

Company Valuations

Knowing how much to sell at what price



Before we delve into this topic, we must start by reminding you that this is not legal advice, just a high level description of the various methods used in the industry. You must seek professional advice on valuations and term sheets.

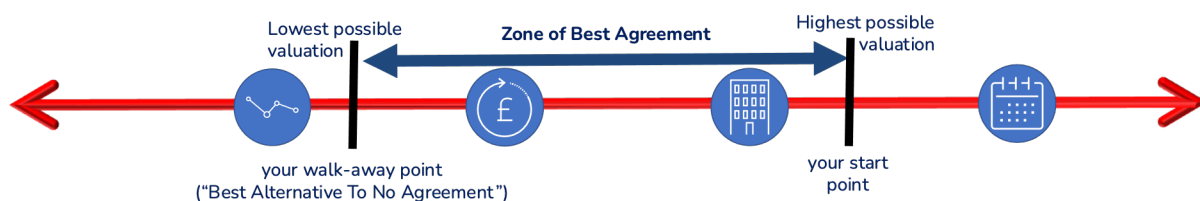
What valuation to place upon your company is often a difficult thing to undertake as each company is different. It is often said that valuing pre revenue, and especially pre-revenue technology companies is an art, more than a science - the art of negotiation.

Often people try to use standard tools such as Discounted Cash Flow and Net Present Value but the wide range of uncertainties in the input variables for this approach leads to an unacceptable error range in the final valuations.

Low cash flow predictability	High cash burn	Investors lack info to do due diligence
Weak asset base	Substantial working capital requirements	
New management team		

At the of the day, Price is what the market will pay and Value is what it is worth to the investor. The valuation of your business is critical: a high 1st round price may limit your ability to attract future investors. With equity, you are not giving anything, you are selling, and you must negotiate the right price. There are several estimates that we can use to give us a range of company values. These estimates provide the framework around which we can negotiate. Example models include:

Min/ Max % Stage Valuation	Discounted Cashflow Asset Valuation	Cost to Duplicate Market Comparisons
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Stage Valuation, a simple rule of thumb based approach. This is a rough and ready reckoner, that gives you a ball park starting point. Numbers are not valid for all sectors.

Stage of Development		Estimated Company Value
1	Exciting business idea or business plan	Grant Funding/FFF
2	Strong management team to implement the plan	250,000 - 500,000
3	Demonstrates final product/technology prototype & supply chain in place	500,000 - 1 million
4	Range of strategic partners in place, or signs of relevant customer base	1 million – 2 million
5	Repeat sales, clear signs of revenue growth & obvious path to profitability	2 million – 5 million



Min / Max %, another common approach. In return for 18 months cash burn, resulting in a significant change to the company status, such as taking a prototype to initial sales, then investors expect a minimum of 15% (where they gain some shareholder rights) and a maximum of 30%, where the company is often considered over diluted.

Asset valuation. Here we combine the value of buildings, equipment, products & resources – This includes tangible as well as intangible. As an early stage company it is tricky to value intangible assets, such as brands. Many people include the value of grants awarded, but not drawn down.



Cost to duplicate. If we had to start again – what would it cost to get to where we are now? This assumes you would not make the same mistakes, the rest of the market has moved, perhaps you would aim for a different point second time round that is more useful. This is often asked assuming that your key team has been headhunted away to the new venture.

Discounted Cash Flow. Often used with other models. We look at the future cash generated by the company, and convert it to today's cash. This effectively removes inflation and makes everything in today's money. We then multiply this cash value by a risk factor. In early stage companies, the risk factor is significant – making this model best suited for companies that are in their mid to late growth stage.



Market Comparison. This is a method that is favoured by the professional investor. In essence what have others paid for similar companies to this opportunity. The difficulty lies in making sure that the companies are truly similar. A significant difficulty for unlisted companies is securing the raw data to make the comparisons. Dedicated subscription databases are available to help.

Basic “Venture Capital” Valuation Methodology. This can look difficult, but is not so bad. You start off by deciding how much money is required now. Then estimate the income at time of exit. With the income “known”, you look at exit comparables to then estimate your future company value. You can then use an Internal rate of return calculation to give the basis for a deal today



Raising finance is rarely easy. If you can not agree a valuation one approach is to use a *convertible note*, which is a loan that can be converted to stock at some future date. The loan will often carry interest and the future stock will be at a discounted price to the new investors. Often used either at the very earliest days, when IP is notoriously difficult to value, or as a stop gap from existing investors between rounds.

Sometimes new shares are issued to investors if the management team fails to hit company targets, and in some cases given to management if they exceed targets. This is all down to negotiation. The value of your company significantly increases as you provide evidence that the project is progressing.

Inflexion Points

