

Valuation of Angel Deals

York Angel Investors Inc.

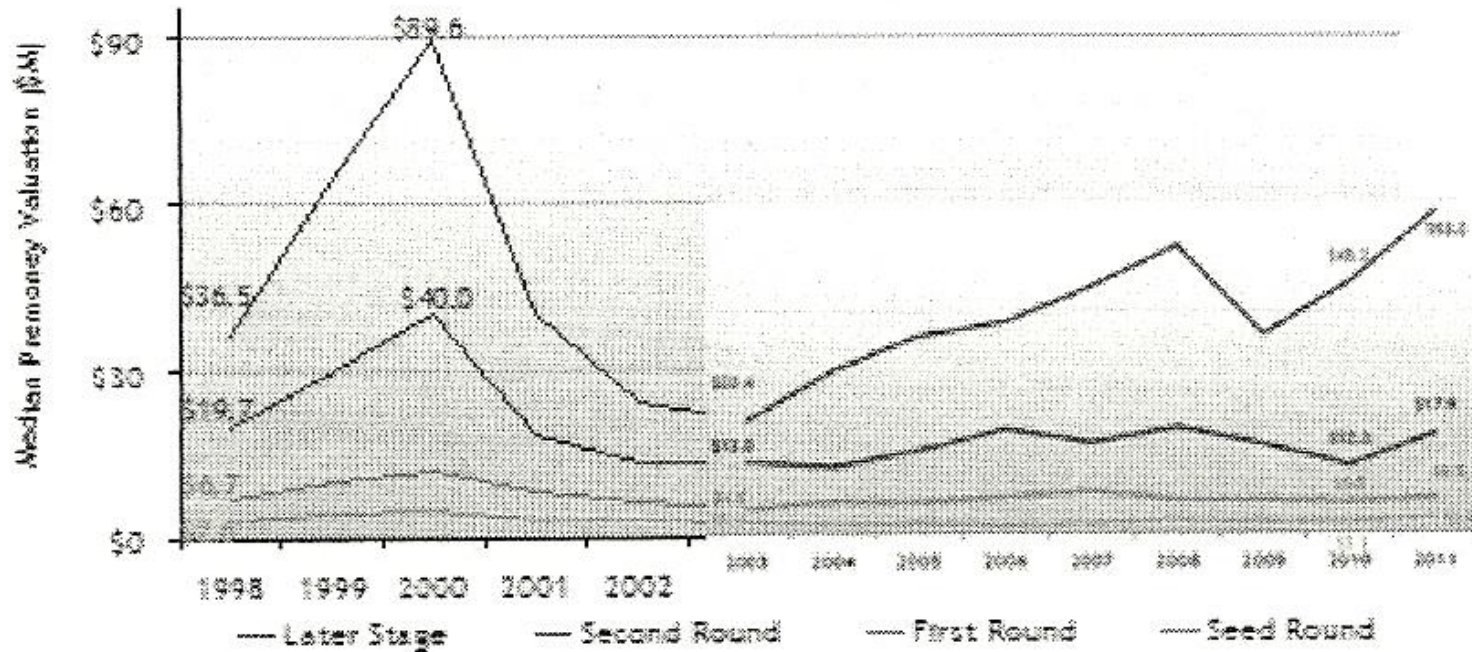


Valuation

- Valuation in Early Stage is a Negotiation
- Very few pre-revenue companies are worth more than \$1,000,000.00
- Selling the Future Potential

Stock	Price	Mkt Cap	PE	Value (L12M)	Value? (N12M)
AAPL	\$392.05	368.16B	8.89	↓	↑→
FB	\$ 26.63	61.20B	1,712.67	→	↓→
AMZN	\$260.00	117.92B	∞	↑	↓

Valuation by Stage



Source: Dow Jones VentureSource

Typical Angel Investments

- \$150,000 - \$1,000,000 (total round)
- Average in North America: ~ \$300,000
- Six to twenty investors
- Average check: ~\$30,000
- Valuation: \$0.5 to \$3 million
- Angel ownership: 20 - 40%

Typical Angel Seed/Startup Valuations

- \$0.5 million to \$3 million
- Many angel groups have decided to walk away from all deals over \$4 million!
- OK....but where in the range of \$0.5 million to \$3 million??
- It depends on many factors

Factors affecting valuation

- Uniqueness / depth of technology offering.
- Management experience
- Management self-confidence and persistence
- Perceptions of the marketplace
- Competition amongst investment groups
- Other?

Valuation Survey

- Paucity of data
- Angel leaders say: Valuations
 - Vary by business sector
 - Vary by region
 - Vary by economic cycle
- Informal survey by Bill Payne

Valuation: Survey of Angel Groups

- 2011 – 35 groups in the US and Canada
- Pre-revenue valuation of pre-revenue companies
- Results:
 - Range: \$0.8 million to \$3.4 million
 - Mean: \$2.1 million, median: \$2.0 million
 - 23/35 (2/3) between \$1.5 and \$2.5 million
 - 8 above \$2.5 million, 4 below \$1.5 million

Valuation Methodologies

- Berkus Method
- Rule of Thirds
- VC Method
- Multiplier Method – Investment in / Profit or Rev.
- Scorecard Valuation Methodology
- The Cayenne Calculator
- Risk Factor Summarization Method
- Others ...
- Informal based on a combination of many

Berkus Method

- Five categories of up to \$500K that can be “earned” to form a valuation. Allows a maximum pre-money valuation of up to \$2M (or a post rollout value of up to \$2.5M).
 - An Innovative idea that has growth potential
 - Prototype
 - Quality Management Team
 - Strategic Relationships (Customer/Vendor Alliance)
 - Product Rollout or Sales

Rule of Thirds

- Suggests that 1/3 of a new company's projected valuation should come from the early-stage angels, 1/3 from management (i.e. option pool), and 1/3 from the founder(s).
- Valuation = 3 x Founder's Capital

VC Method

- Works backward from the Investor's required ROI rather than forward from the cash flow forecasts.

