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5 Methods to Value Your Early Stage Company

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About this Guide

This guide is designed to help you understand the various options to value your early stage company. Included are examples of how to calculate the value based on standard assumptions. Each company has its unique assumptions that should be carefully applied for actual valuations

Quist has a flawless reputation for delivering high-quality valuations and business analysis. Founded in 1984, Quist is a leading independent business valuation firm that provides strategic insights for greater business value. We specialize in valuations for corporate finance, financial reporting, estate planning, and tax purposes. Our clients include small to mid-sized private or public companies in a wide range of industries including technology, manufacturing, B2B/ B2C services, food and beverage and similar.

We work with you to assess what your business is worth and recognize that as your company grows, your needs change. We bridge real world realities with advanced valuation theory. We've got the expertise to meet your needs today and in the future.



Shina Culberson
President – Quist Valuation

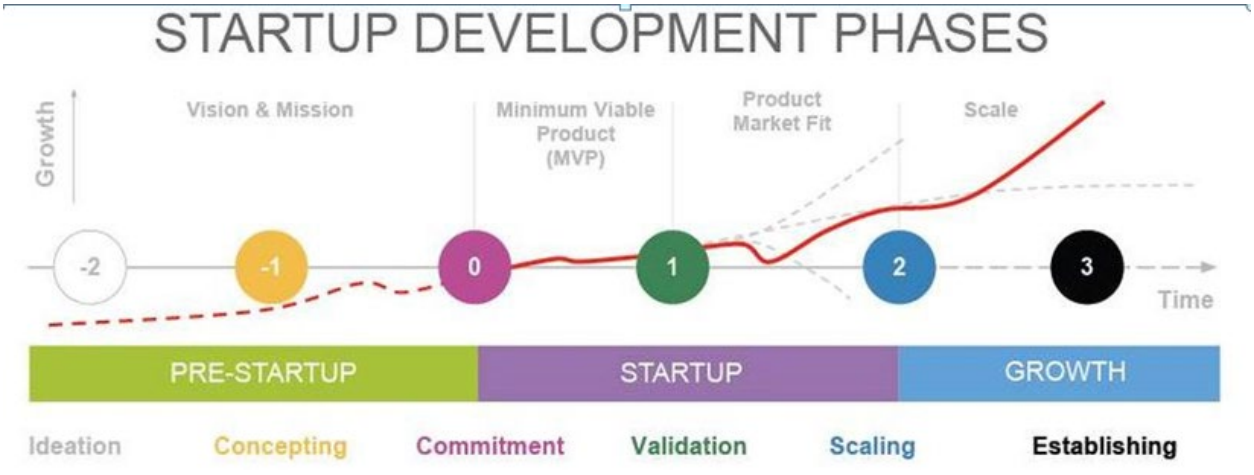


Victoria Hall
Corporate Business Development

Victoria Hall leads business development initiatives at Quist. She joined the company in 2013 as a Senior Financial Analyst, and has performed over 500 valuations for portfolio companies of venture capital firms and individual businesses. Her background at EchoStar Corp. in mergers and acquisitions for telecommunications and technology makes her a well- rounded part of the team. Ms. Hall specializes in business and securities valuations for corporate finance and financial reporting purposes, including portfolio company valuations, goodwill impairment testing and valuation of intangible assets and intellectual property.

Shina Culberson is known for her direct style and laser focus. As the President of Quist, she brings over 2 decades of financial and valuation experience. Over the course of her career she has participated in hundreds of valuation engagements for public and private companies in manufacturing, bio tech, food and beverage, software, hardware, energy, and entertainment. She served as a Director at Charles Schwab Investment Management managing the International Credit Research Team for over 50 debt issuers and had oversight responsibility for approximately $32 billion in portfolio holdings.

Stages of Company Development and Funding



The investor's definition of value is their overall fund return requirements.

- 65% of start-up companies fail. VCs need to reach reasonable returns over the whole portfolio
- You may be ok at 5x return, but VCs may need 10x – 20x to compensate for previous bad/failed investments

Based on the stage of your company there are several methods to choose for the valuation. Stages are loosely defined as:

- **Seed:** Friends and Family – Ideas before there is a "real" company, product or customers
- **Early Stage**: Angel funding – Beta or first release product and possibly a few customers
- **Expansion Stage**: VC Series A funding – Revenue generation and growth
- **Later Stage**: VC Series B+ funding – Market expansion, profitability and preparation for exit

Methods of Valuation

1. Venture Capital Method
2. Burn Rate Method
3. Scorecard Method
4. Risk Factor Adjusted Method
5. Discounted Cash Flow Method

Venture Capital Method

- Investor wants to make 10x return on their investment
- Entrepreneur wants to raise $2,000,000
- Projected exit strategy includes a $50,000,000 exit value
- BIG ASSUMPTION: No further investment rounds are anticipated

What are the Post Money value and the Pre-Money value of the company?

