Valuation of Early Stage Companies

December 16, 2015

Marcia Dawood, BlueTree Allied Angels and Golden Seeds
Bill Payne, Angel Resource Institute, Frontier Angel Fund

Use chat to submit questions

Yes, you’ll get the slides

We’re recorded, so come back and listen again
The Rising Tide Program

- Mission: Fuel the success of angel groups and accredited individuals active in the early-stage landscape
- World’s largest trade group for angel investors
  - 220+ angel groups
  - 13,000 accredited investors
  - Voice of accredited individuals, portals, and family offices
- 50 US states + Canada
- Research/education partner

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Member Groups & Accredited Platforms

- Golden Seeds
- Life Science Angels
- Nashville Capital Network
- FundersClub
- Launchpad Venture Group
- Tech Coast Angels
- Sienna Angels
- Angellist
- Alliance of Angels
- Common Angels
- OhioTechAngels
- Sand Hill Angels
- New Dominion Angels
- Houston Angel Network
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Rising Tide Angel Training Program

Founding Members:

[Logo] NextWave
Driving Diversity in Entrepreneurship and Angel Investing

[Logo] Portfolia

Education Partners:

[Logo] ACA
ANGEL CAPITAL ASSOCIATION

Support by:

[Logo] Kauffman
The Foundation of Entrepreneurship
OUR SPEAKERS

Bill Payne
Fellow and Lead Instructor
Angel Resource Institute and Frontier Angel Fund

- Seasoned angel investor – 70 deals with four angel groups
- Teaches best practices using Power of Angel Investing Series to angels honing their skills and entrepreneurs seeking capital
- Las Vegas, NV and Whitefish, MT

OUR SPEAKERS

Marcia Dawood
Managing Director
Golden Seeds and BlueTree Allied Angels

- Board member of Angel Capital Association
- Evaluates and mentors startup companies and investment opportunities with a clear emphasis on women led businesses
- New York, NY
Topics We’ll Explore Today

- Pre and Post Money Valuation Definitions
- Factors Impacting Valuation & Recent Trends in the US
- How to Calculate Valuation
- What If the Entrepreneur and Investors are Far Apart?
- What If You Get It Wrong?
- Are We in a Bubble?
Pre and Post Money Valuation Definitions

Pre-money Valuation + Investment = Post-money Valuation

\[
\text{%Ownership} = \frac{\text{Investment}}{\text{Post-money Valuation}}
\]

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Pre and Post Money Valuation Definitions

- If Company A has a pre-money valuation of $2m and raises an investment of $500,000 then the post-money valuation is $2.5m.
  - % ownership of the company = $500,000/2.5m = 20%

- “I’ll give you $200,000 for a 10% stake in your company” – would value a company at a $2m post and $1.8 pre
  - $200,000/.10=$2,000,000
  - $2,000,000-$200,000=$1,800,000
Factors Impacting Valuation & Recent Trends in the US

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Factors Impacting Valuation

- Economy
- Location
- Round size
- Stage of Development of the Target Company
- Business Sector of the Target Company
- Assessment of the Target Company – i.e. Team, Market Size, IP
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Median US Pre-money Valuation
(rounds preceding Series A)

Source: Halo Reports (Angel Resource Institute)

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Pre-money Valuation by Region

Source: Halo Report 2Q15 (Angel Capital Association)
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US Angel Round Size is Increasing

Source: Halo Report 2Q15 (Angel Resource Institute)

Investment Landscape

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Factors Impacting Valuation

Sector or Industry:
Tech
Life Science
Consumer Products

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Assessment of the Target Company:
Team
IP
Market size
Revenue?
Use of Funds/Exit

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How To Calculate Valuation
Valuations Methodologies
(for establishing the pre-money valuation of pre-revenue startups)

- Discounting exit valuation or proforma financials
  - Venture Capital Method
  - Chicago Method
- Comparing target to typical funded startup
  - Scorecard Method
  - Dave Berkus Method
  - Risk Factor Summation Method
- Online questionnaire
  - Cayenne Calculator