Post-Money Valuation = Sale Price / Expected ROI

ROI is typically in the range of 20 – 40x meaning there must be an expectation that the sale price will be \$20 - \$40M to generate a \$1M “Post Money” valuation.

The sale price can be estimated by establishing a reasonable expectation for revenues at the period of liquidation and, based on those revenues, estimate earnings from industry-specific statistics.

Multiplier Method

- Investment In
 - Quick and simple, multiply the existing capital investment by 10.
- Profit or Revenue
 - Multiply revenues by some multiple (e.g. 2.0 – 4.0) or profit (EBITDA) by (e.g. 8.0 – 10.0)
 - Numbers vary by industry and presenter.

The Scorecard Method

(popular among angels)

Scorecard Method

- Determine a median value for pre-revenue companies in given industry and region
 - Consider recent local deals (at same stage)
 - Consider regional and national valuation trends
- Determine critical issues
- Assign % weighing for each critical issue
- Multiply median value by weighted average

Pre-revenue Median Value

For purposes of this workshop assume median local pre-money valuation of pre-revenue companies is \$1,500,000.

Customize Issues and Weighting

Management	25-40%
Size of opportunity	20-30%
Product/service and technology	15-25%
Marketing/sales channels	5-15%
Competitive environment	5-15%
Other factors	0-20%

Valuation Issues and Suggested Weighting

Management	30%
Size of opportunity	25%
Product/service and technology	15%
Marketing/sales channels	10%
Competitive environment	10%
Other factors	10%

Valuation Worksheet

- Strength of the Entrepreneur and the Management Team (30%)

Impact	Experience
+	Many years of business experience
++	Experience in this business sector
+++	Experience as a CEO
++	Experience as a COO, CFO, CTO
+	Experience as a product Manager
-	Experience in Sales or Technology
---	No Business experience

Impact	Willing to step aside, if necessary, for an experienced CEO
--	Unwilling
0	Neutral
+++	Willing

Impact	Is the founder coachable?
+++	Yes
---	No

Impact	How complete is the management team?
-	Entrepreneur only
0	One competent player in place
+	Team identified and on the sidelines
+++	Complete team in place

Valuation Worksheet

- Size of the Opportunity (25%)

Impact	Size of the target market (total sales)
--	< \$50 million
+	\$100 million
++	> \$100 million

Impact	Potential for revenues of target company in five years
--	< \$20 million
++	\$20 to \$50 million
-	> \$100 million (will require significant additional funding)

Valuation Worksheet

- Strength of the Product and Intellectual Property (15%)

Impact	Is the product defined and developed
--	Not well defined, still looking at prototypes
0	Well defined, prototype looks interesting
++	Good feedback from potential customers
+++	Orders or early sales from customers

Impact	Is the product compelling to customers?
---	This product is a vitamin pill
++	This product is a pain killer
+++	This product is a pain killer with no side effects

Valuation Worksheet

- Marketing / Sales / Partners (10%)

Impact	Sales channels, sales and marketing partners
---	Haven't even discussed sales channels
++	Key beta testers identified and contacted
+++	Channels secure, customers placed trial orders
--	No partners identified
++	Key partners in place

Valuation Worksheet

- Competitive Environment (10%)

Impact	Strength of competitors in this marketplace
--	Dominated by a single large player
-	Dominated by several large players
++	Fractured, many small players

Impact	Strength of competitive products
--	Competitive products are excellent
+++	Competitive products are weak

Valuation Worksheet

- Other (10%)

Impact	Need for additional rounds of funding
+++	None
0	Another angel round
-	Need venture capital

Impact	Other
++	Positive other factors
--	Negative other factors

Evaluate Hypothetical Opportunity

- 30% Management – quality team in place, except sales
- 25% Opportunity – appears to be a huge opportunity
- 15% Product – disruptive technology, prototype done
- 10% Sales – team not in place, channels unclear
- 10% Competition – many small players, lack technology
- 10% Other factors – foreign market, partners

Calculate Weighted Average Multiple

Issue	Analysis	Weight	Factor	Input
Management	On board, except sales	30%	130%	0.390
Opportunity	Enormous	25%	150%	0.375
Product	Disruptive, prototype OK	15%	180%	0.270
Sales	No channels, all foreign	10%	20%	0.020
Competition	No big players, messy	10%	150%	0.150
Other	Partners? Foreign sales?	10%	50%	0.050

Weighted Average Multiple = 1.255

Calculate Pre-money Valuation

Median value	\$1.50 MM
Weighted multiple	<u>X 1.255</u>
Pre-money Valuation	\$1,882,500

= \$1.9 million

Summary

- Accommodate stage of business
- Best practice: Use multiple valuations methods
- Scorecard Method is a useful valuation method for seed/startup companies
 - Valuations can vary somewhat from region to region
 - Valuation can vary somewhat among business sectors
 - Valuation vary somewhat with the business cycle
 - Modify to meet your individual or group needs
 - Use consistently over time