Exit Value	$50,000,000
Divided by: Return Requirement	10x
Post Money Value	$5,000,000
Less: Investment	($2,000,000)
Equals: Pre-Money Value	**$3,000,000**

NOTE:

1. Return requirements are a proxy for discount rates on future cash flows. The higher the perceived risk, the higher the return requirement and thus the discount rate.

2. Time to exit is an important consideration in return requirements.

   a. A return requirement of 10x is equivalent to a target IRR of 58% in 5 years

   b. A return requirement of 10x is equivalent to a target IRR of only 25% in 10 years

3. Know the market multiples for your industry. Know whether your industry is priced off of a multiple of revenue or a multiple of earnings to understand the exit value for your company.

Burn Rate Valuation Method

1. Calculate company "burn rate" and total funds needed
2. Build in 10-25% cushion (safety net)
3. Test against exit strategy/value
4. Valuation = (Burn Rate + Cushion) / Investor Equity %

Assumptions:

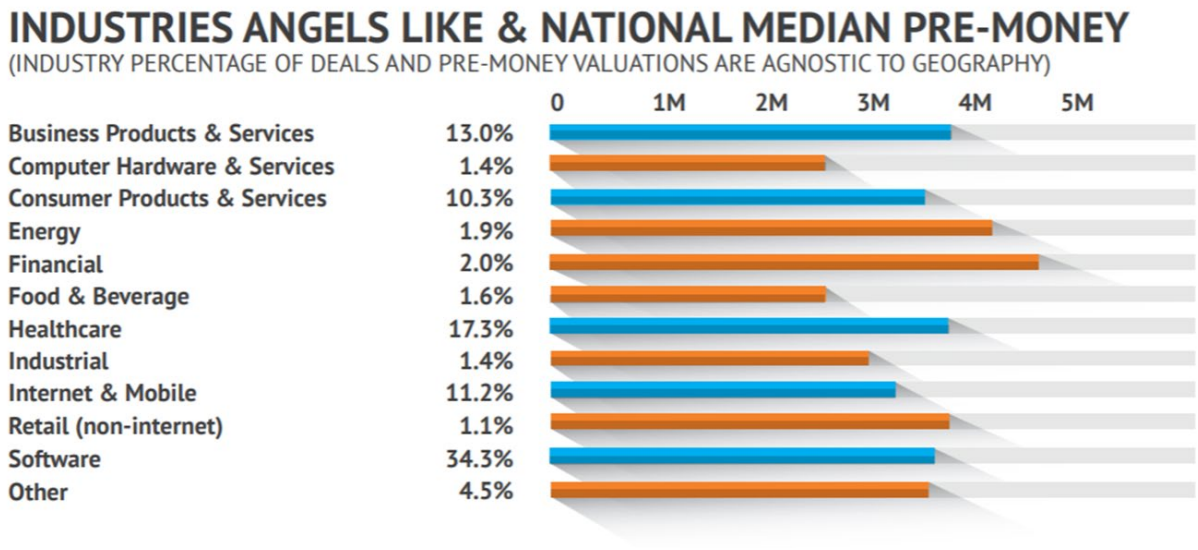
- ✓ Burn rate = $50,000 per month
- ✓ 18 month to major milestone (i.e. product release, positive cash flow, etc.)
- ✓ Burn Rate = $25,000 x 18 months = $450,000
- ✓ Cushion = $450,000 * (1 + 10%) = approx. $500,000
- ✓ Company will exchange 25% ownership for the $500,000 investment

What are the Post Money value and the Pre-Money value of the company?

Burn Rate/month	$50,000
Time to major milestone	18 months
	$900,000
Cushion (~10%)	$100,000
Total Investment	$1,000,000
Divided by: Investor Equity	25%
Post Money Value	**$4,000,000**
Less: Investment	($1,000,000)
Equals: Pre-Money Value	**$3,000,000**

Risk Factor Method

1. Start with average valuation for companies in your industry (reference the Halo Report published by the Angel Resource Institute at www.angelresourceinstitute.org)



2. Consider strengths and weaknesses of the business
   - ☐ Management
   - ☐ Stage of Business
   - ☐ Competition
   - ☐ Technology Risks
   - ☐ Regulatory Risks
   - ☐ Manufacturing Risks
   - ☐ Sales and Marketing Risks
   - ☐ Funding/Raising capital Risks
   - ☐ Litigation Risks
   - ☐ Reputation Risks
   - ☐ Potential Exit Risks

