

Valuation of Your Business
OR
Voodoo Supported by Numbers

**Business Owners and Entrepreneurs
Symposium**

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Why Put a Number on Company Value?

- I. Preparing for Equity Funding
- II. Stock Value for Employee-Owned Companies
- III. Stock Option Pricing
- IV. Preparing to Sell
- V. Morbid Curiosity

Valuation's Role

- Determines what a share of stock is worth
 - Determines what percentage you own after a VC round
 - Determines what employees will pay for a share
 - Determines option strike price
- Can have tax implications
- .
- **VALUATION IS SUBJECTIVE**
 - Value to Whom?
 - Why is it Valuable to that Person?
- **IT'S ALWAYS WORTH LESS THAN YOU THINK**

Why Valuation is important

	Pre-Funding		Post Series A		Post Series B		Sale @ \$100M
	Ownership	Value	Ownership	Value	Ownership	Value	Value
Founders	75.0%	????	37.5%	\$ 1,500,000	25.0%	\$ 7,500,000	\$ 25,000,000
Option Pool	25.0%	????	12.5%	\$ 500,000	8.3%	\$ 2,500,000	\$ 8,333,333
Series A (\$2M)			50.0%	\$ 2,000,000	33.3%	\$ 10,000,000	\$ 33,333,333
Series B (\$10M)					33.3%	\$ 10,000,000	\$ 33,333,333
Total				\$ 4,000,000		\$ 30,000,000	\$ 100,000,000

	Pre-Funding		Post Series A		Post Series B		Sale @ \$100M
	Ownership	Value	Ownership	Value	Ownership	Value	Value
Founders	75.0%	????	45.0%	\$ 2,250,000	30.0%	\$ 9,000,000	\$ 30,000,000
Option Pool	25.0%	????	15.0%	\$ 750,000	10.0%	\$ 3,000,000	\$ 10,000,000
Series A (\$2M)			40.0%	\$ 2,000,000	26.7%	\$ 8,000,000	\$ 26,666,667
Series B (\$10M)					33.3%	\$ 10,000,000	\$ 33,333,333
Total				\$ 5,000,000		\$ 30,000,000	\$ 100,000,000

Methods of Valuation

- Discounted Cash Flows
- Comparables
 - Similar Deals
 - Public Companies
- Target Ownership

Discounted Cash Flow

- The Value a Series of Cash Flows has **now**
- Takes time value of money into account (interest rate)
- Purely numerical – works for operating companies only

DCF Example

Discount Rate	Year 1 Cash Flow	Yr 2	Yr 3	Yr 4	Yr 5	Value of Company (NPV)
10%	\$100,000	\$200,000	\$300,000	\$400,000	\$500,000	\$1,065,258

Voodoo:

- Discount Rate
- Accurately Estimating Cash Flow

Pros and Cons of DCF

- Pros
 - Highly quantitative
 - Provides specific, objective (?) numbers as a basis for negotiation
 - Speaks to “Intrinsic Value” of company
- Cons
 - Too many variables
 - Depends upon accurate forecasting
 - Doesn't account for strategic value
 - Difficult to discount for risk and illiquidity

Comparables

- Most closely resembles Real Estate valuations
- Two Methods:
 - Compare to transactions
 - Compare to public companies
- Adjust up or down for specific circumstances

Adjustments to the Comparables

- Current capitalization
 - Cap table
 - Past investment rounds
 - Current cash position
- Product development
 - In Beta
 - In release
- Management
 - Good or bad management

Adjustments to the Comparables

- Business Development
 - Sales booked
 - Quality of sales pipeline
 - Profitability
- Growth Rate
 - Larger growth rate can overcome smaller earnings
- Public vs. Private
 - A private company will be devalued compared to public 50% or more

Comparing to Transactions

useful for VC rounds, gearing up for sale

Company	Sales Price	P/E	P/Sales
A	\$1,000,000	10.5	2.3
B	\$2,500,000	21.0	3.0
C	\$1,750,000	20.0	2.0
D	\$4,250,000	15.0	2.75
Average		16.63	2.51
		Earnings	Sales
Company		\$200,000	\$2,000,000
Valuation		\$3,325,000	\$5,025,000

Comparing to Public Companies

useful for internal stock & option pricing

Company	Market Cap (\$1000s)	P/E	P/Sales
A	\$1,000,000	10.5	2.3
B	\$2,500,000	21.0	3.0
C	\$1,750,000	20.0	2.0
D	\$4,250,000	15.0	2.75
Average		16.63	2.51
		Earnings	Sales
Company		\$200,000	\$2,000,000
Discount		3	3
Valuation		\$1,100,000	\$1,650,000

Pros and Cons of Comparables

- Pros
 - For company sales, no need to adjust for risk or liquidity
 - Most common method for early stage
 - Fast
- Cons
 - Highly subjective – picking comparables is difficult
 - Public vs. Private comparisons tricky
 - Imperfect distribution of information