Scorecard Method

A real estate analogy – appraising target startups using comps
- Starting point: Median valuation of similar startups
  - Similar stage of development
  - Similar business sector
  - Similar location
- Comparing features of target to the norm
- Adjust median by your appraisal of the target
### Scorecard Criteria Weightings

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Weighting</th>
<th>Comparison</th>
<th>Adjusted Weighting</th>
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</thead>
<tbody>
<tr>
<td>Entrepreneur, Team, Board</td>
<td>30%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Size of Opportunity</td>
<td>25%</td>
<td></td>
<td></td>
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<tr>
<td>Product/Technology</td>
<td>15%</td>
<td></td>
<td></td>
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<tr>
<td>Competitive Environment</td>
<td>10%</td>
<td></td>
<td></td>
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<tr>
<td>Sales/Marketing</td>
<td>10%</td>
<td></td>
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<tr>
<td>Need for More Financing</td>
<td>5%</td>
<td></td>
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<tr>
<td>Other</td>
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### Hypothetical Example

<table>
<thead>
<tr>
<th>Criteria</th>
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<th>Comparison</th>
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<td>Size of Opportunity</td>
<td>25%</td>
<td>100%</td>
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<tr>
<td>Product/Technology</td>
<td>15%</td>
<td>140%</td>
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<tr>
<td>Competitive Environment</td>
<td>10%</td>
<td>80%</td>
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<td>Sales/Marketing</td>
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<td>60%</td>
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<tr>
<td>Need for More Financing</td>
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<td>100%</td>
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<td>Other</td>
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<td>75%</td>
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</table>
Hypothetical Example

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<tbody>
<tr>
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<td>Size of Opportunity</td>
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<td>Product/Technology</td>
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<td>Need for More Financing</td>
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<tr>
<td>Other</td>
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<td>80%</td>
<td>0.04</td>
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</tbody>
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Calculate Pre-money Valuation

- Add up Adjusted Weightings = 1.06
- Determine median pre-money valuation for startups in your area for startups in the same business sector
- Let’s assume the US median from the Halo Reports
- Then: $4 million multiplied times the adjusted weighting = $4.24
What If the Entrepreneur and Investors are Far Apart?

- Entrepreneur can feel over diluted and leave
- Starts off the relationship on a sour note
- Takes twice as long with twice as much $
What If You Get It Wrong

If the seed-stage valuation is too high…
  - The financial contribution is undervalued
  - Smart money will walk away
  - The time to close seed rounds can be significantly extended
  - The likelihood of a downround later is higher
    - Especially if the company has a hiccup and misses an important milestone

If the seed-stage valuation is too low…
  - Entrepreneurs are less motivated
    - Especially after multiple rounds of funding
Are We in a Bubble?
Additional Resources


Dave Berkus Method:  http://berkonomics.com/?p=1214

Location Impacts Valuation:  http://www.forbes.com/sites/mariannehudson/2015/06/05/startup-valuations-why-location-matters/

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Speakers Contact Information

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bill@billpayne.com

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Thank you!
Upcoming Webinars

January 13, 2016: Experience from the Trenches: How Angels Use Accredited Investing Platforms

January 27, 2016: DEMO of Seraf - tool for angel investors

Webinar programs archived at: www.angelcapitalassociation.org/events/webinars/

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Additional Resources

Marianne Hudson
Executive Director
Angel Capital Association

http://www.angelcapitalassociation.org/news-forbes/

Christopher Mirabile
Managing Director, Launchpad; Board Chair, Angel Capital Association

http://www.angelcapitalassociation.org/news-inc/
Upcoming ACA Events

- February 25, 2016, Western Syndication Meeting, Irvine, CA
- March 9-10, 2016, NW Regional Meeting, Seattle, WA
- May 9 – 11, 2016: ACA Summit, Philadelphia, PA
- [http://www.angelcapitalassociation.org/events/](http://www.angelcapitalassociation.org/events/)