3. Each risk receives a rating between -3 and +3 to indicate the relative impact
4. Calculate the total (+)s and (-)s for a total and add/subtract $100,000 for each point

Risk Factor Example

- +3 (maximum) / -3 (minimum)
- i.e. Stage of Business
  - 0 if pre-revenue
  - +1 if beta
  - +3 if paying customers
- +1 = $100,000 added to pre-money value
- -3 = $300,000 subtracted from pre-money value

Risk Factors:	+3 (max) / -3 (min)	
Median Company Value		$3,650,000
Management	+3	$300,000
Stage of Business	+1	$100,000
Regulatory Risks	0	$-0-
Manufacturing Risks	0	$-0-
Sales and Marketing Risks	-2	($200,000)
Funding/Raising Capital Risks	-1	($100,000)
Competition	-1	($100,000)
Technology Risks	-1	($100,000)
Litigation Risks	0	$-0-
Reputation	-1	($100,000)
Potential Exit Risks	+3	$300,000
Risk Adjusted Pre-Money Value		**$3,750,000**

Scorecard Method

1. Start with median valuation for companies in your industry and region (similar to the Risk Factor Method)
2. Each of the top factors that impact value for early stage companies is considered (total weight equals 100%)
3. Each factor is evaluated and given an assessment anywhere from 0% to 400% (note: an assessment of 100% is equivalent to a factor of 1 and therefore has no impact on the starting value for the company)

Scorecard Factors:	Weight	Assessment (0-400%)	Weighted Factor Adjustment (Weight x Assessment)
Average Company Valuation			$3,650,000
Team	30%	200%	0.600
Market Opportunity/Size	25%	200%	0.500
Product/Technology	15%	50%	0.075
Competitive Environment	10%	50%	0.050
Marketing /Sales Partnerships	10%	25%	0.025
Need for additional capital	5%	0%	0.000
Other	5%	100%	0.050
Total	100%		1.300
Scorecard Adjusted Valuation			**$4,745,000**

Discounted Cash Flow Method

- Model future cash flows (consider both a bottom up and a top down in your projections)
- Exit Multiples (IPO and M&A transactions)
- Revenue vs. EBITDA multiples
- Understand what factors drive acquisition amounts

Discounted Cash Flow Method - Scenario Testing

- Create multiple scenarios (low, mid, high case)
- Identify risk variables (price, # of units, cost per unit, market velocity)
- Model different outcomes
- Probability-weight each scenario

Discount Rate - A proxy for VC returns

Stage of Development	Discount Rate
Startup or Seed	48% - 80%
First Stage or Developmental	38% - 58%
Second Stage or Expansion / Product Release	33% - 50%
Third Stage or Revenue Generation / Growth	29% - 44%
Fourth Stage or Profitable	25% - 40%
Bridge or Mezzanine	24% - 34%

Discounted Cash Flow – Example

		Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
Net Income		500,000	750,000	1,000,000	1,250,000	1,500,000
Cash Flow Adjustments						
Depreciation & Amortization		10,000	15,000	20,000	25,000	30,000
Changes in Capex needs		(15,000)	(20,000)	(25,000)	(30,000)	(35,000)
Changes in WC needs		(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
Free Cash Flow to Equity		490,000	740,000	990,000	1,240,000	1,490,000
Discount Period		1.00	2.00	3.00	4.00	5.00
Present Value Discount Factor	38%	0.7246	0.5251	0.3805	0.2757	0.1998
Present Value of Net Cash Flow		355,072	388,574	376,702	341,905	297,708

Present Value of Interim Cash Flows	1,759,961
Present Value of Terminal Value	2,215,220
Total Concluded Value	**$3,975,182**

Terminal EBITDA	1,530,000
EBITDA Multiple	10.0x
	15,300,000
Dicount Period	6.00
Discount Factor	0.1448
Terminal Value	$ 2,215,220

Putting it all together

Method	Value
Venture Capital Method	$3,000,000
Burn Rate Method	$3,000,000
Risk Factor Method	$3,750,000
Scorecard Method	$4,745,000
Discounted Cash Flow Method	$3,975,182
Average	**$3,694,036**
Median	**$3,750,000**

Need help determining the most appropriate method of valuing your company?

Colorado-based Quist Valuation has 35 years of experience in business valuation. We specialize in helping individuals and businesses determine their true value. If you are interested in learning more, our team of expert analysts can walk you through the process.

Visit online at QuistValuation.com, or let's talk directly. Contact us at info@quistvaluation.com or call 303-494-1664.

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