Traditional VC Valuation Metrics

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- While being aware that Warren Buffett is no fan of EBITDA multiples, as Venture Capital investors frequently rely on them we need to take a look at some of the important, more traditional VC valuation metrics

Traditional VC Valuation Metrics

- The starting point is naturally the EBITDA multiple
- VCs have benchmark multiples that they try to operate on.
- This makes their model easy to interpret
- It also helps them to target their exit multiple - as they always want to exit on a higher multiple

Traditional VC Valuation Metrics

- This simple example demonstrates the value of EBITDA multiple arbitrage
- If the company had paid 6x at entry they would have paid $10m more for the deal
- If they had exited at 4xm they would have made $20m less

- Entry Multiple: 4x EBITDA
  - EBITDA = $5m
  - Entry Value = $20m
- Exit Multiple: 6x EBITDA
  - Exit EBITDA = $10m
  - Exit Value = $60m
- Value of Multiple Arbitrage: 6x-4x =2x = $20m

Traditional VC Valuation Metrics

- What factors do VCs rely on for their valuations?
- These are presented in no particular order and we are focusing on key financial metrics rather than the subject issues of management, product, competition and markets

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- Profits / Earnings
  - EBITDA margin and multiple
  - Growth Rate - the faster the more valuable
  - Recurring Revenue - more valuable than one off revenue
  - Gross Margins - higher the better e.g. software 80%
  - Scalability - ability of the business to grow to scale without huge investments in staff or infrastructure

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- Another approach which appears overly simplistic but has some logic is a "multiple of the raise" approach
- VCs want to get between 25% and 33% of the company
- So if you want to raise $1m, the VC approach would be to give you a pre-money $3m - $4m valuation (excluding option dilution)

Traditional VC Valuation Metrics

- A final word on VC valuations
- Getting the highest valuation is not always the best strategy
- With liquidation preferences, VC investors protect their investment in respect to the founders
- If the next round or exit round is a down round (below the current valuation), founders and early investors can be wiped out

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