Xconomy

Xconomist of the Week: Phil Libin, Evernote, and the Death of the Exit

Wade Roush 10/27/11

Xconomist Phil Libin, the CEO of Mountain View, CA-based Evernote, is a little unusual among his Silicon Valley brethren. He's on the record as saying that the online notekeeping startup doesn't want to be acquired. "There has never been an *exit strategy* at **Evernote**," he wrote in an FAQ-style blog post after Evernote raised $50 million in a round led by Sequoia Capital and Morgenthaler Ventures this July. "We don't want to exit, we want to build a permanently great company."

But if you don't exit, how do your backers ever see a return on their investment? The trick, as it turns out, is to keep raising venture money forever—or at least, for a very long time. Some of Sequoia and Morgenthaler's $50 million went into the pockets of Evernote's early investors rather than into the company's coffers. And in the future, perhaps other investors will pay off Sequoia and Morgenthaler. This kind of so-called "secondary market" trading is becoming more and more common in Silicon Valley, and Libin's point is that it opens up an entirely new strategy for startups: focus on growing, rather than getting acquired or going public.

"The goal is to build a profitable, permanently great company," says Libin. "Probably a public company eventually, though there's no rush for that and an IPO is not an exit, just another in the long string of partial liquidity events where some investors leave and some come in. Multiple private rounds and secondaries is a great tool to reach that goal."

I talked with Libin this week about his "100 year" plan for Evernote and the progress the company has made so far. The truth is that Evernote, more than most other companies, *needs* to survive in some form for 100 years or longer, since its whole pitch is that it will store user' personal notes—text, photos, audio, Web pages, e-mails, you name it—forever.

That's a pretty big promise. But the three-year-old freemium service has become so popular—with more than 11 million users and more than 10,000 outside developers writing apps that connect to Evernote's services—that it seems likely to stay around, at least for a while. Here's an edited writeup of my conversation with Libin.

Xconomy: You've talked about wanting Evernote to be a "100 year company." What does that mean in practical terms, and how is the way you're running Evernote different from the way you ran your first two startups, Engine 5 and **Corestreet**?

Phil Libin: I think the difference between Evernote and both of my previous startups is that the first two times around, we took this question quite seriously of "What is our exit strategy?" That question permeated the company culture. But it's not a particularly natural question. It presupposes a lot of things.

I think what was happening for many years was that liquidity and exits were tied together in the VCs' minds, and therefore in the entrepreneurs' minds. So if the business model demands some kind of liquidity, sooner or later the investors want their money back, on a finite time scale. I think what's happening now, just in the past couple of years, is that a bunch of the better startup companies are really not thinking about exits at all, so they are free to think about how do you build a good company and get a good return for your investors. That's a much nicer, more natural way to think.

X: What has changed?

PL: Starting with **Facebook**, liquidity and exits were totally decoupled. You don't need to exit for your investors to get their money back. It's the decoupling of liquidity and exits that is probably the most underappreciated change going on in Silicon Valley, because once you separate liquidity and exits, you can incent entrepreneurs to build truly great companies, without having to take shortcuts.

X: But to a large extent, the trend you're talking about comes down to one person and one fund—Yuri Milner at Digital Sky Technologies, who has invested large amounts in Facebook, **Twitter**, **Zynga**, and other companies, and provided liquidity to a lot of early shareholders in the process. Not every startup has a Yuri Milner or a Sequoia Capital willing to buy out early shareholders. So how broad-based is this phenomenon?

PL: I think Yuri was definitely the guy who got it started, or at least gave it enough mass to get started. But at this point it is powering itself. In hindsight, it looks like the obvious thing to do. But part of Yuri's genius is seeing that which, in hindsight, is obvious. It's not like he had significantly more money. It's just that for whatever reason, the startup narrative conflated exits and liquidity, but Yuri and a couple of other [investors in] Facebook broke that and said, "Look, this doesn't make sense." So the world has totally changed. But it's only been like this for two to three years, at the most.

X: How is this trend at work within Evernote?

PL: The idea with Evernote was to make a 100-year company, which means we have to have a series of financing events, liquidity events, which serve two purposes. First, they allow existing shareholders to sell the stock they want to sell and allow other people to buy it. That means founders and other employees who have been here a long time have the ability to get some liquidity. The other point of these financings is to enable a steady increase in operations. We get acquisition currency that enables us to acquire other companies. Right now the secondary markets support doing that about once a year. If the market changes, that's fine. Our goal is to always have enough cash so that we never have to time the market.

X: I've spoken with Silicon Valley executives who are concerned that allowing startup employees to cash in their shares on the secondary markets will destroy their incentive to stick around for the long haul. Do you ever worry about that?

PL: No, that is ridiculous. You don't have a hold on people. I don't want people waiting around here because we have set up structures that mean they can't leave. We want employees to be here because they love being here. We want them to be comfortable that they can sell 5, 10, or 20 percent of their holdings and be secure enough to buy a house or send a kid to college.

Plus, if you sell 20 percent, you still have 80 percent. My job is to take care of the employees, and if I can't come up with a single reason for people to stay once they hold 80 percent of their shares instead of 100 percent, that's my problem.

X: Let's change gears and talk about Evernote's progress. You had your first developer conference and competition this summer, where you invited lots of programmers who are working on apps and services that connect to Evernote. You've long had application programming interfaces that let outside developers write such software, but up until the conference, you had never really spoken about Evernote as a platform that other companies can build on top of, in the same way that developers might think of Facebook or Salesforce.com as platforms. Why not?

PL: I think we started planning the developer conference about nine months in advance. We said to ourselves, "We think we have enough traction now to where we could help the community advance further by having a conference and a competition." Our plan had always been to make a platform of this—but you're right, we were pretty careful not to overhype that phrase. It's the sort of thing that you want other people to say about you, not to say about yourself, just for credibility.

X: What's the evidence that you've turned that corner?

PL: Just the numbers that we see—there are more than 8,000 third-party developers at this point, and they've built quite a bunch of high-quality products. Some were featured at the conference. There is a next phase that we'll get to, which we also announced at the conference, where developers will be able to put Evernote functionality inside their apps. We're pretty excited about that. There is a high degree of uncertainty, but we are working with some selected third-party developers now and seeing preview builds. You'll be able to access your Evernote notes from outside Evernote, and third parties will be able to build plugins and extensions that allow much richer integration. All of that is launching early next year. That's the next major stage for us.