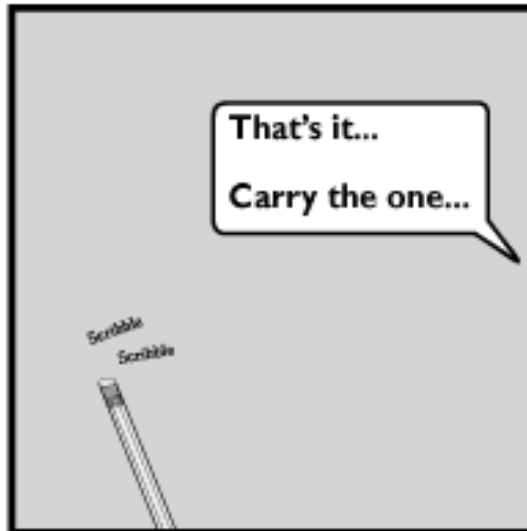
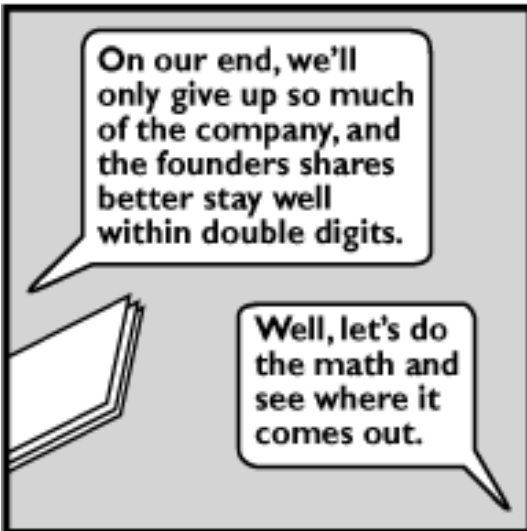
Target Ownership Example

- Calculates a percentage based on required ROI
- Investment requirement: \$2 Million
- VC Returns: 40% - 60% ROI
 - = 5X in 3 years (60%)
 - = 10X in 5 years (60%)
- VC's share at the end of Year 5: \$20 Million (~10X times \$2 Million)

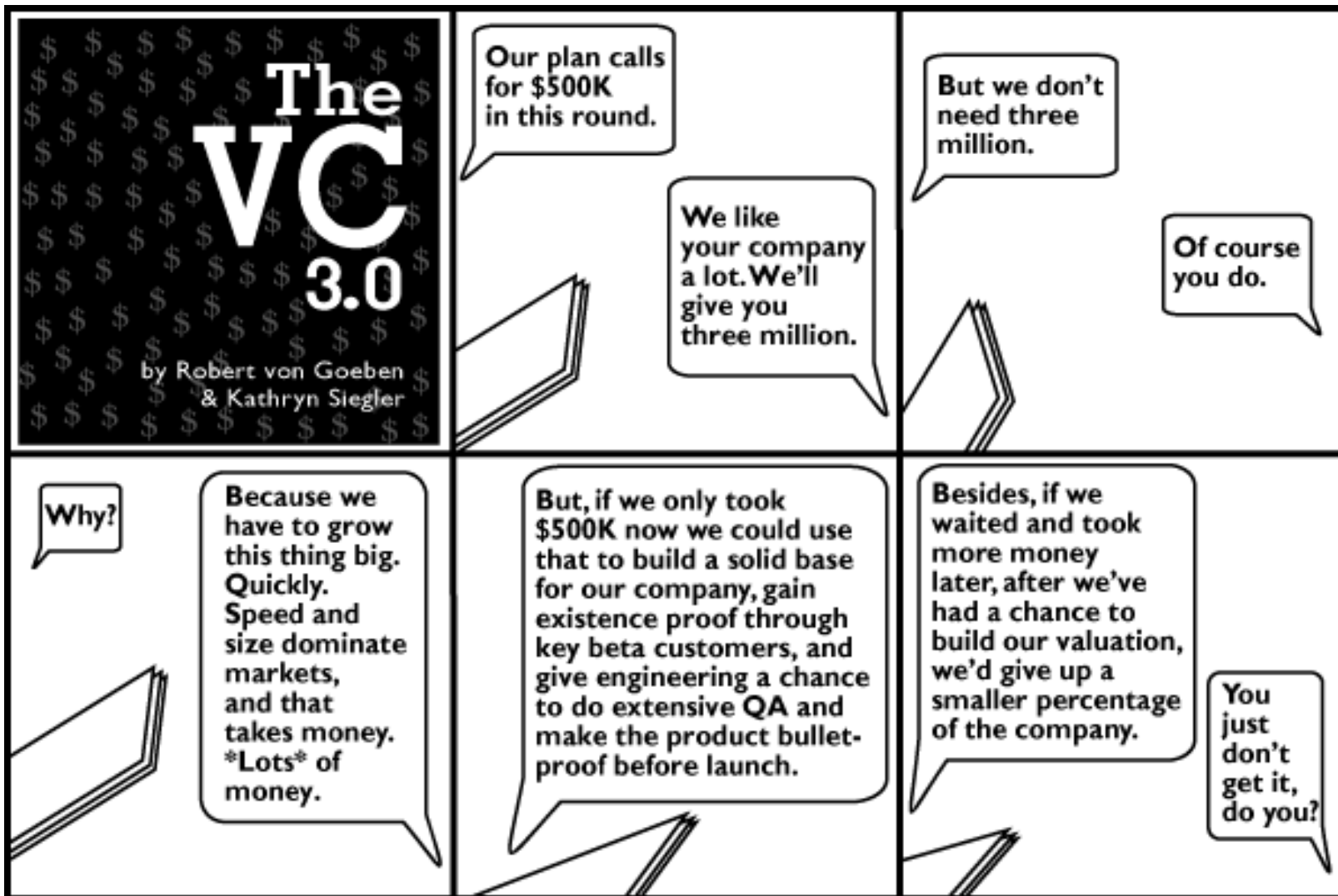
Venture Capital Method Ex.

	Your Projections, Average P/E	Our Discount, Your Projections, Lowest P/E
Net Income (NI)	\$20 Million	\$20 Million
Discount Rate	-	100% (50%)
Adjusted NI	\$20 Million	\$10 Million
Earnings/Share	\$2.00	\$1.00
P/E	10	5
Share Price	\$20	\$5
Market Cap.	\$200,000,000	\$50,000,000
V.C. Share	10%	40%

Total # of shares = 10,000,000



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