Startup Valuation Methodologies

Startup Valuation Methodologies

❖ As we have seen, trying to value a startup appears to be

  ❖ 1. Very difficult

  ❖ 2. Very unscientific

❖ Look at some methods we can adopt to make our valuation process more rigorous

Startup Valuation Methodologies

- The Berkus Approach

- Dave Berkus, 1996

- Looks at valuing a startup based on the detailed assessment of five criteria

- Detailed assessment of each of the five success factors

- How much value does each add?

- Total up to come to a valuation

- "Stage Development Method"

- Basic Value

- Technology

- Execution

- Strategic relationships in core market

- Production and consequent sales

Startup Valuation Methodologies

❖ The Cost to Duplicate Method

❖ This approach uses all the costs
and expenses incurred in the start
up to come to a fair market value

❖ Takes no account of future value

❖ No account of intangible assets
e.g. brand value, goodwill,
intellectual property and patents

Startup Valuation Methodologies

❖ Future Projection Method

❖ This is a forecast DCF which attempts to evaluate the return on investment over the next 10 years

❖ Sales projections, growth, cost and expenditure

❖ Range of scenarios

❖ Highly sensitive to input assumptions

❖ Discount rate critical to the evaluation, as is the terminal value

Startup Valuation Methodologies

❖ Market Multiple Approach

❖ This uses precedent transactions for similar companies as a benchmark for valuation

❖ Similar to the traditional Precedent Transactions method

❖ Difficult to find comparable peer group as ever

❖ Sensitive to the stage of the company

❖ Limited public information about the Peer Group

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❖ Score Card Approach

❖ Compare startup to companies already funded and then make adjustments against a range of factors

❖ Evaluate each factor agains the peer group - adjust each factor

❖ Total adjustment applied to orginal valuation

Criteria	Weight	Target Company	Factor	
Team	30%	125%	37.5%	
Size of Opportunity	25%	150%	37.5%	
Product/ Technology	15%	100%	15%	
Competitive Environment	10%	75%	7.5%	
Sales/Marketing	10%	80%	8%	
Need for more financing	5%	100%	5%	
Other	5%	100%	5%	
Total	100%		115.5%	

Startup Valuation Methodologies

❖ Score Card Approach - Bill Payne Method

❖ Valuation $5m

❖ This example; strong team (125%) and size of opportunity (150%)

❖ Normal (100%) - Product/Technology, Need for additional investment, Other factors

❖ Weaker - Competitive environment (75%) and Marketing & Sales (80%)

❖ Total 115.5% - Adjusted valuation: $5.775m

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❖ Detailed Worksheet for arriving at the adjustment factors provided with this lecture

❖ scorecard valuation worksheet.pdf

❖ Source: angelcapitalassociation.org

VALUATION WORKSHEET

Weighting	Factors and Issues
	IMPACT ON THE VALUATION OF PRE-REVENUE, STARTUP COMPANIES
0-30%	Strength of the Entrepreneur and the Management Team

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 only 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
+++	Competent team in place

0-25%	Size of the Opportunity

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
0	> $100 million (may require significant additional funding)

0-15%	Strength of the Product and Intellectual Property

Impact	Is the product defined and developed?
---	Not well define, 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

Startup Valuation Methodologies

❖ An Excel spreadsheet - Score Card Startup Valuation - is provided with this lecture

❖ Use in conjunction with the Worksheet to evaluate your own startup company

Criteria	Weight	Target Company	Factor	
Team	30%		0%	
Size of Opportunity	25%		0%	
Product/ Technology	15%		0%	
Competitive Environment	10%		0%	
Sales/Marketing	10%		0%	
Need for more financing	5%		0%	
Other	5%		0%	
Total	100%		0%	

Startup Valuation Methodologies

- Risk Factor Summation

- Combines the Scorecard Method and the Berkus Method to provide detailed risk evaluation

- Arrive at a valuation using the methods already covered

- Different business risks are then factored into the valuation +/-

- Adjust the initial valuation based on the sum of these risk factors

- Management, political, manufacturing, market competition, investment and capital accumulation, technological, legal, environmental

Risk Factor Summation Method

The Risk Factor Summation Method

INITIAL VALUE			$1,500,000
1. MANAGEMENT RISK	Very low	+$500,000	$2,000,000
2. STAGE OF THE BUSINESS	Normal		
3. LEGISLATION/POLITICAL RISK	Normal		
4. MANUFACTURING RISK	Normal		
5. SALES AND MANUFACTURING RISK	Normal		
6. FUNDING/CAPITAL RAISING RISK	Normal		
7. COMPETITION RISK	Very high	-$500,000	$1,500,000
8. TECHNOLOGY RISK	Low	+$250,000	$1,750,000
9. LITIGATION RISK	Very low	+$500,000	$2,250,000
10. INTERNATIONAL RISK	Normal		
11. REPUTATION RISK	Very low	+$500,000	$2,750,000
12. POTENTIAL LUCRATIVE EXIT	Normal		
BOX VALUATION			$2,750,000

Source: Slideshare

Startup Valuation Methodologies

- ❖ Venture Capital Method

- ❖ Bill Sahlman, HBS

- ❖ Calculate exit value

- ❖ Track back to expected ROI to calculate the pre-money investment

- ❖ Note the calculation takes account of the option pool dilution for both management team (20%) and staff (10%)

Exit Value | $100m

/20x =

Target ROI x
Post Money Valuation | $5m

- $1m =

 - Amount Invested
= Pre-Money Valuation | $4m

x 70% =

Option Pool dilution =
Pre Money Valuation
after dilutions | $2.8m

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