

Frank Lonardelli is the Founder, CEO and President of Arlington Street Investments. ASI has a 15 + year track record of successful real estate investing and currently has over $500 Million dollars in commercial real estate development located in high profile inner city sites in Calgary, Alberta. ASI has received 2 National Investment Awards for its projects in the last 3 years and has been the subject of several articles written about its successful strategy and projects from both regional and nationally recognized business and industry publications. ASI exclusively raises private equity from their growing list of accredited investors, family offices and institutional investment houses.